COUNTYWIDE AUDIT OF FIDUCIARY FUNDS:

CLERK-RECORDER

For the Period
July 1, 2014 through June 30, 2015

Audit Number 1519
Report Date: April 21, 2016
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Orange County Auditor-Controller

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Auditor-Controller Web Site
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TO: Hugh Nguyen  
Clerk-Recorder

SUBJECT: Countywide Audit of Fiduciary Funds: Clerk-Recorder

We have completed our audit of internal controls over fiduciary funds in the Clerk-Recorder for the period July 1, 2014 through June 30, 2015. Our final report is attached for your review.

I submit an Audit Status Report quarterly to the Audit Oversight Committee (AOC) and a monthly report to the Board of Supervisors (BOS) where I detail any critical 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 AOC and BOS.

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

Toni Smart, CPA, Director  
Auditor-Controller Internal Audit Division

Attachments

Other recipients of this report:  
Members, Board of Supervisors  
Members, Audit Oversight Committee  
Eric Woolery, Auditor-Controller  
Frank Kim, County Executive Officer  
Dana Ohanesian, Financial Services Manager, Clerk-Recorder  
Adam Steckler, Manager, Budget and Finance, Clerk-Recorder  
Foreperson, Grand Jury  
Robin Stieler, Clerk of the Board of Supervisors  
Macias Gini & O’Connell LLP, County External Auditor
Transmittal Letter

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OBJECTIVES
As part of a Countywide Audit of Fiduciary Funds, we have completed our audit of internal controls over fiduciary funds in the Clerk-Recorder for the period July 1, 2014 through June 30, 2015. We conducted this audit to ensure fiduciary funds are properly administered and maintained in compliance with County policy, procedures, and fund requirements. Our audit objectives were to:

1. Evaluate internal controls to ensure fiduciary fund transactions are accurate, valid, adequately supported, processed timely, properly recorded, and that fund receipts and disbursements are made in accordance with the established fund purpose and uses.

2. Evaluate internal controls to ensure fiduciary fund reconciliations are accurate, complete, and timely in compliance with County policy and departmental policy.

3. Evaluate for proper segregation of duties and management reviews and approvals related to the administration of fiduciary funds.

4. Determine if administration of fiduciary funds is effective and efficient (e.g., no backlogs, duplication of work, benefit in automating manual process).

RESULTS
Objective #1: Our audit found that internal controls are in place to ensure fiduciary fund transactions are accurate, valid, adequately supported, processed timely, properly recorded, and transactions were made in accordance with the established fund purpose and uses. We have no audit findings under this objective.

Objective #2: Our audit found that internal controls over fund reconciliations are in place to ensure fiduciary fund reconciliations are accurate, complete and timely in compliance with County policy and departmental policy, except for Fund 356 that has not been reconciled. We also found that there are long-outstanding reconciling items requiring research and resolution. We identified two (2) Control Findings to start reconciling Fund 356 and to continue researching and resolving the outstanding reconciling items in Fund 318 and Fund 356.

Objective #3: Our audit found that internal controls are in place regarding segregation of duties and management reviews and approvals of fiduciary fund transactions and fund reconciliations. We have no audit findings under this objective.

Objective #4: Our audit did not disclose any instances concerning duplication of work or backlogs; however, we did find that documentation for establishing the fiduciary funds, known as the Chart of Accounts (COFAs), was old and had limited information, and a fund reconciliation procedure that is outdated. We identified two (2) Control Findings to work with the Auditor-Controller to update the COFAs and procedures to reflect current practices.
BACKGROUND
We conducted a Countywide Audit of Fiduciary Funds to ensure funds are properly administered and maintained in compliance with County policy, procedures, and fund requirements. This report is on our audit of selected fiduciary funds administered by the Clerk-Recorder. We are issuing separate reports for our audits of fiduciary funds in the County Executive Office, Child Support Services, District Attorney/Public Administrator, Health Care Agency/Public Guardian, OC Community Resources, OC Public Works, Probation, Registrar of Voters, Sheriff-Coroner, and Treasurer-Tax Collector.

Fiduciary funds are used to account for assets held by the County in a trustee or agency capacity on behalf of outside parties, including employees, individuals, private organizations or other governments. These funds cannot be used to support the County’s programs. Fiduciary funds are to be used and accounted for in accordance with applicable legal requirements; Federal, State, and other governmental regulations; trust agreements, trust indentures, or other fiduciary agreements; and generally accepted accounting principles.

County Accounting Manual (CAM) Procedures F3 – Requesting Establishment/Deletion of Funds/Agency and F4 – Fiduciary Funds provide the policy, procedures, and internal control requirements for establishing and maintaining fiduciary funds. Fiduciary funds are classified as one of the following: 1) Private-Purpose Trust Funds; 2) Pension and Other Employee Benefits Trust Funds; and 3) Agency Funds. For this audit, we are including only select Private-Purpose Trust Funds and Agency Funds as described below:

Public Administration Trust Funds (Fund Class U1) – This type of private-purpose trust fund is used to account for trust arrangements where the principal and income benefit individuals, private organizations, or other governments. Examples include unidentified funds, unclaimed prisoner funds, and decedents’ property held for escheatment.

Agency Funds (Fund Class A5) – This type of agency fund is used by certain County departments to hold various types of cash receipts and deposits in a fiduciary capacity. Disbursements are made from these funds by checks issued by the Auditor-Controller upon requisition of the responsible department.

As of June 30, 2015, the Clerk-Recorder had the following fiduciary funds:

<table>
<thead>
<tr>
<th>Fund</th>
<th>Fund Class</th>
<th>Name/Date Established</th>
<th>Purpose</th>
<th>FY 14/15 Receipts/Disbursements</th>
<th>Fund Balance at 6/30/15</th>
</tr>
</thead>
<tbody>
<tr>
<td>319</td>
<td>A5</td>
<td>Share Marriage License Fee Established: Unknown</td>
<td>Used to distribute funds to the State derived from marriage license fees.</td>
<td>Receipts: $74,121 Disbursements: $74,125</td>
<td>$6,798</td>
</tr>
<tr>
<td>333</td>
<td>A5</td>
<td>County Clerk Established: July 1994</td>
<td>Used to distribute funds to the State derived from various fees collected.</td>
<td>Receipts: $191,042 Disbursements: $199,861</td>
<td>$20,750</td>
</tr>
<tr>
<td>356</td>
<td>A5</td>
<td>Recorder’s Refund Established: July 1963</td>
<td>Comprised of five (5) department balance sheet accounts (sub-accounts), see below.</td>
<td>Total 356 Receipts: $960,716 Total 356 Disbursements: $955,316</td>
<td>$113,207</td>
</tr>
<tr>
<td>356</td>
<td>A5</td>
<td>Trust – State Certified Copies</td>
<td>Used to distribute funds to the State derived from various vital records fees collected.</td>
<td>Receipts: $576,290 Disbursements: $572,423</td>
<td>$55,216</td>
</tr>
</tbody>
</table>
Internal Auditor’s Report

**SCPOE AND METHODOLOGY**

Our audit of internal controls over fiduciary funds administered by the Clerk-Recorder was performed to ensure fiduciary funds are properly administered, safeguarded, and maintained in compliance with County policy, procedures, and specific fund requirements for the period from July 1, 2014 through June 30, 2015. Our audit included inquiry, auditor observation, and limited testing for assessing the adequacy of internal controls and compliance with established County and departmental procedures. We limited our scope for our Countywide Audit of Fiduciary Funds to select Public Administration Trust Funds (Fund Class U1) and Agency Funds (Fund Class A5).

**Scope Exclusions.** We did not include the following fund classes in our Countywide Audit of Fiduciary Funds. These will be considered for future audits based on our risk assessment and audit planning process:

- Unapportioned Tax and Interest Funds (Fund Class A2)
- Pension Trust & Other Employee Benefits (Fund Classes P1, P2, P3, P4, P5, P6)
- OCDA Redevelopment private purpose trust fund (Fund Class U2)

**FOLLOW-UP PROCESS**

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). 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 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. We bring to the AOC’s attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. Such open issues appear on the AOC agenda at its 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 form to facilitate our review.

**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 by Management 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. Our Internal Control Audit enhances and complements, but does not substitute for the Clerk-Recorder’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 audit would not necessarily disclose all weaknesses in the Clerk-Recorder’s operating procedures, accounting practices, and compliance with County policy.

The Auditor-Controller Internal Audit Division is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations.

**ACKNOWLEDGEMENT**

We appreciate the courtesy extended to us by the personnel of the Clerk-Recorder during our audit. If you have any questions regarding our audit, please contact me directly at (714) 834-5442, Scott Suzuki, Assistant Director at (714) 834-5509, or Lily Chin, Audit Manager at (714) 834-4096.
Finding No. 1 – Fund 356 (Refund Account) is not Reconciled (Control Finding)

Criteria
County Accounting Manual (CAM) Procedure F-4, Section 2.6.5 Reconciliation of Fiduciary Funds states that departments and agencies are responsible for reconciling, at least monthly, each fiduciary fund balance per the department’s or agency’s subsidiary ledger records or other detailed records to the Auditor-Controller’s General Ledger balance shown for the fiduciary fund.

Details
Fund 356-9200-1634 (Refund Account) is used to refund fee overpayments to customers. Overpayments are deposited into this fund and the refunds are issued generally within two weeks or sooner. As of June 2015, the fund balance was $21,182, with approximately $29,000 in fund receipts and disbursements during FY 2014-15. We reviewed a sample of refunds and found that they were processed timely. The Clerk-Recorder reported that the refunds for the last week of June 2015 were all processed on July 2, 2015.

For the fund reconciliation, we were informed that it has not been formally reconciled to the General Ledger due to other priorities and that formalizing the process and clearing old items was planned before we began our audit. The Clerk-Recorder’s office informed us that the fund balance of $21,182 was mainly an accumulation of refund checks that were undeliverable due to issues such as wrong addresses and no forwarding addresses or stale dated checks that were not re-issued. Currently the threshold is $10 to process refunds, but the threshold used to be $5, which resulted in numerous refunds and required additional resources to research and resolve old items.

The Clerk-Recorder plans to formally reconcile and research the fund balance, and will follow the county escheatment process in the future if these monies become stale after unsuccessful attempts to track down payees.

Recommendation No. 1:
The Clerk-Recorder take measures to formally reconcile Fund 356 Refund Account to the General Ledger, including identifying and resolving the outstanding balance in compliance with County policy.

Clerk-Recorder Management Response:
Concur. The unreconciled fund balance stated in your audit report was identified by my accounting staff in FY 2013-14, and we immediately informed the Auditor-Controller in July 2014 on the FY 2013-14 Trust Fund and Fund Account Balance Certification Form. This balance was carried forward from prior years under the previous administration before I took office in 2013. My accounting staff researched to the best of their ability, but it is increasingly difficult to research records older than 7 years without the aid of CAPS+ Data Warehouse reports. During the period of FY 2013-14 and FY 2014-15, we issued approximately 2,465 refund checks, and only six checks totaling $283 were pending reconciliation. We will consult with the Auditor-Controller to determine the acceptable method to reconcile and resolve the difference before your follow up audit.

Finding 2 – Reconciling Differences Need to be Resolved (Control Finding)

Criteria
CAM F-4 - Fiduciary Funds, Section 2.6.5 states that reconciliations must identify the differences between the department’s or agency’s detailed or subsidiary records and the General Ledger balance of the fund, the reasons for those differences, and the planned disposition of any reconciling items.
Details
Reconciling differences have not been identified and resolved for Fund 318 (Property Transfer Tax) and Fund 356 (sub-account for State certified copies) in the June 2015 fund reconciliations as follows:

- $349,769 in reconciling differences found in Fund 318
- $162 found in Fund 356

The Clerk-Recorder reported to us that the differences resulted from the reconciliations not being performed by prior management and because supporting documentation was not always available. The Clerk-Recorder Budget and Finance Manager has been researching the reconciling difference in Fund 318. As of December 2, 2015, the difference has been reduced to approximately $300,000. The Clerk-Recorder is continuing to research to identify and resolve the differences; however, some old supporting documents are not always available.

Recommendation No. 2:
The Clerk-Recorder continue to identify and resolve the reconciling differences in Funds 318 and 356.

Clerk-Recorder Management Response:
Concur. My Accounting Manager alerted me to the reconciling difference in Fund 318 in FY 2013-14, and we immediately informed the Auditor-Controller in July 2014 on the FY 2013-14 Trust Fund and Fund Account Balance Certification Form. This balance was carried forward from prior years under the previous administration before I took office in 2013. My accounting staff has researched to the best of their ability, but it is increasingly difficult to research records older than 7 years without the aid of CAPS+ Data Warehouse reports. During the period of FY 2013-14 and FY 2014-15, there were no outstanding reconciling items for current year transactions. We will consult with the Auditor-Controller to determine the acceptable method to reconcile and resolve the difference before your follow up audit.

The $162 reconciling difference in Fund 356-9200-1480, State Certified Copies, is related to timing issues between Accounts Receivable invoices and monthly payments to the State. The fund reconciliation worksheet has already been updated to include this adjustment.

Finding 3 – Fiduciary Fund Documents Lacking Required Elements (Control Finding)

Criteria
CAM F-3 - Requesting Establishment/Deletion of Funds/Agencies, Section 2.3 states:

“The AIT or request letter must contain the following information: (A) The legal authority for establishing the new fund or agency; (B) If no legal authority, the policy/administrative reason or other authority for establishing the fund or agency; (C) Whether or not the fund or agency is a budgeted fund or agency, and if available, the Activity Code to be used for this budget; (D) A description of the revenue sources for the fund or agency, and the uses of the fund or agency; (E) Any expiration date for the fund or agency; (F) Whether the fund will earn its own interest, or if it does not, which other fund should receive the interest earned on balances in the new fund (this does not apply to new agencies); (G) If the fund will not earn its own interest, the reason for the redirection of interest: legal or contractual provision, or management decision; (H) The specific account codings and dollar amounts or appropriations and estimated revenues to be established for the fund or agency, if the fund or agency is being established pursuant to 2.2.3 above; (I) The responsible controlling department for the new fund or new agency; and (J) For funds with separate cash accounts, the planned disposition of any residual account balances when the fund is closed. Include legal or other authority for the distribution.”
COFAs are documents used to establish or modify various funds in the County. Our audit found COFAs were not available for Funds 318, 319, and 356. The Clerk-Recorder provided memos from 1963, 1984, and 1987 that established or updated the fiduciary funds, which occurred prior to the implementation of the Auditor-Controller policy. Because these funds were established prior to the existing policy, the memos lack certain elements as required by the policy, such as citing legal or other authority for fund distributions, expiration dates, whether it is interest bearing, and the planned disposition of any account residual balances when the fund is closed.

We also found that the description of fund monies contained in the memos and the title of certain funds are inconsistent with uses of the funds. This may have resulted from changes in the old organizational structure when consolidating the County Recorder and County Clerk. For example:

- **Fund 318 – Recorder Trust.** This fund is currently used for property transfer taxes resulting from real property transactions. No other monies are accounted for currently. The fund name was changed from Real Property Transfer Tax to Recorder Trust in 1984 to also hold micrographics conversion funds; however, the micrographics funds are now held in a separate special revenue fund.

- **Fund 356 – Recorder’s Refunds.** This fund has five (5) sub-accounts and is used for various State fees and refunds. The State fees are not refunds, rather they are the State’s share of fees collected.

Auditor-Controller General Accounting is responsible for establishing and maintaining COFA documents. They are aware of the fact that some of the fund establishment documents are old and lack the required elements. Currently, if a department/agency requests a revision to a COFA that is not in the current format, the Auditor-Controller will require them to use the current COFA format that includes all required elements. We were informed by Auditor-Controller General Accounting that it is a goal to eventually have all COFAs in the current format. The Clerk-Recorder should work with the Auditor-Controller in determining which COFAs can be updated. Our audit did not note any other issues arising from the old COFAs.

The absence of complete written fiduciary fund documentation increases the risk of misunderstandings and miscommunication regarding rights, responsibilities, and authorized uses for the department or agency holding the fiduciary funds in a trustee capacity.

**Recommendation No. 3:**
The Clerk-Recorder work with the Auditor-Controller to ensure that all fiduciary fund accounts are fully supported with complete written documentation, including fund title descriptions that are consistent with the funds held.

**Clerk-Recorder Management Response:**
**Concur.** As stated in your audit report, these Clerk-Recorder fiduciary funds have been in existence for several decades, and were created prior to the Auditor-Controller policy for Chart of Account (COFA) formatting. We will work with the Auditor-Controller to revise and submit updated COFA forms using the new format before your follow up audit.

**Finding 4 – Policies/Procedures for Fund Reconciliations Need Updating (Control Finding)**

**Criteria**
Policies and procedures should be updated to reflect current processes to ensure consistency in work by current and new staff members.
Details
The Clerk-Recorder has written policies and procedures for determining amounts due to the state trust fund and for reconciling trust accounts; however, the written procedures for reconciling trust accounts (Fund 318) were not updated to document current processes because they reference the old CAPS system. We were informed that some procedures had not been updated because of other priorities.

Recommendation No. 4:
The Clerk-Recorder ensure policies and procedures for reconciling Fund 318 are updated to reflect the current process.

Clerk-Recorder Management Response:
Concur. The Clerk-Recorder will update all policies and procedures to match the current process for preparing and reconciling trust funds before your follow up audit.
ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit findings and recommendations, we will classify audit report items into three distinct categories:

- **Critical Control Weaknesses:**
  These are Audit Findings or a combination of Auditing Findings that represent critical exceptions to the audit objective(s) and/or business goals. Such conditions may involve either actual or potential large dollar errors or be of such a nature as to compromise the Department’s or County’s reputation for integrity. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

- **Significant Control Weaknesses:**
  These are Audit Findings or a combination of Audit Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses require prompt corrective actions.

- **Control Findings:**
  These are Audit Findings concerning internal controls, compliance issues, 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.
ATTACHMENT B: Clerk-Recorder Management Responses

TO: Toni Smart, CPA, Director
Auditor-Controller Internal Audit Division

FROM: Hugh Nguyen, Clerk-Recorder

SUBJECT: Response to Audit No. 1519 Countywide Audit of Fiduciary Funds

Recommendation No. 1: The Clerk-Recorder take measures to formally reconcile Fund 356 Refund Account to the General Ledger, including identify and resolving the outstanding balance in compliance with County policy.

Clerk-Recorder Response: Concur

The unreconciled fund balance stated in your audit report was identified by my accounting staff in FY 2013-14, and we immediately informed the Auditor-Controller in July 2014 on the FY 2013-14 Trust Fund and Fund Account Balance Certification Form. This balance was carried forward from prior years under the previous administration before I took office in 2013. My accounting staff researched to the best of their ability, but it is increasingly difficult to research records older than 7 years without the aid of CAPS+ Data Warehouse reports. During the period of FY 2013-14 and FY 2014-15, we issued approximately 2,465 refund checks, and only six checks totaling $283 were pending reconciliation. We will consult with the Auditor-Controller to determine the acceptable method to reconcile and resolve the difference before your follow up audit.

Recommendation No. 2: The Clerk Recorder identify and resolve the reconciling differences in Funds 318 and 356.

Clerk-Recorder Response: Concur

My Accounting Manager alerted me to the reconciling difference in Fund 318 in FY 2013-14, and we immediately informed the Auditor-Controller in July 2014 on the FY 2013-14 Trust Fund and Fund Account Balance Certification Form. This balance was carried forward from prior years under the previous administration before I took office in 2013. My accounting staff has researched to the best of their ability, but it is increasingly difficult to research records older than 7 years without the aid of CAPS+ Data Warehouse reports. During the period of FY 2013-14 and FY 2014-15, there were no outstanding reconciling items for current year transactions. We will
consult with the Auditor-Controller to determine the acceptable method to reconcile and resolve the difference before your follow up audit.

The $162 reconciling difference in Fund 356-9200-1480, State Certified Copies, is related to timing issues between Accounts Receivable invoices and monthly payments to the State. The fund reconciliation worksheet has already been updated to include this adjustment.

**Recommendation No. 3:** The Clerk-Recorder work with the Auditor-Controller to ensure that all fiduciary fund accounts are fully supported with complete written documentation, including fund title descriptions that are consistent with the funds held.

*Clerk-Recorder Response: Concur*

As stated in your audit report, these Clerk-Recorder fiduciary funds have been in existence for several decades, and were created prior to the Auditor-Controller policy for Chart of Account (COFA) formatting. We will work with the Auditor-Controller to revise and submit updated COFA forms using the new format before your follow up audit.

**Recommendation No. 4:** The Clerk-Recorder ensure policies and procedures for Fund 318 are updated to reflect the current process.

*Clerk-Recorder Response: Concur*

The Clerk-Recorder will update all policies and procedures to match the current process for preparing and reconciling trust funds before your follow up audit.