

Internal Audit Department

ORANGE COUNTY

INTERNAL CONTROL REVIEW OF TREASURER-TAX COLLECTOR'S INTEREST APPORTIONMENT PROCESS

For the Period
July 1, 2006 through June 30, 2007

An evaluation of the adequacy and integrity of internal controls; compliance with applicable rules and County policy; and process efficiencies and effectiveness over the Treasurer-Tax Collector's processing of \$317 million in interest apportionments during the audit period.

AUDIT NO: 2634
REPORT DATE: FEBRUARY 20, 2008

Treasurer-Tax Collector Corporate Controls:
Centralized Core Business System Audit

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Deputy Director: Eli Littner, CPA, CIA
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Internal Audit Department

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Internal Audit Department

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Letter from Director Peter Hughes



Transmittal Letter



AUDIT NO. 2634 FEBRUARY 20, 2008

TO: Chriss W. Street
Treasurer-Tax Collector

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

SUBJECT: Internal Control Review of Treasurer-Tax Collector's Interest Apportionment Process

We have completed our Internal Control Review of the Interest Apportionment Process of the Treasurer-Tax Collector for the period July 1, 2006 through June 30, 2007. The interest apportionment process involves the accounting and distribution of **\$317 million** in annual interest earnings from the County's **\$6.1 billion** investment pools. The final Internal Auditor's Report is attached for your review and responses.

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 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 6 months from the release of the first Follow-Up Audit 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.

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.

Letter from Director Peter Hughes



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 listed on the Internal Auditor's Report on page 2.

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Audit No 2634*

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July 1, 2006 through June 30, 2007

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INTERNAL AUDITOR'S REPORT

AUDIT No. 2634

FEBRUARY 20, 2008

TO: Chriss W. Street, Treasurer-Tax Collector

SUBJECT: Internal Control Review of Treasurer-Tax Collector's
Interest Apportionment Process

Scope of Review

We conducted an Internal Control Review of the Treasurer-Tax Collector's Interest Apportionment Process for the period July 1, 2006 through June 30, 2007. The Treasurer-Tax Collector's interest apportionment process is a centralized and core business process that has countywide impact. The process involves the accounting and distribution of **\$317 million** in annual interest earnings from the County's **\$6.1 billion** investment pools. Our audit was conducted in accordance with professional standards established by the Institute of Internal Auditors.

Results

Based on our audit, **no material weaknesses were identified**. However, we did identify **three (3)** observations that we consider as **Significant Issues**, **two (2)** observations considered **Control Findings**, and **two (2)** observations as **Efficiency/Effectiveness Issues** resulting in **ten (10) 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 the Treasurer-Tax Collector'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 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 the Treasurer-Tax Collector'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 the Treasurer-Tax Collector. 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,

A handwritten signature in blue ink that reads "Peter Hughes".

Dr. Peter Hughes, CPA, Director
Internal Audit Department

ATTACHMENTS

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Paul C. Gorman, Chief Assistant Treasurer-Tax Collector
- Foreperson, Grand Jury
- Darlene J. Bloom, Clerk of the Board of Supervisors



EXECUTIVE SUMMARY

AUDIT No. 2634

FEBRUARY 20, 2008

OBJECTIVES

The Internal Audit Department conducted an Internal Control Review of the Treasurer-Tax Collector's Interest Apportionment Process that included in its scope a 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 of the interest apportionment process were to determine if:

1. Interest apportionments are processed completely, accurately, timely, and in accordance with department procedures and management's authorization.
2. Interest apportionments have adequate supporting documentation to justify distribution of earnings.
3. The change process for interest apportionment allocations includes appropriate supporting documentation and management review/approval.
4. Business processes are efficient and effective as related to the interest apportionment process.

BACKGROUND

The mission of the Treasurer-Tax Collector (T-TC) is to provide efficient and effective cash management through optimized investment and property tax collection services for the County of Orange and our local schools, cities and special districts. The T-TC's annual budget is approximately \$15.3 million and has approximately 90 employees. The T-TC is comprised of four divisions: Treasury, Tax Collection, Information Technology, and Administration. Treasury is responsible for the receipt, custody, deposit, investment, and recording of the **\$6.1 billion investment pools** for the County, school districts and special districts. The Accounting/Compliance Unit within the Treasury Division provides financial reporting, fund accounting, ledger reconciliations, investment accounting, and compliance services.

Audit Highlight

Significant Issues were noted in the areas of: (1) reconciliations of interest receivable; (2) interest apportionment worksheets; and (3) expenditures made from unapportioned interest.



The County sponsors two external investment pools: the Orange County Investment Pool (the County Pool) and the Orange County Educational Pool (the Educational Pool). The investment pools distribute income to participants based on their relative participation during the period. Income is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and reduced by (4) investment and administrative expenses.

The Treasury Division maintains the County Pool and the Educational Pool for the County and other non-County entities for the purpose of benefiting from economies of scale through pool investment activities. The County Treasurer *Investment Policy Statement* establishes a Money Market Fund and an Extended Fund as components of the County Pool and Educational Pool. Interest earnings on investments held in these pools are allocated to individual funds monthly based on the average daily balance on deposit with the Treasurer-Tax Collector. **For fiscal year 2006/07, the T-TC processed interest apportionments to pool participants totaling \$317 million.**

Relationship to County Bankruptcy

In response to the County bankruptcy in 1994, the California State Auditor issued an audit report on the County Treasurer's investment strategy in March 1995. The audit results stated that public trust was violated at that time by allocating \$93 million in interest earnings from the investment pool to the County and improperly shifting nearly \$300 million in losses incurred by specific investments to all investment pool members. Because of the amount of interest processed and apportioned, and the relationship of interest earnings with the bankruptcy, it is considered an important and critical County process.

During the audit period, the County had a succession of the elected Treasurer-Tax Collector on December 5, 2006. The controls, processes and management decisions we reviewed were in place prior to the current elected Treasurer-Tax Collector.

SCOPE

Our audit included an evaluation of controls and processes over interest apportionment for the period July 1, 2006 through June 30, 2007. Our methodology included inquiry, auditor observation and examination and testing of relevant documentation. Our audit did not include a review of information technology controls or any application controls testing over T-TC automated systems. We also did not review the administrative charges for investment services.



RESULTS

Based upon the four objectives of our audit, we noted the following:

- ▶ **Objective 1.** *Interest apportionments are processed completely, accurately, timely, and in accordance with department procedures and management's authorization.*

- ▶ **Results:** Overall controls and processes are in place to ensure interest apportionments are processed completely, timely and with management's authorization. However, we note in our report three observations where improvements are needed:

1) Formula and input errors on interest apportionment worksheets were causing inaccurate allocations between the investment pools and were not detected through supervisory reviews (*Finding 2 - Significant Issue*); 2) Expenditures made from the unapportioned interest earnings fund for bond purchases (purchased interest component) were not stated in the fund's criteria when established, or disclosed to pool participants (*Finding 3 - Significant Issue*); and 3) Operational policies and procedures for interest apportionment were incomplete (*Finding 5 - Control Finding*).

These are discussed in the Detailed Observations, Recommendations and Management Responses section of this report. See Attachment A for a description of Report Item Classifications.

- ▶ **Objective 2.** *Interest apportionments have adequate supporting documentation to justify distribution of earnings.*

- ▶ **Results:** Overall controls and processes are in place to ensure interest apportionments have adequate supporting documentation to justify distribution of earnings. However, we note in our report two observations where improvements are needed:

1) Reconciliations of interest receivables were not prepared timely and completely. Treasurer-Tax Collector's staff caught up with over two years of consecutive monthly reconciliations in September 2007. In addition, the Treasurer-Tax Collector's June 2007 interest receivable reconciliation disclosed that its records were not completely reconciled and exceeded the Auditor-Controller's balances by over \$3 million due to unrecorded and unidentified reconciling differences (*Finding 1 - Significant Issue*); and 2) The Treasurer-Tax Collector's office does not prepare a formal monthly "proof of earnings" to ensure actual interest earned is allocated properly to all pool participants (*Finding 4 - Control Finding*).



- ▶ **Objective 3:** *The change process for interest apportionment allocations includes appropriate supporting documentation and management review/approval.*
- ▶ **Results:** Overall controls and processes are in place to ensure the change process for interest apportionment allocations include appropriate supporting documentation and management review/approval.
- ▶ **Objective 4:** *Business processes are efficient and effective as related to the interest apportionment process.*
- ▶ **Results:** No significant inefficient or ineffective procedures concerning backlogs or duplication of work in interest apportionment processing were noted or came to our attention.

However, we note in our report two observations where business process effectiveness should be enhanced: **1)** One accountant was responsible for performing the critical accounting-related tasks for interest apportionment without back-up staff (*Finding 6*) and; **2)** Spreadsheet controls need to be strengthened to ensure appropriate access and documentation on how to properly generate accurate interest apportionments (*Finding 7*). Both of these observations are considered **Efficiency/Effectiveness Issues**.



DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. Reconciliations of Interest Receivable (Significant Issues)

A. Timeliness of Reconciliations

The Treasurer-Tax Collector's office prepares interest receivable reconciliations between the Treasurer-Tax Collector's records and the Auditor-Controller's General Ledger balances for interest earned in fiduciary funds for unapportioned interest, schools, and John Wayne Airport. These reconciliations ensure that all interest earned and received by the Treasurer-Tax Collector was properly recorded in the Auditor-Controller records. **Interest receivable in June 2007** according to the Auditor-Controller's General Ledger **totaled over \$31 million.**

Our review of the monthly interest receivable reconciliations noted that **over two years** of consecutive monthly reconciliations were **not prepared timely** for the period July 2005 through June 2007. The Treasurer-Tax Collector's office prepared all 24 monthly reconciliations in September 2007.

The Auditor-Controller's County Accounting Manual section F-4 – *Fiduciary Funds*, states that departments/agencies are responsible for reconciling, at least monthly, each fiduciary fund balance to the Auditor-Controller's General Ledger balance. Reconciliations should be performed timely to detect errors as they occur resulting in more reliable financial reporting.

Recommendation No. 1A

We recommend the Treasurer-Tax Collector timely prepare and review interest receivable reconciliations on a monthly basis.

Treasurer-Tax Collector Management Response:

Concur. The reconciliations are current and all necessary adjustments related to the outstanding reconciliations during this period have been made. Management has cross-trained an Accountant/Auditor II to provide a backup for this important process. By having a strong backup this helps to eliminate the possibility of this problem reoccurring in the future.

B. Identifying and Resolving Reconciling Items

Complete reconciliations identify the differences between department/agency subsidiary records and the Auditor-Controller's General Ledger; the reasons for those differences; and the planned disposition of any reconciling items.



Our review of the interest receivable reconciliation for **June 2007** disclosed that the Treasurer-Tax Collector's records for interest receivable exceeded the Auditor-Controller's General Ledger balances by over **\$3 million** due to 117 reconciling items. At the time of our review, the Treasurer-Tax Collector's office had caught up with past due monthly reconciliations and were working towards resolving 15 unsupported differences (net effect of \$120,000) and 102 supported, but unrecorded adjustments over 60 days old (net effect of \$3.2 million).

Recommendation No. 1B

We recommend the Treasurer-Tax Collector ensure that all reconciling items for interest receivable are adequately identified, supported, and promptly resolved.

Treasurer-Tax Collector Management Response:

Concur. All reconciling items have been resolved. The procedures for preparation of the monthly interest receivable reconciliations include prompt resolution and review of any reconciling items.

2. Interest Apportionment Worksheets (Significant Issue)

The Treasurer-Tax Collector's office prepares and maintains worksheets to serve as the basis for allocating interest earnings and receipts from the extended fund between the County and Educational investment pools. Allocations between the investment pools are updated when the Treasurer-Tax Collector's office inputs daily accrued income and receipt transactions into the worksheets during interest apportionment processing.

We reviewed the worksheets between April and June 2007 and found **two worksheets contained one formula and six data input errors** causing an inaccurate allocation between the County and Educational investment pools. Although supervisory reviews were performed to ensure accuracy, these formula and data input errors were not detected during the reviews.

Subsequent to the end of our fieldwork, the Treasurer-Tax Collector's office provided documentation evidencing the worksheet corrections and respective journal voucher entries to correct the errors.

Because the Treasurer-Tax Collector's office uses the worksheets to allocate current and future interest and receipts from extended funds between the County and Educational investment pools, it is important that the worksheets contain correct information to prevent the risk of inaccurate interest apportionments. A detailed desk review in addition to a supervisory review would help ensure the accuracy of the worksheets.



Recommendation No. 2

We recommend the Treasurer-Tax Collector establish procedures to ensure the accuracy of interest apportionment worksheets.

Treasurer-Tax Collector Management Response:

Concur. Management is updating the procedures for preparation, desk review, and a supervisory review of the Extended Fund interest allocation to ensure the accuracy of the interest apportionment worksheets. Management will finalize these procedures by February 28, 2008.

Spreadsheet access and formula locking for the Extended Fund interest apportionment worksheets was instituted on October 18, 2007. The critical Extended Fund allocations file(s) are now restricted whereby only the individuals directly related to the process are provided access. The spreadsheets are now restricted and only certain fields allow for data entry access. Spreadsheet passwords restricting access to authorized staff prevents unauthorized changes. The supervisory review process includes a procedure to ensure beginning balances match the prior period ending balances to ensure the integrity of worksheet formulas.

3. Expenditures Made From Unapportioned Interest (Significant Issues)

The Treasurer-Tax Collector's office receives and apportions interest earnings to investment pool participants through **Unapportioned Interest Fund No. 691**, established following the County bankruptcy in April 1995. Documentation supporting the fiduciary fund states, in part, that the fund will be used to hold unapportioned interest earnings as they are received until they are apportioned to pool participants.

During our review of Fund No. 691 between April and June 2007, we noted that **expenditures were made that did not meet the criteria prescribed in the documentation supporting this fiduciary fund.** The expenditures noted included payments for "**purchased interest.**" Purchased interest is interest that is due on a bond or other fixed-income security since the last interest payment was made. Bonds usually pay interest every six-month period, but the interest is accrued daily. When a bond is sold, the buyer pays the seller the market price plus the accrued interest, for which the buyer will be reimbursed when the issuer next pays interest.



In their monthly *Treasurer's Management Report* the Treasurer-Tax Collector includes a forecast of the date each month's interest apportionments will be posted to pool participant's cash accounts in the Auditor-Controller's General Ledger. **In preparing each month's forecast, they include a \$2 million estimate of purchased interest paid on bond purchases. Interest earnings are apportioned when there is adequate cash in Fund 691 to post a month's interest earnings.** We noted that this practice was not disclosed in documents used to participate in the investment pool or in the *Investment Policy Statement*.

The Treasurer-Tax Collector's office recorded purchased interest within the cost of pooled cash and investments and disclosed the amount as a receivable for external financial reporting purposes. Following the implementation of the T-TC's current software, purchased interest has been recorded through Fund No. 691; however, this policy and use is not documented as an allowable use of the fund.

Recommendation No. 3A

We recommend the Treasurer-Tax Collector evaluate the process for paying purchase interest and determine an appropriate practice. As options, the Treasurer-Tax Collector either could request an amendment to the documentation supporting Unapportioned Interest Fund No. 691, or could request a separate fiduciary fund to use and account for purchased interest.

Treasurer-Tax Collector Management Response:

Concur. Management has submitted a request to the Auditor-Controller's General ledger unit office with regard to changing the criteria prescribed in the documentation for use of the Unapportioned Interest Fund 691 for payments of purchased interest. Treasury management sees their current practice of classifying purchased interest as Interest Receivable as the appropriate accounting presentation in accordance with generally accepted accounting principles.

The Treasury expects to complete the change in the criteria for Fund 691 by March 31, 2008.

Recommendation No. 3B

We recommend the Treasurer-Tax Collector evaluate interest apportionment practices and determine the appropriate disclosure method for pool participants and other interested parties.

Treasurer-Tax Collector Management Response:

Concur. Treasury Management will perform their due diligence in letting all the stakeholders know the methodology surrounding interest calculations.



- a) New Voluntary Participants will be informed of the interest apportionment practices by including a specific disclosure within the Voluntary Participant Agreement.
- b) Current Pool Participants will be informed via the Monthly Management report in a separate addendum concerning interest apportionment.
- c) Voluntary Participants will be informed via a letter/addendum included with their monthly statement.

Treasury Management will provide these disclosures with their monthly report and monthly voluntary participant statements for March 31, 2008.

4. Proof of Interest Earnings (Control Finding)

Following the County bankruptcy, the California State Auditor issued an audit report on the County Treasurer's investment strategy in March 1995. The audit results stated that public trust was violated by allocating \$93 million in interest earnings from the investment pool to the County and improperly shifting nearly \$300 million in losses incurred by specific investments related to the County to all investment pool members.

A response to the State Auditor report indicated the Treasurer-Tax Collector's office at that time had procedures in place to prepare a monthly "**Proof of Earnings.**" The purpose of this monthly analysis was to ensure all actual interest earned was properly allocated to all pool participants. The proof of earnings verified that records of the Treasurer-Tax Collector's office were in agreement with the interest earnings which were recorded by external custodial institutions.

Our audit disclosed that the Treasurer-Tax Collector's office discontinued preparing the monthly Proof of Earnings. The exact timeframe when the process was discontinued was not known and documentation for prior monthly proof of earnings was not on file. Treasurer-Tax Collector's management indicated the proof of earnings was time-consuming and not used by external parties, thus it was discontinued.

We noted the Treasurer-Tax Collector's office reconciles interest earned, as reported in their subsidiary system Quantum, to the total amount of interest apportioned to pool participants. However, the process does not verify that interest earnings apportioned by the Treasurer-Tax Collector's office are in agreement with the portfolio interest earnings recorded by the external custodial institutions. We were informed there would always be differences between the apportioned and portfolio interest earnings. Our assessment on this report item is the proof of earnings is a sound business practice.



Recommendation No. 4

We recommend the Treasurer-Tax Collector take appropriate actions to ensure a monthly proof of earnings is performed, reviewed and maintained on file for third party confirmation.

Treasurer-Tax Collector Management Response:

Partially Concur. Treasury Management is including the reconciliation of portfolio interest earned to interest apportionments as a component of monthly interest reconciliations. Any differences will be promptly investigated and resolved. This reconciliation will be done in conjunction with the Interest Receivable reconciliation. This control will ensure all actual interest earned will be properly reconciled with and included in the interest apportioned to pool participants.

The Treasurer's office reconciles daily activity, including all interest receipts, with our external custodial institutions. We do not rely on our custody bank for accounting nor do they provide the information necessary to compute daily or monthly interest earnings such as amortization, accretion, and realized gains and losses. We rely on our custody bank to settle trades on a delivery versus payment basis, receive coupon payments and maturities, and to act as custodian of our securities. In addition to reconciling custodian bank daily activity we reconcile month end custodial balances to balances in Quantum, our investment accounting system. The "Proof of Interest" discontinued by Treasury management did not verify or reconcile interest earnings with external custodian institutions. The "Proof of Interest" compared the portfolio yield to the apportionment yield and highlighted known differences between the two.

In addition to the controls and reconciliations currently in place, Treasury Management will formalize and document the process of reconciling portfolio earnings with interest apportionment earnings fully implemented on or before March 31, 2008.

Audit Rejoinder:

The above comment on the controls and reconciliations to ensure all interest earnings are apportioned to pool participants and, that any differences are promptly investigated and resolved, will address the intent of our recommendation.

5. Operational Policies and Procedures (Control Finding)

Because of the criticality and complexity of the interest apportionment process, Countywide impact, and high dollar amount processed annually (**over \$300 million**), it is important to have well-documented procedures. We noted the documented operational policies and procedures for interest apportionment are not complete or current for all aspects of the process.



Documented policies and procedures for interest apportionment provide a tool for training new accounting personnel, increased standardization of the process, clarification of responsibilities, and consistent application of management's expectations. Ideally, documented accounting policies and procedures should include:

- a. Purpose of commonly used funds and accounts.
- b. Standard forms and journal vouchers with explanations of their purpose and preparation.
- c. Data processing reports, including appropriate descriptions of source, content, production frequency and purpose.
- d. Descriptions of routine procedures, but not necessarily limited to, detailed analysis and preparing reconciliations.
- e. Assignment of accounting, supervisory review and approval duties.

Recommendation No. 5

We recommend the Treasurer-Tax Collector review, document, and communicate interest apportionment policies and procedures that reflect management's expectations and department practices.

Treasurer-Tax Collector Management Response:

Concur. Treasury Management understands the importance of having policies and procedures in place for all functions within the organization. Existing policies and procedures for the interest apportionment process will be updated by February 15, 2008 and communicated to appropriate Treasury staff.

EFFICIENCY/EFFECTIVENESS OBSERVATIONS

One of the audit objectives was to identify areas where efficiencies and effectiveness can be enhanced in the process. Our audit noted the following observations:

6. Cross-Training

One accountant was responsible for performing the accounting related tasks for interest apportionment. Because of the complexity and criticality of the process, adequate back-up staff should be available. Cross-training with another Treasurer-Tax Collector accountant had commenced, but was still in-progress. Cross-training employees to perform a variety of tasks help to reduce disruption in the day-to-day operations in the event of a planned or unplanned absence of an employee.

Recommendation No. 6

We recommend the Treasurer-Tax Collector continue cross-training for interest apportionment processing and ensure that another individual is fully trained for interest apportionment.



Treasurer-Tax Collector Management Response:

Concur. Treasury management recognizes the importance of cross-training. We now have two Accountant/Auditor II's cross-trained to perform the interest apportionment and Extended Fund interest allocation function on a rotation. The second Accountant/Auditor was cross-trained during October and November.

7. Spreadsheet Controls

As noted earlier, the Treasurer's office relies on Excel spreadsheets as a key financial information tool in their interest apportionment processes. These spreadsheets contain sophisticated formulas used to process interest apportionment results. The use of macros and multiple spreadsheets which are linked together allows users to build complicated models with minimal or no documentation. These complex spreadsheets are not supported by the same control environment as formally developed, purchased applications, and are not restricted from unauthorized access by security controls.

The County of Orange Accounting Manual, Number S-1, *Development of Financial Computer Systems*, states, in part, that internal controls for a financial information system should address the following areas:

- *Information Security* – The financial information system should ensure the logical use of information technology resources is restricted by adequate identification, authentication, and access controls that link users and resources with access rules.
- *Documentation* – The financial information system should include user procedure manuals, operations manual, and training manuals.

Because over \$300 million in interest is apportioned annually using these critical spreadsheets, we have the following observations and recommendations in the areas of access controls and documentation for these spreadsheets:

A. Access Controls

Access controls for spreadsheets used in the interest apportionment process can be strengthened to ensure data integrity. We noted that:

- Spreadsheets are not password protected to restrict access.
- Access controls at the file level to create, read, update, and delete were not assigned.
- Spreadsheet data from prior periods is not secured to prevent inadvertent or intentional changes to standing data.
- Historical files are not locked as "read-only."



Recommendation No. 7A

We recommend the Treasurer-Tax Collector evaluate access controls over spreadsheets supporting interest apportionment processes and determine the appropriate controls to decrease the risk of unauthorized access and modification.

Treasurer-Tax Collector Management Response:

Concur. Spreadsheet access and formula locking for the Extended Fund interest apportionment worksheets was instituted on October 18, 2007. The critical Extended Fund allocations file(s) are now restricted whereby only the individuals directly related to the process are provided access. The spreadsheets are now restricted and only certain fields allow for data entry access. Spreadsheet passwords restricting access to authorized staff prevent unauthorized changes. The supervisory review process includes a procedure to ensure beginning balances match the prior period ending balances to ensure the integrity of worksheet formulas.

B. Documentation for Spreadsheets

Documentation showing how to properly use spreadsheets enhances the current and future ability to generate accurate interest apportionments. During the review, it was noted that:

- Documentation does not include a change log showing who made changes and how the changes affected the spreadsheet.
- Embedded comments are absent to explain all input, output, and calculation cells.
- Formatting in the spreadsheet is not presented on a legend.
- A user's manual is not documented explaining the use of the spreadsheet with example input and output values.

Recommendation No. 7B

We recommend the Treasurer-Tax Collector maintain documentation for the noted areas and implement monitoring controls to ensure the long-term usefulness of spreadsheets supporting interest apportionment.

Treasurer-Tax Collector Management Response:

Concur. Treasury Management is evaluating the specific changes requested by Internal Audit in their narrative and recommendation. The documentation requested in this finding are beyond the scope of existing Excel functionality and would require extensive manual documentation. We will explore companion software products that would automate an audit log function and document input, output, and calculation cells as well as formatting changes to spreadsheets. We expect to complete our evaluation process by April 30, 2008, and, depending upon the results of our evaluation, determine the timeline for purchase and implementation of the selected software solution.



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



ATTACHMENT B: Treasurer-Tax Collector Management Responses

	OFFICE OF THE TREASURER-TAX COLLECTOR	CHRIS W. STREET TREASURER-TAX COLLECTOR
	HALL OF FINANCE & RECORDS 12 CIVIC CENTER PLAZA, SUITE G76 POST OFFICE BOX 4515 SANTA ANA, CA 92701 www.ftc.ocgov.com	PAUL C. GORMAN, C.F.A., CTP CHIEF ASSISTANT TREASURER-TAX COLLECTOR WALTER DANIELS ASSISTANT TREASURER-TAX COLLECTOR TAX COLLECTION ROBIN RUSSELL ASSISTANT TREASURER-TAX COLLECTOR ADMINISTRATION CLARISSA ADRIANO-CERES ASSISTANT TREASURER-TAX COLLECTOR INFORMATION TECHNOLOGY
	January 30, 2008	
	Dr. Peter Hughes, CPA Director, Internal Audit County of Orange 400 Civic Center Drive West Building 12, Room 232 Santa Ana, CA 92701-4521	RECEIVED INTERNAL AUDIT DEPARTMENT 1008 FEB -4 AM 7:36
	Dear Dr Hughes:	
	Pursuant to Audit Oversight Committee Administrative Procedure No. 1, we have prepared our response to the draft results of your Management Letter on Internal Control Review of Treasurer-Tax Collector's Interest Apportionment Process for the period July 1, 2006 through June 30, 2007. The recommendation numbers used in your report reference our response.	
	Recommendation No. 1A We recommend the Treasurer-Tax Collector timely prepare and review interest receivable reconciliations on a monthly basis.	
	Treasurer-Tax Collector response: Concur. The reconciliations are current and all necessary adjustments related to the outstanding reconciliations during this period have been made. Management has cross-trained an Accountant/Auditor II to provide a backup for this important process. By having a strong backup this helps to eliminate the possibility of this problem reoccurring in the future.	
	Recommendation No. 1B Ensure that all reconciling items for interest receivable are adequately identified supported and promptly resolved.	
	Treasurer-Tax Collector response: Concur. All reconciling items have been resolved. The procedures for preparation of the monthly interest receivable reconciliations include prompt resolution and review of any reconciling items.	
	Recommendation No. 2 The Treasurer-Tax Collector establishes procedures to ensure the accuracy of interest apportionment worksheets.	



ATTACHMENT B: Treasurer-Tax Collector Management Responses (continued)

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Treasurer-Tax Collector response:

Concur. Management is updating the procedures for preparation, desk review, and a supervisory review of the Extended Fund interest allocation to ensure the accuracy of the interest apportionment worksheets. Management will finalize these procedures by February 28, 2008.

Spreadsheet access and formula locking for the Extended Fund interest apportionment worksheets was instituted on October 18, 2007. The critical Extended Fund allocations file(s) are now restricted whereby only the individuals directly related to the process are provided access. The spreadsheets are now restricted and only certain fields allow for data entry access. Spreadsheet passwords restricting access to authorized staff prevents unauthorized changes. The supervisory review process includes a procedure to ensure beginning balances match the prior period ending balances to ensure the integrity of worksheet formulas.

Recommendation No. 3A

The TTC should evaluate the process for paying for purchased interest and determine an appropriate practice.

Treasurer-Tax Collector response:

Concur. Management has submitted a request to the Auditor-Controller's General ledger unit office with regard to changing the criteria prescribed in the documentation for use of the Unapportioned Interest Fund 691 for payments of purchased interest. Treasury management sees their current practice of classifying purchased interest as Interest Receivable as the appropriate accounting presentation in accordance with generally accepted accounting principles.

The Treasury expects to complete the change in the criteria for Fund 691 by March 31, 2008.

Recommendation No. 3B

The TTC should evaluate interest apportionment practices and determine the appropriate disclosure method for pool participants and other interested parties.

Treasurer-Tax Collector response:

Concur. Treasury Management will perform their due diligence in letting all the stakeholders know the methodology surrounding interest calculations.

- a) New Voluntary Participants will be informed of the interest apportionment practices by including a specific disclosure within the Voluntary Participant Agreement.
- b) Current Pool Participants will be informed via the Monthly Management report in a separate addendum concerning interest apportionment.
- c) Voluntary Participants will be informed via a letter/addendum included with their monthly statement.

Treasury Management will provide these disclosures with their monthly report and monthly voluntary participant statements for the period ended March 31, 2008.



ATTACHMENT B: Treasurer-Tax Collector Management Responses (continued)

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Recommendation No. 4

The TTC take appropriate action to ensure a monthly proof of earnings is performed, reviewed and maintained on file for third party confirmation.

Treasurer-Tax Collector response:

Partially Concur. Treasury Management is including the reconciliation of portfolio interest earned to interest apportionments as a component of monthly interest reconciliations. Any differences will be promptly investigated and resolved. This reconciliation will be done in conjunction with the Interest Receivable reconciliation. This control will ensure all actual interest earned will be properly reconciled with and included in the interest apportioned to pool participants.

The Treasurer's office reconciles daily activity, including all interest receipts, with our external custodial institutions. We do not rely on our custody bank for accounting nor do they provide the information necessary to compute daily or monthly interest earnings such as amortization, accretion, and realized gains and losses. We rely on our custody bank to settle trades on a delivery versus payment basis, receive coupon payments and maturities, and to act as custodian of our securities. In addition to reconciling custodian bank daily activity we reconcile month end custodial balances to balances in Quantum, our investment accounting system. The "Proof of Interest" discontinued by Treasury management did not verify or reconcile interest earnings with external custodian institutions. The "Proof of Interest" compared the portfolio yield to the apportionment yield and highlighted known differences between the two.

In addition to the controls and reconciliations currently in place, Treasury Management will formalize and document the process of reconciling portfolio earnings with interest apportionment earnings and this will be fully implemented on or before March 31, 2008.

Recommendation No. 5

We recommend the Treasurer-Tax Collector review, document, and communicate interest apportionment policies and procedures that reflect management's expectations and department practices.

Treasurer-Tax Collector response:

Concur. Treasury Management understands the importance of having policies and procedures in place for all functions within the organization. Existing policies and procedures for the interest apportionment process will be updated by February 15, 2008 and communicated to appropriate Treasury staff.

Recommendation No. 6

We recommend the Treasurer-tax Collector continue cross-training for interest apportionment processing and ensure that another individual is fully trained for interest apportionment.



ATTACHMENT B: Treasurer-Tax Collector Management Responses (continued)

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Treasurer-Tax Collector response:

Concur. Treasury management recognizes the importance of cross-training. We now have two Accountant/Auditor II's cross-trained to perform the interest apportionment and Extended Fund interest allocation function on a rotation. The second Accountant/Auditor was cross-trained during October and November.

Recommendation No. 7A

We recommend the Treasurer-Tax Collector evaluate access controls over spreadsheets supporting interest apportionment processes and determine the appropriate controls to decrease the risk of unauthorized access and modification.

Treasurer-Tax Collector response:

Concur. Spreadsheet access and formula locking for the Extended Fund interest apportionment worksheets was instituted on October 18, 2007. The critical Extended Fund allocations file(s) are now restricted whereby only the individuals directly related to the process are provided access. The spreadsheets are now restricted and only certain fields allow for data entry access. Spreadsheet passwords restricting access to authorized staff prevent unauthorized changes. The supervisory review process includes a procedure to ensure beginning balances match the prior period ending balances to ensure the integrity of worksheet formulas.

Recommendation No. 7B

We recommend the Treasurer-Tax Collector maintain documentation for the noted areas and implement monitoring controls to ensure the long-term usefulness of spreadsheets supporting interest apportionment.

Treasurer-Tax Collector response:

Concur. Treasury Management is evaluating the specific changes requested by Internal Audit in their narrative and recommendation. The documentation requested in this finding are beyond the scope of existing Excel functionality and would require extensive manual documentation. We will explore companion software products that would automate an audit log function and document input, output, and calculation cells as well as formatting changes to spreadsheets. We expect to complete our evaluation process of software solutions by April 30, 2008, and, depending upon the results of our evaluation, determine the timeline for purchase and implementation of the selected software solution.

If you have additional questions or follow-up comments, please contact Paul Gorman, Chief Assistant Treasurer-Tax Collector at 834-2288.

Very truly yours,

A handwritten signature in black ink, appearing to read "CW Street".

Chriss W. Street
Orange County Treasurer-Tax Collector