



# Orange County Auditor-Controller Internal Audit



Audit of Unearned Revenue:  
Health Care Agency

For the Year Ended  
June 30, 2016

Audit Number 1619-A  
Report Date: March 31, 2017



O R A N G E C O U N T Y  
**AUDITOR-CONTROLLER**  
I N T E R N A L A U D I T

**Eric H. Woolery, CPA**  
**Orange County Auditor-Controller**

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**ERIC H. WOOLERY, CPA**  
AUDITOR-CONTROLLER



**Transmittal Letter**

**Audit No. 1619-A**

**March 31, 2017**

**TO:** Richard Sanchez, Director  
Health Care Agency

**SUBJECT:** Audit of Unearned Revenue:  
Health Care Agency

We have completed our audit of internal controls over the recording of unearned revenue by the Health Care Agency (HCA) for the year ended June 30, 2016. Our final report is attached for your review.

I submit an **Audit Status Report** quarterly to the Audit Oversight Committee (AOC) and a quarterly report to the Board of Supervisors (BOS) where I detail any critical and significant audit findings released in reports during the prior quarter 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.

A handwritten signature in blue ink, appearing to read "Toni Smart".

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
- Lilly Simmering, Deputy Chief Operating Officer
- Anna Peters, Deputy Agency Director, HCA Financial & Administrative Services
- Tonya Riley, Director of Satellite Accounting Operations, Auditor-Controller
- Salvador Lopez, Accounting Manager III, Auditor-Controller/HCA Accounting
- Foreperson, Grand Jury
- Robin Stieler, Clerk of the Board of Supervisors
- Macias Gini & O'Connell LLP, County External Auditor



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# Internal Auditor's Report

**Audit No. 1619-A**

**March 31, 2017**

TO: Richard Sanchez, Director  
Health Care Agency

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

SUBJECT: Audit of Unearned Revenue:  
Health Care Agency

## OBJECTIVES

We have completed our audit of internal controls over the recording of unearned revenue by the Health Care Agency (HCA) for the year ended June 30, 2016. The purpose of this audit is to support an initiative to partner with the County's external auditors to leverage audit resources. Our audit objectives were to:

1. Evaluate if internal controls over recording of unearned revenue in the County's financial system are adequate to ensure transactions are complete, accurate, valid, and processed timely.
2. Assist the external auditor function with its evaluation of unearned revenue.
3. Determine if the County's procedures for recording unearned revenue are efficient and effective, e.g., no backlogs, duplication of work, or manual processes that could benefit from automation.

## RESULTS

**Objective #1:** Our audit found internal controls over recording of unearned revenue in the County's financial system are adequate to ensure transactions are complete, accurate, valid, and processed timely.

**Objective #2:** Our audit assisted the external auditor function with its evaluation of unearned revenue.

**Objective #3:** Our audit did not disclose any instances concerning backlogs, duplication of work, or manual processes needing automation.

## BACKGROUND

HCA's mission is "in partnership with the community, protect and promote the health & safety of individuals and families in Orange County through assessment and planning, prevention and education, and treatment and care."

HCA is a regional provider, charged with protecting and promoting individual, family, and community health through coordination of public and private sector resources.



# Internal Auditor's Report

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HCA's service environment is complex, with 180 different funding sources and over 200 state and federal mandates. The mandates under which HCA operates require the County to provide for, or regulate, certain health services. Many mandates also carry specific requirements for staffing, operations, claiming, and record-keeping.

Many of HCA's services are preventive in nature and are not readily apparent to the public. Some examples of services include: food protection, hazardous waste regulation, water quality monitoring and pollution prevention, mental health services, alcohol and drug abuse services, preventive health services for the aging, healthcare for incarcerated individuals, communicable disease control, child health and disability programs, immunizations, public health field nursing, and public health clinics.

HCA is composed of the following service areas:

- Administrative Services - Provides accounting, contracting, finance, human resources, information technology, management services, and purchasing services support that enables HCA staff to provide the best possible service to our community through efficient and effective operations.
- Behavioral Health Services - Provides a culturally-competent and client-centered continuum of behavioral health (mental health and substance use disorder) care, which includes crisis, prevention, early intervention, outpatient, residential and inpatient services for all eligible Orange County residents.
- Correctional Health Services - Provides comprehensive medical and mental health care to all adult inmates within the five County of Orange correctional facilities, as well as the children and youth residing within its six residential facilities operated by staff from the Probation Department and Social Services Agency.
- Public Health Services - Monitors and investigates the occurrence of disease, injury, and related factors in the community and, in collaboration with community partners, develops and implements preventive strategies to maintain and improve the health of the public.
- Regulatory/Medical Health Services - Coordinates and oversees emergency medical services and prehospital care, employee health for all County of Orange employees, health disaster preparedness and management, environmental health issues involving food safety, water quality and harmful conditions in our community, and medical safety net that provides urgent, emergent medical services to eligible low-income adults.

## Unearned Revenue

A basis of accounting for governmental funds exists where revenue is recognized when amounts are measurable and available. Known as the modified accrual basis of accounting, receiving alone is not sufficient to recognize revenue (cash basis accounting) and revenue recognition can occur before amounts are actually received (accrual basis of accounting). Revenues received in advance of meeting all the earning requirements are a liability and require an entry to balance sheet account Unearned Revenue. It is a liability of resources obtained prior to revenue recognition. As of June 30, 2016, unearned revenue was **\$18,804,221**.





# Internal Auditor's Report

**Table 1 – Unearned Revenue Account Codes**

<b>Account Code</b>	<b>Account Name</b>
9540	Unearned Revenue Received
9543	Law Enforcement Services
9544	Support Services
9550	Billed Unearned Revenue

## SCOPE AND METHODOLOGY

Our audit examined HCA's processing of unearned revenue and related internal controls for the year ended June 30, 2016. 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 to select HCA's special revenue fund (Fund 13Y – Mental Health Services Act).

**Scope Exclusions.** Our audit did not include an audit of application controls over CAPS+ Financial and Purchasing System.

## 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 generally 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 generally 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 their next scheduled meeting for discussion.

As there were no findings in this report, completion of a **Follow-Up Audit Report Form** is not necessary as no Follow-Up Audit will be conducted.

## MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROL

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 of the Treadway Commission (COSO) Internal Control - Integrated Framework.



# Internal Auditor's Report

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Our Internal Control Audit enhances and complements, but does not substitute for HCA'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 control, 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 HCA's operating procedures, accounting practices, and compliance with County policy.

## **ACKNOWLEDGEMENT**

We appreciate the courtesy extended to us by the personnel of the Health Care Agency during our audit. If you have any questions regarding our audit, please contact me directly at (714) 834-5442, or Scott Suzuki, Assistant Director at (714) 834-5509.