

Internal Audit Department

O R A N G E C O U N T Y

INTERNAL CONTROL REVIEW: AUDITOR-CONTROLLER CLAIMS & DISBURSING'S VENDOR PAYMENT PROCESS

We audited the internal controls over Claims & Disbursing's vendor payment process, where over \$1.6 billion in payments were made during Fiscal Year 2006-07, and found the vendor payments were processed completely, accurately, timely and in accordance with Auditor-Controller procedures and expectations.

For the Year Ending:
June 30, 2007

AUDIT NO: 2720-4
REPORT DATE: APRIL 2, 2008

Corporate Controls:
Centralized Core Business System Audit

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Internal Audit Department

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Internal Audit Department

Providing Facts and Perspectives Countywide

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OC Fraud Hotline (714) 834-3608

Letter from Director Peter Hughes



Transmittal Letter



AUDIT NO. 2720-4

APRIL 2, 2008

TO: David E. Sundstrom
Auditor-Controller

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

SUBJECT: Internal Control Review of Auditor-
Controller Claims & Disbursing's
Vendor Payment Process

We have completed an Internal Control Review of Auditor-Controller Claims & Disbursing's vendor payment process for the year ending June 30, 2007, in which Claims & Disbursing processed approximately **68,559 vendor payments** totaling over **\$1.6 billion**. Our final report is attached for your review.

This report is one in a series of audit reports on the processes reviewed in Claims and Disbursing. There are separate audit reports we have issued for other processes in Claims & Disbursing including the Educational and Professional Reimbursement Process (#2720-1); Employee Social Security Numbers (#2720-3); and the Mileage and Other Expenses Reimbursement Process (#2720-2). Our audit was conducted in accordance with professional standards established by the Institute of Internal Auditors.

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 now begin at six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

Letter from Director Peter Hughes



We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendation is implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

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

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendations.

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

Attachments

Other recipients of this report are listed on the Internal Auditor's Report on page 5.

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Claims & Disbursing's
Vendor Payment Process
Audit No. 2720-4*

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June 30, 2007

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INTERNAL AUDITOR'S REPORT

AUDIT No. 2720-4

APRIL 2, 2008

TO: David E. Sundstrom, Auditor-Controller

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

SUBJECT: Internal Control Review of Auditor-Controller
Claims & Disbursing's - Vendor Payment Process

Audit Highlight

We audited the internal controls over Claims & Disbursing's vendor payment process, where over \$1.6 billion in payments were made during Fiscal Year 2006-07, and found the vendor payments were processed completely, accurately, timely and in accordance with Auditor-Controller procedures and expectations.

OBJECTIVES

The Internal Audit Department conducted an Internal Control Review of the vendor payment process in Auditor-Controller Claims & Disbursing (A-C Claims), which included an evaluation of the adequacy and integrity of internal controls; compliance with applicable rules, regulations and department policies, and evidence of process efficiencies and effectiveness. The objectives of our audit were to evaluate internal controls and determine if they are in place to ensure:

- ▶ Vendor payments are processed completely, accurately, and timely in accordance with Auditor-Controller procedures and management's expectations.
- ▶ Vendor table codes are properly and accurately created, modified, and deleted, and are regularly monitored.
- ▶ A-C Claims' quality assurance audits and stratification reviews were adequate in evaluating the effectiveness of the vendor payment review and approval process.
- ▶ Business processes are efficient and effective as related to A-C Claims' processing of vendor payments.

This area is an Auditor-Controller centralized, core business process that has countywide impact. This report is one in a series of audit reports we have issued for the processes we reviewed in A-C Claims.

BACKGROUND

The mission of the Auditor-Controller (A-C) is to promote public oversight, provide accountability, and support financial decision-making for the County. The A-C is comprised of three divisions: Central Operations, Agency Accounting and Information Technology. Central Operations provides the "core" accounting activities required of the Auditor-Controller which benefit the County as a whole.



The Claims & Disbursing Unit (A-C Claims) within the A-C Central Operations provides payroll and claims processing for all County departments. Vendor payments are made on behalf of originating departments/agencies for Board-approved contracts, price agreements, purchase orders, and miscellaneous vendor invoices for goods and services received in the County. During Fiscal Year 2006/07, A-C Claims processed **68,559 vendor payments totaling \$1,681,244,252.**

Departments/agencies are responsible for reviewing their vendor invoices to ensure that goods/services were received; billing terms agree with the contracts; proper account coding is provided, and the payment is approved by an authorized signer. A-C Claims reviews vendor invoices to ensure payment approval by authorized department/agency personnel, verifies invoices have appropriate supporting documents; and inputs payment information into the Countywide Accounting and Personnel System (CAPS) for payment processing.

A-C Claims reviews all vendor payments except for five departments/agencies that have Auditor-Controller satellite accounting staff (Housing and Community Services, IWMD, RDMD, JWA, and HCA). These satellite offices process, review and approve payments relating to Board-approved contracts; however, all other vendor payments are processed in A-C Claims. Vendors are paid through the following three payment types:

- **Payment Vouchers** - checks issued for vendor invoices that are processed within a normal (2-day) payment cycle.
- **Manual Warrants** - electronic fund transfers issued by the Treasurer's Office daily or within a normal payment cycle.
- **Manual Checks** - checks that are issued immediately by Auditor-Controller Check Writing for an emergency situation.

The table below summarizes vendor payments for FY 2006/07:

Payment Types	Counts	Amount (\$)
Payment Vouchers	66,905	571,233,874
Manual Warrants	1,638	1,109,775,805
Manual Checks	16	234,573
Total	68,559	\$1,681,244,252



SCOPE

Our audit evaluated controls and processes over vendor payments from when A-C Claims receives department/agency vendor payments up to the submission of the payments to the Disbursing function for check issuance. Our review covered the period from July 1, 2006 through June 30, 2007. We did not include the processes and controls in the Disbursing function of A-C Claims, in Auditor-Controller satellite accounting offices, or A-C Claims' process to recover duplicate payments. Our methodology included inquiry, auditor observation and examination and testing of relevant documentation.

RESULTS

We audited the internal controls over Claims & Disbursing's vendor payment process, where over \$1.6 billion in payments were made during Fiscal Year 2006-07, and found the vendor payments were processed completely, accurately, timely and in accordance with Auditor-Controller procedures and expectations. **No material weaknesses or significant issues were identified.** However, we noted **seven (7) control findings and 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.

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

- ▶ **Objective:** *Vendor payments are processed completely, accurately, and timely in accordance with Auditor-Controller procedures and management's expectations.*
- ▶ **Results:** Overall controls and processes are in place to ensure vendor payments are processed completely, accurately, and in accordance with Auditor-Controller procedures and management's expectations. We noted where enhancements can be made in areas of missed vendor discounts, sales taxes, and invoice processing timeframes. These are **Control Findings** and are discussed in the Detailed Observations, Recommendations and Management Responses section of this report.
- ▶ **Objective:** *Vendor table codes are properly and accurately created, modified, and deleted, and are regularly monitored.*
- ▶ **Results:** Controls and processes are in place to ensure vendor codes are created/modified/deleted properly and accurately. We noted where enhancements can be made in obtaining vendor taxpayer identification numbers and performing supervisory reviews, which are considered **Control Findings**.



- ▶ **Objective:** *A-C Claims' quality assurance audits and stratification reviews were adequate in evaluating the effectiveness of the vendor payment review and approval process.*
- ▶ **Results:** Controls and processes are in place to ensure quality assurance audits and stratification reviews are adequately performed to evaluate the effectiveness. We noted where enhancements can be made in the quality assurance audits and stratification reviews, which are considered **Control Findings**.
- ▶ **Objective:** *Business processes are efficient and effective as related to Claims & Disbursing processing of vendor payments.*
- ▶ **Results:** No inefficient or ineffective procedures such as backlogs or duplication of work were noted or came to our attention concerning the vendor payment process.

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 Auditor-Controller'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 Auditor-Controller's operating procedures, accounting practices and compliance with County policy.

OC Internal Auditor's Report



Acknowledgment

We appreciate the courtesy and cooperation extended to us during the audit by the personnel of Auditor-Controller Claims & Disbursing. 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.

Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Shaun Skelly, Senior Director, A-C/Accounting and Technology
Jan Grimes, Director, A-C/Central Accounting Operations
Robert Leblow, Senior Manager, A-C/Claims and Disbursing
Toni Smart, Manager, A-C/Internal Audit and Staff Services
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors



DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Vendor Payment Review Process

Departments/agencies are responsible for reviewing and approving payment on their vendor invoices. Auditor-Controller Claims & Disbursing (A-C Claims) reviews department/agency vendor invoices for approval by authorized personnel, verifies the existence of appropriate supporting documents, and inputs payment information into the Countywide Accounting and Personnel System (CAPS) for payment processing.

Because of the high volume of vendor payments processed in A-C Claims, we used statistical sampling to randomly select and test **88 vendor payments totaling \$6,093,914**, which is 3% of the total vendor payments. Each vendor payment could contain one or more invoices. Our sample size was derived based upon a population of 68,559 vendor payments, a 90% Confidence Level, and a Sampling Error Rate of 3% established by us. We noted the following based on our audit of the 88 vendor payments:

Observation No. 1 – Vendor Discounts Not Taken

Two (2) vendor invoices had payment terms of 2% @ 30 Net 31, which allowed a 2% discount to be taken if payment was received within 30 days. A-C Claims processed these two payments within the discount period; however, the discounts totaling \$47.15 were not taken. **Vendor discounts not taken result in overpayment to vendors when payments are issued within the discount period.**

Recommendation No. 1

Auditor-Controller Claims & Disbursing ensure vendor discounts are identified and taken when applicable.

Auditor-Controller Management Response:

Concur. We will remind staff of the need to check for discounts and require supervisors to include a check for discounts when reviewing payments. We will include this in the stratification audit attribute testing worksheet. This has also been included as part of the training packet for new Claims employees.

Observation No. 2 – Sales Taxes

Two (2) vendor invoices for dental supplies and sprinkler heads did not charge for sales tax. In these instances, vendor invoices should have included sales tax, and resulted in an **underpayment of sales/use tax totaling \$763.49**. A-C Claims did not detect the items as taxable, paid the invoices as billed, and did not report or remit the applicable sales tax.



According to California Revenue and Taxation Code, Section 6202, when a purchaser (County) buys tangible personal property from a retailer (vendor), a sales/use tax should be charged; the purchaser is liable for the tax; and sales tax liability remains until it has been paid to the State Board of Equalization.

Recommendation No. 2

Auditor-Controller Claims & Disbursing ensure sales taxes are charged and detected on all applicable purchases. On the exceptions noted above, Claims & Disbursing should take appropriate action with the State Board of Equalization concerning payment of sales tax due.

Auditor-Controller Management Response:

Concur. The items noted in the audit were subsequently included on a quarterly sales tax report and remitted to the State. We will remind staff of the importance of checking sales tax amounts and also begin sending selected individuals to sales tax training classes.

Observation No. 3 – Processing Timeframes

A-C Claims' internal goal is to process and issue vendor payments within **10 business days** from the date that payment requests are received in A-C Claims. Based on our testing of 88 vendor payments, we noted:

- Sixty-five (74%) payments were processed within 10 business days after receipt in A-C Claims.
- Sixteen (18%) payments were processed and issued ranging from 11 to 31 days after receipt in A-C Claims.
- Seven (8%) payment requests were not date stamped when received from agencies/departments; therefore, we were unable to determine the timeliness of the processing.

Ensuring that vendors with the County receive timely payment has been an area of County-wide interest. The timeliness of processing vendor payments is dependent on both the originating department/agency and A-C Claims because both perform reviews and approvals.

A-C Claims indicated they process about 800 payments daily, are impacted by staffing turnover, and have a six-month training period for new deputized employees who approve vendor payments, all which impact processing times. Because 74% of payments were processed within 10 days, the process appears to be efficient. Date-stamping invoices upon receipt enables A-C Claims to evaluate achievement of their internal goal.



Recommendation No. 3

Auditor-Controller Claims & Disbursing continue efforts in processing invoices within their internal goal and ensure all payment requests are date-stamped upon receipt.

Auditor-Controller Management Response:

Concur. We agree that all payments should be date stamped upon receipt and that is our current policy. Sometimes documents are date stamped on the reverse and this does not appear on the scanned document. We will remind our compliance staff to check for date stamps on all items received over the counter or through our internal mail distribution process.

VENDOR PAYMENT TABLE

A-C Claims' Compliance Unit maintains the vendor payment table for the County. The vendor payment table is used to create payments against contracts for vendors doing business with the County. Maintaining the vendor payment table involves adding new vendor codes, modifying existing vendor codes, and deleting vendor codes with authorization from departmental Deputy Purchasing Agents. Maintaining a vendor payment table provides strong controls against duplicate or unauthorized payments. We tested 25 vendor code additions, modifications, and deletions in the vendor payment table and noted the following:

Observation No. 4 – Taxpayer Identification Number

Four of 25 vendor codes tested were added into the vendor payment table without a signed W-9 form *Request for Taxpayer Identification Number and Certification*. The Auditor-Controller is required by law to obtain taxpayer identification information for each vendor prior to making a payment, except in emergency situations.

Recommendation No. 4

Auditor-Controller Claims & Disbursing ensure all vendor code additions have a signed W-9 form containing required taxpayer identification information.

Auditor-Controller Management Response:

Concur. We will emphasis (sic) this issue with the processing staff and continue to monitor for this in our compliance audits.

Observation No. 5 – Supervisory Review

Vendor codes can be added, deleted, or modified based upon requests from department/agency Deputized Purchasing Agents, or by A-C Claims staff by using a "Vendor Table Update Request." A-C Claims started performing documented supervisory reviews of the Vendor Table Update Requests in June 2007 to ensure the updates are valid and correctly input.



Our review of three (3) vendor code updates found supervisory reviews were performed and documented; however they were not performed timely. We noted they were performed between two to four months after the code updates were input.

Recommendation No. 5

Auditor-Controller Claims & Disbursing ensure supervisory reviews of Vendor Table Update Requests are performed timely.

Auditor-Controller Management Response:

Concur. Due to workload levels and staff vacancies, vendor table change reviews were backlogged. This backlog is currently being worked by staff through overtime.

QUALITY ASSURANCE AUDITS

The Compliance Unit within A-C Claims & Disbursing performs Quality Assurance audits three times a year to ensure vendor payments were properly made and consistently processed by A-C Claims (central) and by the satellite accounting offices. Any issues identified are included in a Compliance Letter that is distributed to individuals in A-C Claims and the satellite offices. This letter does not require corrective actions or responses from affected departments/agencies.

The Compliance Unit last conducted a Quality Assurance audit in April 2007 of 30 vendor payments processed from January 2006 through December 2006; and the Compliance Letter was issued on June 8, 2007. We judgmentally selected 5 of the 30 vendor payments from the Quality Assurance audit to ensure it was properly conducted. We noted the following:

Observation No. 6 – Accuracy of Quality Assurance Audits

Two of five vendor payments tested were not reviewed accurately and concluded upon appropriately.

The Compliance Unit utilizes a *Quality Assurance Testing Summary* checklist that contains key attributes of the vendor payment review and approval process. We noted that some attributes were “*Not Applicable*” to the vendor payment; however, the reviewer incorrectly marked “*Satisfactory*” on the checklist for the non-applicable test attributes.

Also, the reviewer did not identify a missing invoice in the amount of \$154.35. The checklist incorrectly indicated that “*Satisfactory*” payment documentation was complete, scanned into ERMI, and the amount approved and paid was not greater than the amount invoiced. To be an effective monitoring process over vendor payments, the accuracy of Quality Assurance audit fieldwork is important.



Recommendation No. 6

Auditor-Controller Claims & Disbursing takes measures to ensure Quality Assurance audits are accurately performed, which could be accomplished through additional training and/or supervisory reviews.

Auditor-Controller Management Response:

Concur. We will increase training and review of compliance work performed by staff.

STRATIFICATION REVIEWS

Due to the high volume of daily payment requests received in A-C Claims, they only perform detailed reviews known as "full audits" of vendor payments exceeding \$1,000. For payments less than \$1,000, they perform limited reviews known as a "4-point audits." To evaluate the appropriateness of the \$1,000 threshold, the Compliance Unit performs annual stratification reviews and evaluates if this threshold should be lowered based on the error rate found in the reviews.

The Compliance Unit's latest stratification review of 200 invoices was conducted for the period January 2006 through December 2006, and was in process of finalization during our fieldwork. We judgmentally selected 15 payments from the stratification review and noted the following:

Observation No. 7 – Accuracy of Stratification Reviews

One of 15 vendor payments tested was incorrectly concluded as an "error." The reviewer was unable to locate the invoice to verify it was authorized and in accordance to the terms of the contract. However, we noted the information for this payment was available, that it was properly authorized and in accordance with contract terms; and therefore should not have been an error.

Recommendation No. 7

Auditor-Controller Claims & Disbursing takes measures to ensure Stratification Reviews are accurately performed, which could be accomplished through additional training and/or supervisory reviews.

Auditor-Controller Management Response:

Concur. We will also increase training and review of compliance work performed by staff.



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: Auditor-Controller Management Responses



DAVID E. SUNDSTROM, CPA
AUDITOR-CONTROLLER

AUDITOR-CONTROLLER COUNTY OF ORANGE

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March 27, 2008

TO: Peter Hughes, Director
Internal Audit Department

SUBJECT: Audit Report No. 2720-4, Internal Control Review of Auditor-Controller Claims
& Disbursing – Vendor Payment Process

Following is our response to the recommendations contained in the report on Internal Control Review of Auditor-Controller Claims & Disbursing – Vendor Payment Process, Audit Number 2720.

Recommendation No. 1

Auditor-Controller Claims & Disbursing ensure vendor discounts are identified and taken when applicable.

Auditor-Controller Response

Concur. We will remind staff of the need to check for discounts and require supervisors to include a check for discounts when reviewing payments. We will include this in the stratification audit attribute testing worksheet. This has also been included as part of the training packet for new Claims employees.

Recommendation No. 2

Auditor-Controller Claims & Disbursing ensure sales taxes are charged and detected on all applicable purchases. On the exceptions noted above, Claims & Disbursing should take appropriate action with the State Board of Equalization concerning payment of sales tax due.

Auditor-Controller Response

Concur. The items noted in the audit were subsequently included on a quarterly sales tax report and remitted to the State. We will remind staff of the importance of checking sales tax amounts and also begin sending selected individuals to sales tax training classes.

Recommendation No. 3

Auditor-Controller Claims & Disbursing continue efforts in processing invoices within their internal goal and ensure all payment requests are date-stamped upon receipt.

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ATTACHMENT B: Auditor-Controller Management Responses (continued)

Peter Hughes, Director, Internal Audit Department
March 27, 2007
Page 2 of 2

Auditor-Controller Response

Concur. We agree that all payments should be date stamped upon receipt and that is our current policy. Sometimes documents are date stamped on the reverse and this does not appear on the scanned document. We will remind our compliance staff to check for date stamps on all items received over the counter or through our internal mail distribution process.

Recommendation No. 4

Auditor-Controller Claims & Disbursing ensure all vendor code additions have a signed W-9 form containing required taxpayer identification information.

Auditor-Controller Response

Concur. We will emphasize this issue with the processing staff and continue to monitor for this in our compliance audits.

Recommendation No. 5

Auditor-Controller Claims & Disbursing ensure supervisory reviews of Vendor Table Update Requests are performed timely.

Auditor-Controller Response

Concur. Due to workload levels and staff vacancies, vendor table change reviews were backlogged. This backlog is currently being worked on by staff through overtime.

Recommendation No. 6

Auditor-Controller Claims & Disbursing takes measures to ensure Quality Assurance audits are accurately performed, which could be accomplished through additional training and/or supervisory reviews.

Auditor-Controller Response

Concur. We will increase training and review of compliance work performed by staff.

Recommendation No. 7

Auditor-Controller Claims & Disbursing takes measures to ensure Stratification Reviews are accurately performed, which could be accomplished through additional training and/or supervisory reviews.

Auditor-Controller Response

Concur. We will also increase training and review of compliance audit work performed by staff.

Thank you for the opportunity to respond. Please contact Jan Grimes at 834-2470, if you have any questions on our response.


David E. Sundstrom
Auditor-Controller

JG:wg (Ops Rpt Rspnse to Audit 2720-04)