



INTERNAL AUDIT DEPARTMENT
COUNTY OF ORANGE

*Integrity
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**INTEGRATED
INTERNAL CONTROL REVIEW
OF THE
AUDITOR-CONTROLLER
ACCOUNTS RECEIVABLE AND
COLLECTION PROCESSES**

**As of
December 31, 2004**

AUDIT NUMBER: 2428-A

REPORT DATE: AUGUST 11, 2005

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Deputy Director:	Eli Littner, CPA, CIA
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**Integrated Internal Control Review of the
Auditor-Controller Accounts Receivable and
Collection Processes**

As of December 31, 2004

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Transmittal Letter

Audit No. 2428-A

August 11, 2005

TO: David E. Sundstrom
Auditor-Controller

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

SUBJECT: Integrated Internal Control Review of the Auditor-Controller
Accounts Receivable & Collection Processes

We have completed an Integrated Internal Control Review of the Auditor-Controller Accounts Receivable and Collection Processes as of December 31, 2004. The final **Internal Auditor's Report** is attached along with your responses to our recommendations. In conjunction with this audit, we reviewed the application controls and related general controls of the collection information system. This report contains the results of our audit of manual processes and controls. We have issued a separate report (#2428-B) for information technology related results.

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

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 BOS.

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.

Additionally, we will request your office to complete a Customer Survey of Audit Services. You will receive the survey shortly after the distribution of this report.

Attachment

Other recipients of this report:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Shaun M. Skelly, Chief Assistant Auditor-Controller
Mahesh Patel, Assistant Auditor-Controller, Information Technology
Jan Grimes, Assistant Auditor-Controller, Central Operations
Colin Hoffmaster, Senior Manager, Auditor-Controller/General Accounting
Win Swe, Manager, Auditor-Controller Accounts Receivable & Collections
Tom Megara, Accounts Receivable Manager, A/C Accounts Receivable & Collections
Foreman, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors



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INTERNAL AUDITOR'S REPORT

Audit No. 2428-A

August 11, 2005

David E. Sundstrom
Auditor-Controller
12 Civic Center Plaza, Room 202
Santa Ana, CA 92702

We have completed an Integrated Internal Control Review of the Auditor-Controller Accounts Receivable and Collections Processes as of December 31, 2004. Our audit was performed in accordance with professional standards established by the Institute of Internal Auditors. This report contains the results of our audit of the manual processes and controls. We have issued a separate report (#2428-B) for information technology related results.

Management of the Auditor-Controller's Office is responsible for establishing and maintaining a system of internal controls. 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 of Orange Accounting Manual 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, 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. 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 that the degree of compliance with the procedures may deteriorate. Accordingly, our review performed for the limited purpose described above would not necessarily disclose all weaknesses in the Auditor-Controller's operating procedures, accounting practices, and compliance with County policy.

Based upon our audit, **no material weaknesses or significant issues were identified.** However, we did identify three control findings to improve controls and processes as noted in the Detailed Observations, Recommendations and Management Responses section of this report.

The three control findings relate to the dates used for calculating account delinquency and the timeliness and monitoring processes of Collection Officer activities on delinquent accounts.

While in our two reports we indicate where our observations are directly applicable, **the Auditor-Controller should implement the recommendations in other processes, applications, and networks as they find them 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.

We appreciate the courtesy and cooperation extended to us by the personnel of the Auditor-Controller 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; Eli Littner, Deputy Director at (714) 834-5899; Michael Goodwin, Audit Manager at (714) 834-6066; or Autumn McKinney, IT Audit Manager at (714) 834-6106.

Respectfully submitted,



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

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Thomas G. Mauk, County Executive Officer
- Shaun M. Skelly, Chief Assistant Auditor-Controller
- Mahesh Patel, Assistant Auditor-Controller, Information Technology
- Jan Grimes, Assistant Auditor-Controller, Central Operations
- Colin Hoffmaster, Senior Manager, Auditor-Controller/General Accounting
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- Tom Megara, Accounts Receivable Manager, A/C Accounts Receivable & Collections
- Foreman, Grand Jury
- Darlene J. Bloom, Clerk of the Board of Supervisors

EXECUTIVE SUMMARY

OBJECTIVES

The Internal Audit Department conducted an integrated internal control review of the Auditor-Controller's accounts receivable and collection processes. The objectives of our audit were to determine if:

1. Invoices/claims submitted to the Auditor-Controller are recorded accurately, completely, and timely as accounts receivable on the Auditor-Controller's records.
2. Recorded accounts receivable are adequately monitored using reconciliations and aging reports.
3. Collection efforts on delinquent accounts are performed in accordance with established procedures and statutory requirements, including the process for writing off uncollectible debts.
4. Information Technology (IT) controls related to the above three objectives are adequate.
5. Any ineffective or inefficient processes existing that come to our attention during the audit.

BACKGROUND

The Auditor-Controller (A-C) is the Chief Accounting Officer for the County and oversees its central accounting systems, including the Accounts Receivable and Collections Section. The Section is comprised of the Accounts Receivable and Collections Units, each unit having their own distinct duties and responsibilities:

- Accounts Receivable Unit: This Unit receives copies of the invoices/claims issued by selected County departments to individuals, businesses, governments, and other entities for monies owed to the County. They record each invoice/claim as a receivable on the Auditor-Controller's records, set-up individual accounts on the accounts receivable system (CUBS), and process payments received. The General Ledger balance for these receivables was approximately **\$36.7 million** as of 12/31/04. The accounts receivable balance fluctuates through the year as paid receivables are removed and new receivables are added. The Accounts Receivable Unit processes approximately \$200 million in receivables annually.
- Collections Unit: This Unit performs the collection services for delinquent receivables once the required series of collection letters have been issued. They perform collections for all County departments except for John Wayne Airport, the Social Services Agency, the Probation Department, the Public Defender, and the Treasurer-Tax Collector as these departments either use the collection services of other County departments, or have their own collection units staffed by collection officers. The Collection Unit's major clients are the Sheriff-Coroner, the Health Care Agency, and the Resources and Development Management Department.



CUBS: The Auditor-Controller utilizes Columbia Ultimate Business Systems' Revenue Plus Collector System. This system, known as CUBS, serves as the subsidiary accounts receivable ledger. As such, the initial recording and subsequent collection of receivables are recorded in CUBS. Data in CUBS typically includes names, addresses, social security numbers, and occasionally electronic protected health information (ePHI) as described in the Health Insurance Portability and Accountability Act (HIPAA). CUBS is also used to generate collection notices, maintain collector activity, and produce aging and other management reports. CUBS resides on the Auditor-Controller's local area network (LAN) and is maintained by the Auditor-Controller's Information Technology Division.

The table below summarizes the types of invoices/claims the Accounts Receivable and Collections Section receives and processes, and the approximate accounts receivable balances by client type as of December 31, 2004:

Client Type	Description	Approximate Subsidiary Ledger Balances
Government Invoices	County departments/agencies bill other government entities such as cities, the State, and Federal Government for services performed. These invoices tend to be for large dollar amounts.	\$32,240,136
Health Service and Hazardous Waste Fees	HCA/Environment Health invoices for fees such as health inspections fees, gas station storage tank fees, etc. These invoices are sent to A-C Collections <u>after they have already become delinquent.</u>	\$2,250,599
Auditor Invoices	These comprise the majority of invoices processed. They are sent to individuals and businesses, are high in volume, and are usually for smaller dollar amounts.	\$990,780
Family Conciliation	These are court-ordered fees for child investigations and mediation services.	\$777,853
Non-Sufficient Funds	Checks returned to the Treasurer's Office because of "non-sufficient funds."	\$461,548
TOTAL		\$36,720,916

SCOPE

Our integrated audit scope covered the initial recording of accounts receivable into CUBS; the reconciliations and aging reports used to monitor accounts receivable; and the collection and write-off of delinquent accounts. Additionally, selected IT controls (general and application controls) supporting these processes were included in the audit scope and are discussed in report #2428-B.



Detailed Scope for Manual Processes and Controls:

Our methodology included inquiry; completion of internal control questionnaires; segregation of duties analysis; auditor observation and limited testing of controls over data input, reconciliation of the CUBS subsidiary ledger to the General Ledger; timely and documented follow-up action by Collection Officers on delinquent accounts; department/agency approval for write-offs of uncollectible debts, and management's monitoring of the collection process.

Exclusions:

Our scope excluded cash receipting and processing of payments received for the accounts receivable activity. Our scope also excluded the trial court funding functions (reporting and distribution of fees, fines, and penalty assessments) performed by the Accounts Receivable Unit. We did not perform an application review of the CUBS system in its entirety and we did not review or test the integrity of the data (other than described) contained therein. While the CUBS system contains ePHI, we did not specifically test the requirements of the HIPAA Security Rule. We also did not perform a detailed security audit of the CUBS system, or a vulnerability scan and penetration test of the local area network (LAN) on which it resides.

CONCLUSION

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

1. Controls and processes are in place to ensure invoices/claims are recorded accurately and completely into CUBS and the General Ledger. Concerning the timeliness of processing claims and invoices, we noted the Accounts Receivable Unit uses the date of input as the "assigned date" rather than the invoice date when inputting accounts receivable data into the CUBS system. Using the input date instead of the invoice date affects the reliability of aging reports used by Auditor-Controller management, making some delinquent accounts appear more current. (Finding No. 1)
2. Accounts receivable subsidiary records are reconciled monthly to the General Ledger. Management uses aging reports to monitor the outstanding accounts receivables.
3. Collection efforts on delinquent accounts are generally performed in accordance with established procedures and statutory requirements. Account write-offs are supported with approval from Department/Agency Directors or their designees. However, we noted two reportable conditions where timeliness and monitoring of collection activity should be enhanced. (Finding Nos. 2 & 3)
4. Information technology related results are identified in report #2428-B.
5. We did not identify any inefficient or ineffective processes concerning the areas we included in this audit other than item No. 1 above.



DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

CUBS: DATE OF INPUT AND ASSIGNED DATE

Client departments/agencies prepare their own invoices for services provided to outside entities or fees owed to the County. Copies of these invoices are forwarded to the Accounts Receivable and Collections Section for input into CUBS. As a result, delays can exist between when departments prepare and send out invoices/claims to the clients and when the Accounts Receivable Unit staff records the invoice information into the CUBS collection system.

When the Accounts Receivable Unit records claims in CUBS, the system automatically designates the date of input rather than the invoice date as the basis for the release dates of the late notice (dunning) letter series. As a result, the time interval for releasing the late notices at predetermined intervals starts from when Accounts Receivable inputs them into CUBS), giving debtors additional time before late notices are sent.

CUBS has an “assigned date” field, which either defaults to the input date or can have a different date manually entered. The “assigned date” does not affect the release of the dunning series letters but does affect the aging reports used in Collections to monitor delinquent accounts. We noted that the Accounts Receivable Unit staff use the date of input as the “assigned date,” rather than the invoice date. We believe the “assigned date” should be closer to the date when the receivable obligation was incurred, which is the date of the invoice or claim.

Using the date of input as the “assigned date” affects the reliability of the aging reports used by Auditor-Controller management, making some delinquent accounts appear more current. In our testing of 28 invoices, we observed that using the input date instead of the invoice date provided grace periods ranging from 5 to 47 days in the calculation of delinquency. The “assigned date” is also used as the basis for manually calculating the “1st Delinquency Field,” which is the date on which delinquent accounts are reported to a credit bureau.

We contacted the CUBS vendor to discuss the impact of using different dates in the various input fields. The vendor informed us that the County’s CUBS system has not had much customization and that some customization could be done using “strategies” at no additional cost under the current service agreement. For example, the program can be directed to send a different series of letters if a date field meets certain criteria. The Auditor-Controller should contact the vendor to discuss various customization strategies to minimize the additional time provided to debtors based on the current procedures.

Finding No. 1

The Accounts Receivable Unit records the date of input rather than the actual invoice date as the “assigned date” when recording accounts receivable data into the CUBS system.

Recommendation No. 1

The Accounts Receivable and Collections Section, with assistance from the CUBS vendor, should evaluate its current procedure for recording data in the “assigned date” fields and the basis for calculating delinquent accounts.

Auditor-Controller Management Response:

Concur. Collections and Accounts Receivable will implement this recommendation by December 31, 2005.



TIMELY COLLECTION ACTIVITY

The Collections Unit has a written procedure, *Summary of Time Span for Collection of Each Client Account* that provides the guidelines for collection activities by Collection Officers following the series of delinquency notices. Our testing of six unpaid receivable balances disclosed four instances where there were time gaps in documented collection activity, which exceeded the timelines described in the Collection Unit's procedures. These were attributed to a staffing issue.

- An outstanding receivable of \$240 from an Auditor Invoice (AI) was not subject to a review for further collection action and search for other possible addresses until 10 and 24 months following the initial invoice input, respectively. Procedures for AI's require the account to be reviewed for further action on or about the 70th day from input.
- An outstanding AI receivable of \$192 was not subject to a search for other possible addresses as required by procedures. In addition, 34 months lapsed between the third collection letter and subsequent account review. Procedures require AI receivables to be reviewed for further action on or about the 70th day from input.
- There was no documented Collection Officer activity on a Health Service invoice for \$1,395 until one year after it had been input into CUBS. Procedures require follow-up action by a Collection Officer approximately 40 days after input if the amount exceeds \$200.
- At the Integrated Waste Management Department (IWMD), a series of 31 returned checks for non-sufficient funds (NSF) totaling \$4,001 were received from one debtor over a two-month period. The collector notes indicated a gap of 30 months where no collection actions were documented between April 2002 and November 2004. **Note:** IWMD has recently taken corrective actions to mitigate the acceptance of NSF checks at the landfills by utilizing a new cashiering system and revising procedures for updating the cashiering system upon notification of an NSF check.

Finding No. 2

Controls and processes do not always ensure that timely collection activities are performed following a series of delinquency notices.

Recommendation No. 2

The Accounts Receivable and Collections Section ensure timely collection activities are performed in accordance with established procedures.

Auditor-Controller Management Response:

Concur. All four instances of time gaps relate to invoices that were assigned between December 2000 and March 2003. The controls in place since June 2004 should help preclude the gaps found in prior years. More aging reports are currently being used where follow up of accounts is required at 45-90, 90-180, 180-365 and 365-730 days aged. These aging reports represent four mandatory follow ups of outstanding invoices in addition to any other follow-up activity the collectors schedule themselves. Also, these aging reports are reviewed by the supervising Collection Officer and the Manager of Collections.



QUALITY CONTROL REVIEWS

Quality control reviews of Collection Officer activity help ensure timely and consistent application of the Collection Unit's policy and compliance with established procedures and legal requirements. We were informed that the Senior Collections Officer was responsible for performing the reviews; however, we found they were not being done. Although the Accounts Receivable and Collections Section Manager periodically reviews aging reports, periodic quality control reviews would assist in detecting gaps in collection activities or compliance issues in a timely manner.

Finding No. 3

Quality control reviews of Collection Officer activity are not performed.

Recommendation No. 3

The Accounts Receivable and Collections Section conduct documented quality control reviews of collection activity to help ensure collection activity is performed consistently, timely and in accordance with established policies and procedures.

Auditor-Controller Management Response:

Concur. Procedures are currently in place to ensure that collection officer activity is systematically reviewed and documented. Documentation will include the Collection Supervisor writing review notes in CUBS and also noting, by initials, all aging reports accounts that were reviewed. The Collection Manager will also document the accounts reviewed on aging reports. In addition, a performance goal has been established to ensure reviews are completed and documented. Finally, the supervising collector's administration time will be reduced to allow more focus on account reviews.



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.



ATTACHMENT B: Auditor-Controller Management Responses



DAVID E. SUNDSTROM, CPA
AUDITOR-CONTROLLER

AUDITOR-CONTROLLER COUNTY OF ORANGE

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ASSISTANT AUDITOR-CONTROLLER
INFORMATION TECHNOLOGY

July 22, 2005

TO: Peter Hughes, Director
Internal Audit Department

SUBJECT: Response to Internal Audit Draft Report of Integrated Internal Control
Review of the Auditor-Controller Accounts Receivable and Collection Processes

RECEIVED
INTERNAL AUDIT DEPARTMENT
2005 JUL 25 PM 4: 27

The following are our responses to the recommendations contained in the Draft Report on Integrated Internal Control Review and Accounts Receivable and Collections Process (Audit No. 2428-A).

Recommendation No. 1

The Accounts Receivable and Collections Section, with assistance from the CUBS vendor, should evaluate its current procedure for recording data in the "assigned date" fields and the basis for calculating delinquent accounts.

Auditor-Controller Management Response:

Concur. Collections and Accounts Receivable will implement this recommendation by December 31, 2005.

Recommendation No. 2

The Accounts Receivable and Collections Section ensure timely collection activities are performed in accordance with established procedures.

Auditor-Controller Management Response:

Concur. All four instances of time gaps relate to invoices that were assigned between December 2000 and March 2003. The controls in place since June 2004 should help preclude the gaps found in prior years. More aging reports are currently being used where follow up of accounts is required at 45-90, 90-180, 180-365 and 365-730 days aged. These aging reports represent four mandatory follow ups of outstanding invoices in addition to any other follow-up activity the collectors schedule themselves. Also, these aging reports are reviewed by the supervising Collection Officer and the Manager of Collections.

Recommendation No. 3

The Accounts Receivable and Collections Section conduct documented quality control reviews of collection activity to help ensure collection activity is performed consistently, timely and in accordance with established policies and procedures.



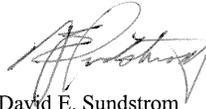
ATTACHMENT B: Auditor-Controller Management Responses (con't)

Peter Hughes, Director, Internal Audit
Audit Report No. 2428-A
July 22, 2005
Page 2

Auditor-Controller Management Response:

Concur. Procedures are currently in place to ensure that collection officer activity is systematically reviewed and documented. Documentation will include the Collection Supervisor writing review notes in CUBS and also noting, by initials, all aging reports accounts that were reviewed. The Collection Manager will also document the accounts reviewed on aging reports. In addition, a performance goal has been established to ensure reviews are completed and documented. Finally, the supervising collector's administration time will be reduced to allow more focus on account reviews.

Thank you for the opportunity to respond to the draft report. Please contact Win Swe at 834-7547 or Tom Megara at 834-7552, if you have any questions on our response.



David E. Sundstrom
Auditor-Controller

MP:wg (Systems/Rsp to IA Rpt)

Attachment

cc: Shaun Skelly, Auditor-Controller
Jan Grimes, Auditor-Controller
Mahesh Patel, Auditor-Controller
Win Swe, Auditor-Controller
Tom Megara, Auditor-Controller
Colin Hoffmaster, Auditor-Controller
Mahesh Patel, Auditor-Controller

