

Internal Audit Department

COUNTY OF ORANGE RETIREE MEDICAL PLAN - ANNUAL REQUIRED COUNTY CONTRIBUTIONS FOR FISCAL YEAR 2008/2009

We reviewed the County's contributions to the Trust established for the Retiree Medical Plan for the period July 1, 2008 through January 31, 2009 and found that the County correctly applied the actuarial recommendation to properly fund the Retiree Medical Plan for Fiscal Year 2008-2009. Employer contributions totaled \$18,460,729 from July 4, 2008 through December 4, 2008.

We identified one (1) **significant issue** and four (4) **control findings** to improve existing controls.

AUDIT No: 2813

REPORT DATE: NOVEMBER 17, 2009

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RISK BASED AUDITING

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OC Fraud Hotline (714) 834-3608

Letter from Dr. Peter Hughes, CPA

Transmittal Letter



Audit No. 2813 November 17, 2009

TO: Thomas G. Mauk
County Executive Officer

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

SUBJECT: County of Orange Retiree Medical Plan -
Annual Required County Contributions

We have completed our audit of the County of Orange Retiree Medical Plan - Annual Required County Contributions. To determine if the County was properly funding the Plan for FY 2008-2009, we audited certain records and documents for the period July 1, 2008 through January 31, 2009. The final **OC Internal Auditor's Report** is attached along with your responses to our recommendations. We performed this audit in accordance with our FY 2008-09 Audit Plan approved by the Audit Oversight Committee.

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 now 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.

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.

Letter from Dr. Peter Hughes, CPA

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

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

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

Attachments

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 4.

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For Fiscal Year 2008-2009

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Audit No. 2813

November 17, 2009

TO: Thomas G. Mauk
County Executive Officer

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

SUBJECT: County of Orange Retiree Medical Plan –
Annual Required County Contributions

Audit Highlight

We reviewed the County's contributions to the Trust established for the Retiree Medical Plan for the period July 1, 2008 to January 31, 2009 to determine if the County correctly applied the actuarial recommendation to properly fund the Retiree Medical Plan for Fiscal Year 2008-2009. Employer contributions totaled \$18,460,729 from July 4, 2008 to December 4, 2008.

We identified one (1) **significant issue** and four (4) **control findings** to improve existing controls.

OBJECTIVES

The Internal Audit Department conducted an audit of certain records and documents for the period July 1, 2008 through January 31, 2009, to determine if the County of Orange was properly funding the Trust established for the Retiree Medical Plan for Fiscal Year 2008-2009. To determine if proper funding was in place, we tested the following for appropriateness, accuracy, and completeness:

1. Methodologies used to calculate the budgeted and revised Annual Required Contribution (ARC) amounts and rates;
2. Implementation of the budgeted and revised ARC Rates in the Auditor-Controller (A-C) Payroll System; and
3. Funding of the County's contributions from A-C Payroll to the Retiree Medical Trust held by the Orange County Employees Retirement System (OCERS) for the Retiree Medical Plan.

In addition, while performing the audit we identified internal control weaknesses for which we noted suggestions for improvement.

BACKGROUND

The County of Orange Retiree Medical Plan assists eligible Orange County (OC) retired employees, retired employees of other public agencies that participate in the Plan, and their spouses and dependents, in maintaining health coverage after retirement. The Plan also establishes an irrevocable Trust to hold contributions and investment earnings. The Trustee of the Trust is the County's Chief Financial Officer. The Orange County Employees Retirement System (OCERS) acts as a third-party administrator and/or investment manager of the Trust in accordance with the written agreement between the County and OCERS.

The Retiree Medical Plan was restructured in 2006 with the agreement of the labor organizations and resulted in an amended retiree medical plan approved by the Board of Supervisors in June 2007 and then amended again in 2008 and 2009. The County pre-funds the Retiree Medical Plan and provides a monthly grant to eligible retired County employees and retired employees of other public agencies that participate in the plan.



From July 4, 2008 through December 4, 2008, the County has contributed \$18,460,729, calculated by the County's A-C payroll system.

The County adopted the Governmental Accounting Standards Board (GASB) No. 45 in fiscal year 2007/2008. GASB 45 requires agencies with more than 200 members to prepare actuarial valuations at least every two years; and if there is a significant change in benefit provisions, participants, or factors that impact long-term assumptions, a new valuation must be performed. The purpose of the actuarial valuation is to determine the projected Plan benefit obligations and calculate the County's 2007-2008 and 2008-2009 Annual Required Contributions for the Plan assuming the County will pre-fund the full ARC through the irrevocable Trust.

The actuarial valuation for Fiscal Years 2007-2008 and 2008-2009 was not finalized by the actuaries until December 2008; therefore, CEO/Budget Office had to develop methodologies to calculate the budgeted contribution amounts and then the budgeted ARC Rates to be implemented into the A-C Payroll System in the interim (July 1, 2008 through December 4, 2008). Upon receipt of the actuarial valuation report, the CEO/Budget Office calculated revised ARC Rates based on remaining balances that still needed to be contributed to meet the ARC amounts recommended by the actuaries for Fiscal Year 2008-2009. The revised ARC Rates were implemented into the A-C Payroll System for December 5, 2008 through June 30, 2009.

Each time payroll is run, the A-C Payroll System calculates the ARC amounts for each eligible County employee and employees of other public agencies that participate in the Retiree Medical Plan. The ARC amounts are then totaled to obtain the County's total contributions for each pay period. Each pay period, the County's total contributions are then deposited into County Fund 17A (Retiree Medical Trust), where the contributions are held until CEO/Public Finance forwards the contributions to OCERS for investing.

SCOPE

Our audit was limited to certain records and documents for the period July 1, 2008 through January 31, 2009 that supported the County's funding of the Retiree Medical Plan for Fiscal Year 2008-2009. Our audit included reviewing the methodologies for the budgeted and revised ARC Rates, implementation of the rates in the A-C Payroll System, and funding of the County's contributions from A-C Payroll to the Trust held by OCERS.

In this audit, we did not review: CEO/Budget's ARC calculations for every County and participating public agency employee position; employee contributions to the Retiree Medical Plan, actuarial assumptions and projections; eligibility for the Retiree Medical grants, payments to the Sheriff's new Health Reimbursement Arrangement; nor lump sum payments paid to terminated employees not eligible for the grant. Our audit was conducted in accordance with professional standards established by the Institute of Internal Auditors.

Our methodology included inquiry, auditor observation and examination, and testing of relevant documentation. In the course of conducting the audit, we interviewed personnel of various County departments, including CEO/Budget Development Office, CEO/Public Finance, Human Resources Department/Employee Benefits, and A-C Payroll, and a consultant from OCERS.



RESULTS

No material weaknesses were identified. We noted **one (1) significant issue** and **four (4) control findings** to enhance controls and processes. These issues are 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:

Audit Objective #1 – Methodologies to Calculate Budgeted/Revised ARC Amounts and Rates: Determine whether the methodologies and calculations for determining the budgeted and revised ARC amounts and rates were appropriate and accurate.

Results: We found the methodologies and calculations for determining the budgeted and revised ARC amounts appeared to be appropriate and accurate.

Audit Objective #2 – Implementation of Budgeted/Revised ARC Rates: Determine whether the budgeted and revised ARC Rates have been implemented into the A-C Payroll System accurately and in the correct pay periods.

Results: Our test work indicated that the budgeted and revised ARC Rates were correctly implemented into the A-C Payroll System for Fiscal Year 2008-2009. We noted **one (1) Control Finding** regarding the review of ARC Rate changes. (See page 5 for details)

Audit Objective #3 – Funding the County's Contributions: Determine if the County was properly funding the Retiree Medical Plan. This objective included reviewing the allocation of payroll contributions into the reporting categories for the County and participating public agencies, electronic wiring of the funds to OCERS, and reconciling and recording the financial activity from the OCERS Statements into the County's records.

Results: It appears the County is properly funding the Retiree Medical Plan; however, we did find **one (1) Significant Issue** and **three (3) Control Findings** regarding: reconciliation method and interest recorded; timeliness in reconciling and recording financial information; documented supervisory reviews; and written procedures. Please see the Detailed Findings, Recommendations, and Management Responses section of this report for more information. (See pages 5 - 8 for details)

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, and circumvention by collusion, and poor judgment. Our audit would not necessarily disclose all weaknesses in CEO's operating procedures, accounting practices and compliance with County policy for the Retiree Medical Plan.

See **Attachment A** for a description of report item classifications.



ACKNOWLEDGMENT

We appreciate the courtesy and cooperation extended to us by CEO/Budget Development, CEO/Public Finance, Human Resources Department/Employee Benefits, and A-C Payroll. If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at (714) 834-5899, or Alan Marcum, Senior Audit Manager at (714) 834-4119.

Attachment A: Report Item Classifications
Attachment B: County Executive Office Responses

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Bob Franz, County Chief Financial Officer
Frank Kim, Director, CEO/County Budget Office
Mitch Tevlin, Manager, CEO/County Budget Office/Budget Development
Louis McClure, Analyst, CEO/Public Finance
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of Supervisors

Detailed Findings, Recommendations, and Management Responses



AUDIT OBJECTIVE #2 – IMPLEMENTATION OF BUDGETED/REVISED ARC RATES:

Observation No. 1 - Review of ARC Rate Changes (Control Finding)

There is no formal control in place to review the ARC Rate changes implemented by A-C Payroll at the request of the CEO/Budget Office. The ARC Rates are a part of the equation that determines the amount of County contributions to be forwarded to Fund 17A (Retiree Medical Trust) each pay period; therefore, the ARC Rates should be reviewed for accuracy prior to the first payroll run using the new rates. Currently, CEO/Public Finance spot checks the ARC Rates, but there is no evidence of review or control to ensure this process is carried out. A written procedure of the review process of the ARC Rate changes should be created and provided to appropriate personnel.

Recommendation No. 1

We recommend CEO ensure a control is in place to review the ARC Rate changes implemented by A-C Payroll. The procedure should be written and provided to appropriate personnel. The review should be documented with the reviewer's signature/initials and date of review, and the document retained for evidence of review and an audit trail.

CEO Response:

Concur. The County Executive Office concurs with the recommendation and has implemented detailed policies and procedures for the administration of the Retiree Medical Trust. Procedures related to the review of ARC changes are included in the policies and procedures.

AUDIT OBJECTIVE #3 – FUNDING THE COUNTY'S CONTRIBUTIONS

Observation No. 2 – Reconciliation Method (Significant Issue)

The reconciliation method used to update County Fund 17A account (Retiree Medical Trust) with financial activity (e.g. deposits, interest, benefits paid, and service fees) from the OCERS Statements is flawed. OCERS provides financial activity on a cumulative statement and individual statements for the County and participating public agencies each month. Currently, the CEO/Public Finance reconciliation process consists of taking the difference between the ending balances for the County and participating public agencies (from the County's Balance Sheet Account Balances printed off the County's Data Warehouse) and the balances that appear on the individual OCERS Statements to determine the amounts needed to update the County's accounts in Fund 17A. The financial activity that appears on each individual OCERS Statement should be calculated and added to the County's balances, and then agreed to OCERS Statement balances for the County and each participating public agency. Interest, benefits paid, and service fees on the OCERS Statements are added/subtracted to obtain the balances; however, there is no agreement of these balances to the overall financial activity reported on the OCERS Statements. We provided a reconciliation format to CEO/Public Finance to assist them with their reconciling responsibilities.

During our reconciliation of the financial activity for the period July 2008 through January 2009, we found an error in the recorded interest amount on JV #017-09-05000730, recorded May 21, 2009. The interest amount should have been \$16,497,305.95 (\$213,847.92 more than the recorded \$16,283,458.03). CEO/Public Finance corrected this error on JV #017-09-06001436, recorded June 29, 2009.

Detailed Findings, Recommendations, and Management Responses



Recommendation No. 2

We recommend CEO/Public Finance ensure their reconciliation method for OCERS Statements to the County's General Ledger (Fund 17A) is appropriate. The reconciliations should be signed and dated by the preparer and reviewer and retained as evidence of review and an audit trail.

CEO Response:

Concur. The County Executive Office concurs with the recommendation and has implemented the recommended reconciliation method. Detailed policies and procedures have been implemented for the administration of the Retiree Medical Trust and the recommended reconciliation method is included in the procedures.

Observation No. 3 – Timeliness of Reconciling and Recording Financial Activity (Control Finding)

Financial activity (e.g., interest, medical benefit payments, service fees, and deposits) on the OCERS Statements were not reconciled and recorded timely into the County's Fund 17A (Retiree Medical Trust). Journal Voucher #017-09-05000730, dated May 21, 2009, recorded the financial activity for the months of July 2008 through January 2009. CEO/Public Finance informed us that the delay was due to a request to OCERS to provide statements without retiree medical premiums and deposit-retiree deductions (information not tracked by the County). The revised OCERS Statements were received as follows: November 2008 Statement received January 20, 2009; December 2008 Statement received February 23, 2009; and the January 2009 Statement received March 24, 2009. The amount of time that lapsed between receipt of the revised OCERS statements and the reconciling and recording of the financial activity for July 2008 through January 2009 appears to be excessive.

County Procedure Number S-2, Section 3.3, Authorization, Execution, and Recording of Transactions, states: ". . . Transactions shall be accurate, timely, properly recorded, and properly classified." County's Procedure, Number F-4, Section 2.6.5, Reconciliation of Fiduciary Funds states "Departments and agencies are responsible for reconciling, at least monthly, each fiduciary balance per the department's or agency's subsidiary ledger records or other detailed records to the A-C's General Ledger balance shown for the fiduciary fund."

Recommendation No. 3

We recommend a control be implemented to ensure timely reconciling and recording of financial activity from the OCERS Statements to the County's Fund 17A (Retiree Medical Trust) so that the County's records are current and accurate.

CEO Response:

Concur. The time lapse between receipt of the updated OCERS statements and recording of the financial activity on the County books was due to the additional analysis necessary to help ensure proper account coding. Detailed policies and procedures have been implemented for the administration of the Retiree Medical Trust and the appropriate timeline for the reconciliation and recording of financial activity of the Trust is included in the procedures.

Detailed Findings, Recommendations, and Management Responses



Observation No. 4 – Documented Supervisory Reviews (Control Finding)

Documented supervisory reviews establish accountability and ensure the propriety, consistency, and completeness of work performed by staff. We noted the following key documents did not contain evidence of a supervisory review; however, we were informed the reviews were performed:

- Retiree Medical Trust 401(H) Deposits by Pay Period and Entity (allocation of contributions to the County and participating public agencies)
- Reconciliation of the OCERS Monthly Balances for the Medical Investment Account Statement

Note: The Retiree Medical Trust 401(H) Deposits by Pay Period and Entity is a key supporting document for the contributions wired to OCERS (on Electronic Fund Transfer forms). The Reconciliation of the OCERS Monthly Balances for the Medical Investment Account Statement is a key supporting document for the recording of financial activity from OCERS Statements to County's Trust Fund 17A (on Journal Vouchers).

Recommendation No. 4

We recommend CEO/Public Finance management ensure the preparer and reviewer of key supporting documents sign/initial and date the documents to increase accountability and provide an adequate audit trail.

CEO Response:

Concur. Detailed policies and procedures have been implemented for the administration of the Retiree Medical Trust and procedures regarding the signing and dating of supporting documents is included in the policies and procedures.

Observation No. 5 – Written Procedures for Retiree Medical Trust Responsibilities (Control Finding)

The following responsibilities for the Retiree Medical Trust are carried out by the CEO/Public Finance Analyst with no detailed written process or procedures:

- reviewing and reconciling the OCERS Statements to the County's accounts;
- recording financial activity from the OCERS Statements into the appropriate accounts and reporting categories for the County and participating public agencies;
- allocating the contributions to the County and participating public agencies;
- determining when to wire contributions and wiring them to OCERS; and
- monitoring the Retiree Medical Trust Fund 17A.

Recommendation No. 5

We recommend CEO/Public Finance provide written procedures/policies for the processes involved in the Retiree Medical Trust, specifically for reconciling and recording financial activity into the appropriate reporting categories, allocating contributions, wiring of contributions to OCERS, and monitoring of the Retiree Medical Trust Fund 17A. In addition, the procedures should include the initialing and dating of key documents by the preparer and the reviewer to ensure timeliness, establish accountability, and strengthen the control environment.

Detailed Findings, Recommendations, and Management Responses



CEO Response:

Concur. The County Executive Office concurs with the recommendation and has implemented detailed policies and procedures for the administration of the Retiree Medical Trust. The procedures include timelines and direction related to the reconciliation between the OCERS statements and the County accounting records, the wiring of funds to OCERS and monitoring of the ARC deposited into Fund 17A. The procedures also provide direction regarding the signing and dating of key documents related to the Trust.



ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit findings 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 concerning internal controls, compliance, or efficiency/effectiveness issues that require management’s corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.

Detailed Findings, Recommendations, and Management Responses



ATTACHMENT B: County Executive Office Responses



County Executive Office

Memorandum

RECEIVED
INTERNAL AUDIT DEPARTMENT

2009 NOV -6 AM 10: 49

November 5, 2009

To: Dr. Peter Hughes
Director, Internal Audit Department

Subject: CEO Response to Audit Report No. 2813 on the County of Orange Retiree Medical Plan

We have received your draft audit report related to the County of Orange Retiree Medical Plan and are submitting our responses to the recommendations as follows:

Recommendation #1

We recommend CEO ensure a control is in place to review the ARC rate changes implemented by A/C Payroll. The procedure should be written and provided to appropriate personnel. The review should be documented with the reviewer's signature/initials and date of review, and the document retained for evidence of review and audit trail.

CEO Response:

Concur. The County Executive Office concurs with the recommendation and has implemented detailed policies and procedures for the administration of the Retiree Medical Trust. Procedures related to the review of ARC changes are included in the policies and procedures.

Recommendation #2

We recommend CEO/PF ensures their reconciliation method for OCERS statements to GL is appropriate. The reconciliations should be signed and dated by the preparer and reviewer and retained as evidence of review and an audit trail.

CEO Response:

Concur. The County Executive Office concurs with the recommendation and has implemented the recommended reconciliation method. Detailed policies and procedures have been implemented for the administration of the Retiree Medical Trust and the recommended reconciliation method is included in the procedures.

Recommendation #3

We recommend a control be implemented to ensure timely reconciling and recording of financial activity from OCERS statements to the County's Fund 17A so that the County's records are current and accurate.



ATTACHMENT B: County Executive Office Responses (continued)

CEO Response:

Concur. The time lapse between receipt of the updated OCERS statements and recording of the financial activity on the County books was due to the additional analysis necessary to help ensure proper account coding. Detailed policies and procedures have been implemented for the administration of the Retiree Medical Trust and the appropriate timeline for the reconciliation and recording of financial activity of the Trust is included in the procedures.

Recommendation #4

We recommend CEO/PF management ensure the preparer and reviewer of key supporting documents sign/initial and date the documents to increase accountability and provide an adequate audit trail.

CEO Response:

Concur. Detailed policies and procedures have been implemented for the administration of the Retiree Medical Trust and procedures regarding the signing and dating of supporting documents is included in the policies and procedures.

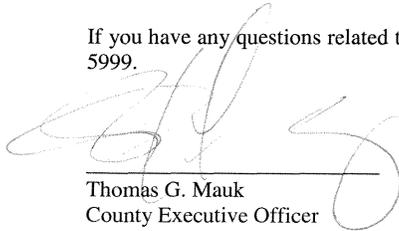
Recommendation #5

We recommend CEO/PF provide written procedures/policies for the processes involved in the Retiree Medical Plan, specifically for reconciling and recording financial activity into the appropriate reporting categories, allocating contributions, wiring of contributions to OCERS, and monitoring of the ARC Trust Fund 17A. In addition, the procedures should include the initialing and dating of key documents by the preparer and the reviewer to ensure timeliness, establish accountability, and strengthen the control environment.

CEO Response:

Concur. The County Executive Office concurs with the recommendation and has implemented detailed policies and procedures for the administration of the Retiree Medical Trust. The procedures include timelines and direction related to the reconciliation between the OCERS statements and the County accounting records, the wiring of funds to OCERS and monitoring of the ARC deposited into Fund 17A. The procedures also provide direction regarding the signing and dating of key documents related to the Trust.

If you have any questions related to these responses, please contact Louis McClure at (714) 834-5999.



Thomas G. Mauk
County Executive Officer

cc: Robert Franz, Chief Financial Officer
Frank Kim, Director, County Budget Office
Louis McClure, Analyst, CEO/Public Finance