

Internal Audit Department

O R A N G E C O U N T Y
6th Largest County in the USA

COUNTY OF ORANGE RETIREE MEDICAL PLAN – ANNUAL REQUIRED COUNTY CONTRIBUTIONS

For Fiscal Year 2012-13

During FY 2012-13, the County contributed \$37,275,730 to the Retiree Medical Plan and has transferred \$46,663,719, including contributions made by some employees and other public entity participants, to the Trust within the Orange County Employees Retirement System (OCERS).

We reviewed the County’s contributions to the Trust established for the Retiree Medical Plan (Plan) for the fiscal year 2012-13 and found that the County correctly applied the actuarial recommendations to properly fund the Plan.

We identified **four (4) Control Findings** to improve existing controls.

AUDIT NO: 1316
REPORT DATE: SEPTEMBER 11, 2014

Director: Dr. Peter Hughes, MBA, CPA, CIA
Senior Audit Manager: Alan Marcum, MBA, CPA
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RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010, 2013
 Member of American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners’ Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors’ Bronze Website Award



2005 Institute of Internal Auditors’ Award to IAD for Recognition of Commitment to Professional Excellence, Quality, and Outreach



ORANGE COUNTY BOARD OF SUPERVISORS' **Internal Audit Department**

GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010, 2013

Providing Facts and Perspectives Countywide

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Transmittal Letter



Audit No. 1316 September 11, 2014

TO: Michael B. Giancola, County Executive Officer
Frank Kim, Chief Financial Officer

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

SUBJECT: Audit of 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 2012-13, we audited certain records and documents for the period from July 1, 2012 through June 30, 2013. 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 2012-13 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). 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. 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 form 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 **OC Internal Auditor's Report** on page 6.

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Annual Required County Contributions
Audit No. 1316*

For the Fiscal Year 2012-13

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Audit No. 1316

September 11, 2014

TO: Michael B. Giancola, County Executive Officer
Frank Kim, Chief Financial Officer

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

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

Audit Highlight

The Internal Audit Department conducted an audit of certain records and documents for the FY 2012-13 to determine if the County of Orange was properly funding the trust established for the Retiree Medical Plan in FY 2012-13.

During FY 2012-13, the County contributed \$37,275,730 to the Retiree Medical Plan (Plan) and transferred a total of \$46,663,719 (including contributions made by some employees and other public entity participants) to the Trust.

We found the County implemented the actuarial recommendations to fund the Plan for FY 2012-13. Our audit identified **four (4) Control Findings** regarding the approval process of the Annual Required Contribution (ARC) rates, the review process of updating ARC rates in CAPS+, the regular transferring of ARCs to the trust account, and the timeliness of reconciling and recording trust activities in the County's books.

OBJECTIVES

The Internal Audit Department conducted an audit of certain records and documents for the FY 2012-13 to determine if the County of Orange was properly funding the trust established for the Retiree Medical Plan in FY 2012-13. To determine if the County properly funded the trust in accordance with the Actuarial recommendation, we:

1. Evaluated the methodologies used to calculate the budgeted and revised Annual Required Contribution (ARC) rates and amounts to ensure the Actuarial Rates were properly implemented in FY 2012-13;
2. Tested the implementation of the budgeted and revised ARC Rates in the County Accounting and Payroll System (CAPS+) for accuracy and completeness;
3. Evaluated the controls to ensure that County contributions made to the Retiree Medical Plan were properly received and recorded in the Retiree Medical Trust account held by the Orange County Employees Retirement System (OCERS); and
4. Evaluated the controls to ensure the 401(h) trust activities reported by OCERS for the Orange County Retiree Medical Plan were accurately and completely posted to the County Accounting and Payroll System (CAPS+).

Our audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing* prescribed by the Institute of Internal Auditors.

RESULTS

Objective #1: We found the methodologies and calculations for determining the budgeted and revised ARC rates and amounts appeared to be appropriate and accurate. However, our audit disclosed **one (1) Control Finding** regarding the approval of the updated rates prior to implementation.

Objective #2: The budget and revised Annual Retiree Contribution rates for FY 2012-13 were appropriately and accurately implemented in CAPS+. However, we noted **one (1) Control Finding** regarding the review process of updating ARC rates in CAPS+.

Objective #3: County's contribution payments for FY 2012-13 have been received and properly recorded in the Retiree Medical Trust account. However, we noted **one (1) Control Finding** regarding the frequency of transferring contributions to OCERS.

Objective #4: All 401(h) Trust account activities for the Orange County Retiree Medical Trust account in FY 2012-13 were properly accounted for in the County's records. However, we noted **one (1) Control Finding** regarding timeliness of reconciling and recording the trust activities.



The following table summarizes our findings and recommendations for this audit. See further discussion in the *Detailed Results, Findings, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications.

Summary Table of Findings and Recommendations

Finding No.	Finding Classification (see Attachment A)	Finding and Page No. in Audit Report	Recommendation	Concurrence by Management?
1.	Control Finding	The revised Annual Required Contribution (ARC) rates were not submitted to the Board of Supervisors (BOS) for approval (pg. 7).	We recommend that the CEO establish a policy to ensure the Annual Retiree Contribution rates (actuarial and/or revised) are submitted to the Board of Supervisors for approval.	Yes
2.	Control Finding	Review of ARC rates update in County Accounting and Payroll System was not being performed as required (pg. 9).	We recommend that the CEO establish controls to ensure that a review of the Annual Required Contribution (ARC) rates update in the County Accounting and Payroll System (CAPS+) is performed as required by the CEO Administrative Procedural Manual, <i>Administration of the Retiree Medical Trust</i> , Section 4.1.	Yes
3.	Control Finding	Annual Required Contributions were not being transferred to 401(h) Trust Account regularly (pg. 11).	We recommend that the CEO ensure that ARC transfers are made regularly and timely to the 401(h) trust account at OCERS.	Yes
4.	Control Finding	Reconciliations and recording of Trust Account activities were not done monthly as required (pg. 12).	We recommend that the CEO ensure that reconciliations and recording of the trust account activities are done monthly as required by the CEO Administrative Procedural Manual.	Yes



BACKGROUND

Retiree Medical Plan Overview

Effective August 1, 1993, the County of Orange adopted the County of Orange Retiree Medical Plan (Plan) to assist career employees in maintaining health insurance coverage following their retirement from County services. This Plan provides eligible retirees and their eligible survivors and dependents with a monthly Grant that will be applied toward the cost of County offered health insurance coverage. The maximum monthly grant for calendar year 2013 is \$497.75. Also, this Plan provides a Lump Sum Benefit to terminated employees not eligible for the Grant.

Due to subsequent labor negotiations, the Plan has been amended and restated. New hires and employees under certain bargaining groups are not eligible to participate in the Plan. Also, Lump Sum Benefit is frozen. Only employees whose employment with the County terminate prior to becoming eligible for a Grant and are employed in an Eligible Classification immediately prior to the respective Lump Sum Freeze Date are eligible for the Lump Sum Benefit.

The County is responsible for administration of the Plan, including level and amount of benefits available to participants, determining participant eligibility, determining health plans qualified to be offered, establishing and administering claims procedures, appointing a Plan Administrator, and all other rights and obligations under the Plan.

Several public entities are treated as County employees and are included in the County payroll system also adopted the Plan. They are listed in the following table:

Public Entity Participants	
1	Orange County Public Law Library
2	Orange County Employees Retirement System
3	Superior Court of California County of Orange
4	Children & Families Commission of Orange County
5	Orange County Cemetery District
6	Orange County Local Agency Formation Commission

Retiree Medical Plan Trust (Trust)

The County funds the Plan through a trust account. Effective July 2, 2007, the County established County of Orange Retiree Medical Trust (an Internal Revenue Code Section 115 trust and 401(h) account) to provide a source of funds to assist the County in meeting its liabilities under the Plan. This Trust is irrevocable and its assets shall be used exclusively for providing medical benefits for eligible retirees and related costs of investment and administration.

The Orange County Employees Retirement System (OCERS) maintains and administers 401(h) Trust Account (Trust) as per the Participation Agreement with the County. OCERS has fiduciary responsibility for investing the assets of the Trust and making monthly benefit payments from this Trust. **On June 30, 2013, the Asset Balance for the 401(h) Trust = \$147,244,178**

The County maintains and administers Section 115 Trust Account. Lump sum benefit payments for some terminated employees not eligible for the grant are processed in this account. Also, this account holds the retiree medical contributions until they are transferred to the 401(h) Trust Account at OCERS. **On June 30, 2013, the Asset Balance for the Section 115 Trust = \$5,165,000**



The County established Fund 17A, a fiduciary fund account in the County accounting system, to record transactions pertaining to the Trust. Transactions recorded in Fund 17A include contributions, interest earnings, investment gains and losses, monthly grant payments, administrative fees and so forth.

Retiree Medical Plan Trust Contributions

The County makes full Annual Required Contributions to the Plan through payroll deductions. Due to subsequent labor negotiations, the Plan has been restructured. Some employees represented by Association of Orange County Deputy Sheriffs (AOCDS) make employee contributions to the Plan to offset the County's Annual Required Contributions. The employee contributions are made through payroll deductions and the rates were agreed upon in the Memorandum of Understanding between the County and AOCDS.

The Participation Agreement for the Trust requires the contribution amounts made by County and public entities are determined under reasonable and consistently applied actuarial methods and assumptions. Governmental Accounting Standard Board (GASB) Statement No. 45 requires the County to have an actuarial valuation at least biennially. The purpose of the actuarial valuation is to determine the projected Plan benefit obligations and calculate the Annual Required Contributions (ARC) and the corresponding contribution rates (known as ARC rates) for each rate group. The County contracted with a firm to provide actuary services for FY 2011-12 and FY 2012-13. The June 30, 2011 GASB 45 Actuarial Valuation Report was issued in July 2012.

The contributions (employer's, employee's and other public entities) are automatically processed in the County Accounting and Payroll System (known as CAPS+) and are posted in Fund 17A every time payroll is processed. The amounts are included in the County Treasurer's Investment Pool (Investment Pool) for investment until CEO Public Finance Division electronically transmits the amount to a third party bank to deposit into the Trust account within OCERS. Monies included in the Investment Pool earn interest on a monthly basis. The monthly gross yield for FY 2012-13 ranged from 0.28% to 0.51%.

During FY 2012-13, the County contributed **\$37,275,730** to the Plan and has transferred **\$46,663,719** to the 401(h) Trust within OCERS. Total amount transferred also included contributions that certain AOCDS members and Other Public Entities made during the fiscal year.

Annual Required Contribution (ARC) Rates

County contributes the full ARC each year as a percent of payroll for each group. The ARC rates were unavailable for the County to implement at the beginning of FY 2012-13; therefore, County Budget Office continued using the ARC rates from FY 2011-12 (referred as budget ARC rates) until the actuarial rates were final. Then the effective rates (referred as revised ARC rates) were calculated for each group for the remaining fiscal year. The County Executive Office approved and implemented the revised rates in pay period 19 effective August 24, 2012.

OCERS Group	FY 2012-13 Budget ARC Rate Prior to August 24, 2012	Actuarial Rate For FY 2012-13	FY 2012-13 Revised ARC Rate Effective August 24, 2012
General (Non-OCTA)	0.5%	0.7%	0.7333%
General	2.6%	3.7%	3.9762%
Probation	2.6%	3.6%	3.8564%
Law Enforcement	0.6%	2.6%	2.9424%
Law Enforcement Management	3.3%	4.9%	5.2977%



SCOPE AND METHODOLOGY

Our audit scope is to evaluate the County's Annual Required Contribution to the 401(h) Trust established for the Retiree Medical Plan (Plan) at Orange County Employees Retirement System (OCERS) for the period July 1, 2012 through June 30, 2013. Our scope included the following elements:

- Review the implementation of the Annual Required Contribution (ARC) rates
- Review the contributions forwarded to 401(h) trust account managed by OCERS
- Review the accounting of the trust activities in County Accounting and Payroll System (CAPS+)

SCOPE EXCLUSIONS

We did not assess the assumptions and projections used as the basis for the calculation of the Actuarial rates provided by the consultant. Also, we did not review contributions made from AOCDS members or public entities. We did not review the process to administer the Plan or evaluate asset performance held in the Trust. Additionally, we did not perform compliance review of Governmental Accounting Standards Board (GASB) on financial reporting and disclosure requirements for Other Post Employment Benefit (OPEB) as they were addressed in the County's Comprehensive Annual Financial Report (CAFR) for the period.

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

Acknowledgment

We appreciate the courtesy extended to us during the audit by the personnel of CEO/Budget Office, CEO/Public Finance, Human Resource Services/Employee Benefits, and Auditor-Controller CAPS+ HR/Payroll System. If we can be of further assistance, please contact me directly at 834-5475 or Alan Marcum, Senior Audit Manager at 834-4119.



Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Michelle Aguirre, Director, CEO/County Budget Office
Suzanne Luster, Director, CEO/Public Finance
Mitch Tevlin, Manager, CEO/County Budget Office
Anil Kukreja, Manager, CEO/County Budget Office
Louis McClure, Administrative Manager II, CEO/Public Finance
Foreperson, Grand Jury
Susan Novak, Clerk of the Board of Supervisors
Macias Gini & O'Connell LLP, County External Auditor

Detailed Results, Findings, Recommendations and Management Responses



Objective #1: Evaluate the methodologies used to calculate the budgeted and revised Annual Required Contribution (ARC) rates and amounts to ensure the Actuarial Rates were properly implemented in FY 2012-13.

AUDIT STEPS AND RESULTS

To accomplish this objective, we performed the following steps:

1. Obtained an understanding of the methodology for calculating the revised ARC rates for each rate group.
2. Obtained an understanding of the process to adopt the budget, actuarial and revised ARC rates in FY 2012-13.
3. Evaluated the reasonableness of the methodology used for calculating the revised ARC rates.
4. Reviewed pertinent documents to verify the calculation included all eligible County positions for FY 2012-13 and were properly classified in the corresponding rate group.
5. Recomputed the revised ARC rates to ensure accuracy.

CONCLUSION

We found that the revised ARC rates were accurately calculated based on the recommended actuarial rates for all rate groups. In addition, we found the methodology used effectively addressed the shortfall for the late implementation of the rates in FY 2012-13. Therefore, we concluded the actuarial rates were properly implemented in FY 2012-13. However, our audit disclosed the approval process for the revised ARC rate should be enhanced. The finding is discussed below:

Finding 1 – The Revised Annual Required Contribution (ARC) Rates Were Not Submitted to the Board of Supervisors (BOS) for Approval (Control Finding)

Summary

The County implemented the actuarial retiree contribution rates for FY 2012-13 in August 2012. Prior to its implementation, the County continued using the rates from FY 2011-12 (referred as budget ARC rates). The actuarial rates were higher than the budget rates; this resulted in an increase of \$13.5 million in total projected contributions than was stated in the original budget, which was based on budget ARC rates. To ensure full funding of the Retiree Medical Plan (Plan) and to make up for the shortfall for the period from July 1, 2012 through August 23, 2012, the effective ARC rates (referred as revised ARC rates) were calculated and implemented for the remainder of the fiscal year. The actuarial and revised ARC rates were approved by the Interim Chief Executive Officer, Interim Chief Financial Officer and Public Finance Manager. However, they were not submitted to the Board of Supervisors (BOS) for approval.

Details

The actuarial ARC rates for the Plan were unavailable for implementation at the beginning of FY 2012-13; therefore, the County used the budget ARC rates in the interim. As part of the annual budget process, the County Budget Office calculated the total projected contribution costs using the budget rates for each department. Then the contribution amount was reported as a line item in the *Final Budget Resolution Exhibit* along with other budget items for the BOS approval and budget adoption in June 2012. Subsequently, the County received the actuarial rates and implemented revised ARC rates in August 2012. Since the actuarial rates were higher (ranging from 0.2% to 2.0%, see table on next page for detail) than the budget ARC rates, this resulted in an increase of \$13.5 million (gross) in total projected contributions than the original budget.

Detailed Results, Findings, Recommendations and Management Responses



OCERS Group	FY 2012-13 Budget ARC Rate Prior to August 24, 2012	Actuarial Rate For FY 2012-13	Rate Change
General (Non-OCTA)	0.5%	0.7%	+ 0.2%
General	2.6%	3.7%	+ 1.1%
Probation	2.6%	3.6%	+ 1.0%
Law Enforcement	0.6%	2.6%	+ 2.0%
Law Enforcement Management	3.3%	4.9%	+ 1.6%

The Interim Chief Executive Officer, Interim Chief Financial Officer and Public Finance Manager reviewed the calculation methodology and results, and approved the revised ARC rates; however, the actuarial or revised ARC rates were not submitted to the BOS for approval and adoption.

The County is making ongoing contributions for all eligible County positions into the County of Orange Retiree Medical Plan. Any changes to the contribution rates would have a financial impact to the County. The implementation of the FY 2012-13 actuarial rates resulted in a gross increase of \$13.5 million of retiree medical contribution. The quarterly budget report process provides the BOS, County departments, members of the public and other interested parties with an overview of the current states of revenues, expenditures, Net County Cost (NCC), total budgeted positions, rate changes and various departmental issues requiring recommended changes to the County's current year budget. However, the higher retiree medical contribution rates or additional appropriations of \$13.5 million were not included in the FY 2012-13 quarterly budget report process at department level or Countywide for BOS consideration.

Although the ARC rates are approved in the County Executive Office and there is no policy requiring the ARC rates be submitted to the BOS for approval and adoption, the approval process should be enhanced. Since there are public entities participating in the same Plan making ongoing employer contributions based on the County's rates, ARC rates should be formally reviewed and approved by the BOS to demonstrate that decisions are made by the governing body in the County, and activities are executed in accordance with County policies and procedures.

Further, we noted that rates for retirement contributions (employer and employee) were submitted to the BOS for approval and adoption annually. Since retiree medical benefit contributions and retirement contributions are similar in nature as both require ongoing employer's contributions, the approval process for adopting these rates should be consistent and the ARC rates should be submitted for BOS approval.

Recommendation No. 1

We recommend that the CEO establish a policy to ensure the Annual Retiree Contribution rates (actuarial and/or revised) are submitted to the Board of Supervisors for approval.

CEO Management Response:

Concur. The County Executive Office (CEO) will establish a policy to ensure annual Retiree Medical contribution rates are submitted to the Board of Supervisors for approval.



Objective #2: Test the implementation of the budgeted and revised ARC Rates in the County Accounting and Payroll System (CAPS+) for accuracy and completeness.

AUDIT STEPS AND RESULTS

To accomplish this objective, we obtained an understanding of the controls to update ARC rates in CAPS+, reviewed supporting documents to verify County employees were properly coded in CAPS+ according to their eligibility for retiree medical benefits and rate group, and verified the retiree medical contributions were accurately calculated in CAPS+. We performed the following audit steps:

1. Obtained and reviewed the County Executive Office Administrative Procedural Manual ~ *Administration of the Retiree Medical Trust* to verify procedures were in place to ensure ARC rates were being updated accurately.
2. Conducted interviews with three (3) Managers in County Budget Office, County Executive Office Public Finance Division and Auditor Controller CAPS+ HR/Payroll System to obtain an understanding of the process (notification, input and validation) of updating ARC rates in CAPS+.
3. Tested a sample of 30 pay records from pay period #14 through pay period #13 in FY 2012-13 to ensure proper ARC rates were used to compute the retiree medical benefit contributions in CAPS+. The attributes we tested were:
 - a. Verified that County employees were properly coded in the CAPS+ according to their eligibility of retiree medical benefits and rate group.
 - b. Recalculated and verified the retiree medical contribution amounts with the amounts processed in CAPS+ to ensure the revised ARC rates were accurately implemented.
 - c. Recalculated and verified the retiree medical contribution amounts were based on base salary plus all compensation earnable items to ensure completeness.

CONCLUSION

We concluded that the revised Annual Retiree Contribution rates for FY 2012-13 were appropriately and accurately implemented in the County Accounting and Payroll System (CAPS+). We also noted that review of ARC rates update in CAPS+ is performed; however, the process should be enhanced to meet the requirements in the CEO Administrative Procedural Manual. The finding is discussed below:

Finding 2 – Review of ARC Rates Update in County Accounting and Payroll System Was Not Being Performed as Required (Control Finding)

Summary

A review of Annual Required Contribution (ARC) rates update in the County Accounting and Payroll System (CAPS+) was not performed as required by the CEO Administrative Procedural Manual.



Details

CEO Administrative Procedural Manual, *Administration of the Retiree Medical Trust*, Section 4.1 ~ Review of ARC Changes, states that “each time the ARC is changed in the payroll system, it is necessary to verify that the correct percentages were entered into the payroll system. This shall be accomplished by taking a random sample of at least three employees from each labor group utilizing the Human Resources portion of the County Accounting and Payroll System (CAPS+) to verify that each sample reflects the correct ARC percentage of payroll under the “RMBR” pay code. This verification of the ARC percentages shall be documented in writing and reviewed by either the County Financial Officer, Public Finance Director or their designee. Both the preparer and reviewer of the verification shall initial the written documentation.”

We found that after the ARC rates were updated in CAPS+, the Auditor-Controller Staff forwarded print screens from CAPS+ of the updated retiree medical deduction rate for all five (5) eligible groups to the CEO Budget Office for verification. However, the verification process was not documented as required by the Procedure Manual and samples were not selected to verify each pay code.

Review and verification are effective controls to ensure that errors are detected and corrected timely. Since ARC rates apply to all eligible positions in the County, it has a significant impact to the funding of the Retiree Medical Plan (Plan) when there is an error that has not been detected and corrected timely. Therefore, it is crucial to ensure all updates are verified as is stated in the CEO Administrative Procedural Manual. Although our audit found that ARC rates were being updated correctly in FY 2012-13, it is best practice to ensure any updates of ARC in CAPS+ are being independently reviewed and verified.

Recommendation No. 2

We recommend that the CEO establish controls to ensure that a review of the Annual Required Contribution (ARC) rates update in the County Accounting and Payroll System (CAPS+) is performed as required by the CEO Administrative Procedural Manual, *Administration of the Retiree Medical Trust*, Section 4.1.

CEO Management Response:

Concur. CEO requested that the testing of the Annual Required Contribution changes be performed by the Auditor/Controller payroll unit. The testing was reviewed and signed by Auditor/Controller payroll staff. The testing was also reviewed by CEO staff but not documented. CEO will ensure that the review and testing of future rate changes is properly documented by CEO staff.

Objective #3: Evaluate the controls to ensure that County contributions made to the Retiree Medical Plan are properly received and recorded in the Retiree Medical Trust account held by the Orange County Employees Retirement System (OCERS).

AUDIT STEPS AND RESULTS

To accomplish this objective, we conducted interviews with the Public Finance Manager and traced all electronic transfers of the retiree medical contribution payments for FY 2012-13 from pertinent documents to OCERS' statements to verify they were received and properly recorded at OCERS.

Detailed Results, Findings, Recommendations and Management Responses



CONCLUSION

Our audit found that controls are in place to ensure the County's contribution payments are received and properly recorded in the Retiree Medical Trust (Trust) account at OCERS. However, we found contributions to the 401(h) Trust Account can be transferred more frequently. The finding is discussed below:

Finding 3 – Annual Required Contributions Were Not Being Transferred to 401(h) Trust Account Regularly (Control Finding)

Summary

The County made three transfers to the 401(h) trust account (Trust) for retiree medical contributions made during FY 2012-13. These transfers were made for contributions that had been set aside for six (6) to thirteen (13) pay cycles. There were 26 pay cycles in FY 2012-13; transfers should be made regularly to maintain the level of asset balance.

Details

CEO Administrative Procedural Manual stated that *“every two to four payroll cycles if possible and provided there are sufficient funds in Fund 17A, the Public Finance analyst administering the Trust will electronically transfer funds from Fund 17A to OCERS for deposit into the IRC 401(h) Trust held at OCERS.”*

There were 26 pay cycles in FY 2012-13. The County made three transfers, totaling **\$46,663,719** to 401(h) trust account (Trust) for contributions (County, AOCDS members and other public entities) made during the fiscal year. These transfers were made for retiree medical contributions that had been set aside for six (6) to thirteen (13) pay cycles.

Please see below table for detail:

Retiree Medical Contribution Transfer Made in FY 2012-13				
Transfer Date	# of Pay Cycles	Pay Period Covered	Amounts	Contributions Made By
November 26, 2012	7	#14 ~ #20	\$10,568,198	County, AOCDS members & Public Entities Participants
May 28, 2013	13	#21 ~ #7	\$24,937,972	County, AOCDS members & Public Entities Participants
June 27, 2013	6	#8 ~ #13	\$11,157,549	County, AOCDS members & Public Entities Participants
Total	26		\$46,663,719	

Pursuant to the Participation Agreement between County and OCERS for the Funding of Retiree Medical Trust Account, Section 5, *Funding of the Account*: “County and other districts and public entities adopting the Retiree Medical Plan and not OCERS shall be responsible for contributing funds to the Account, in their sole and absolute discretion.” However, since the retiree medical benefit contributions are automatically processed in the County Accounting and Payroll System (CAPS+) every time payroll is being processed and there are 26 pay cycles in a fiscal year, transfers should be made more frequently.

Contributions are included into the County Treasurer's Investment Pool (Pool) for investment until CEO Public Finance Department electronically transmits the amount to a third party bank for deposit into the Trust account within OCERS. Since benefit payments and fees would be withdrawn from the 401(h) trust (Trust) account on a monthly basis, the asset balance diminishes until a transfer is made; therefore, a regular transfer is needed to maintain the average trust balance.

Detailed Results, Findings, Recommendations and Management Responses



The Orange County Employees Retirement System (OCERS) invests the assets of the Trust according to its policies and guidelines. Investment market fluctuates and it is impossible to predict the best time to transfer funds; therefore, a systematic transfer can balance risk and return as it allows more time for investment gains or losses to average out. Therefore, it is best practice that transfers are made regularly.

Recommendation No. 3

We recommend that the CEO ensure that ARC transfers are made regularly and timely to the 401(h) trust (Trust) account at OCERS.

CEO Management Response:

Concur. Due to the irrevocable nature of deposits into the Trust, a thorough review of the contributions made through the payroll system each pay period is performed to help ensure accuracy. During the time period covered by this audit, there was turnover in the staff involved in the review process. CEO has recently cross trained staff and streamlined the review process to ensure the transfers to the 401(h) Trust are made every two to four payroll cycles.

Objective #4: Evaluate the controls to ensure the 401(h) trust activities reported by Orange County Employee Retirement System (OCERS) for the Orange County Retiree Medical Plan are accurately and completely posted to the County Accounting and Payroll System (CAPS+).

AUDIT STEPS AND RESULTS

To accomplish this objective, we conducted interviews with the Public Finance Manager, and reviewed and traced pertinent documents in the County to confirm that all 401(h) trust activities recorded on OCERS statements in FY 2012-13 were properly accounted for in the County's book.

CONCLUSION

We concluded that controls are generally in place to ensure all 401(h) trust activities for the Orange County Retiree Medical Trust (Trust) account in FY 2012-13 were properly accounted for in the County's general ledger. However, we noted reconciliation and recording of Trust Account activities in the County's book were not done monthly. The finding is discussed below:

Finding 4 – Reconciliations and Recording of Trust Account Activities Were Not Done Monthly as Required (Control Finding)

Summary

The reconciliation and recording of 401(h) Trust account activities into the County's general ledger were not done monthly. During FY 2012-13, only four reconciliations and journal vouchers were prepared to reconcile and record 401(h) trust account activities into the County Accounting and Payroll System (CAPS+).

Details

The Participation Agreement between the County and Orange County Employees' Retirement System (OCERS) for the Funding of Retiree Medical Trust Account, states that OCERS is responsible for administering the 401(h) Trust account (Trust), investing the assets of the Trust account and making payments to the retiree medical plan. The reporting of the trust activities are summarized and included on OCERS Monthly Statements, which are usually available by the end of the following month, and are sent to the County via email monthly.

Detailed Results, Findings, Recommendations and Management Responses



The Trust account activities reported on the OCERS Monthly Statements include retiree medical contributions, benefit payments, investment gains or losses, interest and maintenance fees. The retiree medical contributions are automatically recorded in CAPS+ every time the County makes a transfer to the Trust. However, benefit payments, investment gains or losses, interest and maintenance fees, requires that the County prepare a journal voucher to record the activities into CAPS+.

The journal voucher to record the activities in CAPS+ is done at the time the County prepares the reconciliation of 401(h) Trust account. Based on our review, the recording and reconciliation of 401(h) Trust account activities were not done timely. During FY 2012-13, only four journal vouchers and reconciliations were prepared.

Retiree Medical Trust Reconciliation and Journal Vouchers	
Period Covered	Date Prepared
June 2012 ~ Dec. 2012	March 6, 2013
January 2013 ~ April 2013	June 10, 2013
May 2013	July 18, 2013
June 2013 ~ July 2013	September 30, 2013

CEO Administrative Procedural Manual, 2.2 ~ *OCERS Statement Reconciliation*, states that “*at the end of each month, OCERS will provide to the County financial statements itemizing the deposits, revenues and expenditures made by the Trust.....Once the OCERS statements are received, the activity reflected on the statements must be recorded on the County’s accounting records. A Journal Voucher shall be prepared following the receipt of the monthly OCERS statement in order to record the Trust activity in Fund 17A..... Each participating entity’s balance shall be reconciled to the appropriate Department Balance Sheet Account on a monthly basis.*”

Recording of all trust activities must be timely to ensure County’s accounting records are complete and accurate, and financial statements are reliable. Reconciliation is a critical internal control to ensure the accuracy and completeness of transactions: to identify, investigate and correct any transactions if needed. Therefore, recording of financial transactions and reconciliations should be done timely. Besides, the Trust asset balance includes contributions made from other participating public entities; therefore, the County has a fiduciary duty to account for and reconcile the activities in the Trust on a regular basis.

Recommendation No. 4

We recommend that the CEO ensure that reconciliations and recording of the trust account activities are done monthly as required by the CEO Administrative Procedural Manual.

CEO Management Response:

Concur. CEO currently reconciles the balances of the Trust monthly. Multiple monthly reconciliations are then combined into one journal voucher for purposes of recording the monthly financial activity to the County’s accounting records. CEO intends to continue reconciling the Trust balances monthly but combine monthly reconciliations and prepare journal vouchers quarterly. CEO will revise its policies and procedures to reflect preparation of journal vouchers at least quarterly.



ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations 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: County Executive Office Responses



County Executive Office Memorandum

September 8, 2014

To: Peter Hughes
Director, Internal Audit Department

Subject: CEO Response to Audit Report No. 1316 on the County of Orange Retiree Medical Plan

RECEIVED
INTERNAL AUDIT DEPARTMENT
2014 SEP -8 AM 10:38

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

Recommendation #1:

We recommend that the CEO establish a policy to ensure the Annual Retiree Contribution rates (actuarial and/or revised) are submitted to the Board of Supervisors for approval.

CEO Response to Recommendation #1:

Concur. The County Executive Office (CEO) will establish a policy to ensure annual Retiree Medical contribution rates are submitted to the Board of Supervisors for approval.

Recommendation #2:

We recommend that the CEO establish controls to ensure that a review of the Annual Required Contribution (ARC) rates update in the County Accounting and Payroll System (CAPS+) is performed as required by the CEO Administrative Procedural Manual, *Administration of the Retiree Medical Trust*, Section 4.1.

CEO Response to Recommendation #2:

Concur. CEO requested that the testing of the Annual Required Contribution changes be performed by the Auditor/Controller payroll unit. The testing was reviewed and signed by Auditor/Controller payroll staff. The testing was also reviewed by CEO staff but not documented. CEO will ensure that the review and testing of future rate changes is properly documented by CEO staff.

Recommendation #3:

We recommend that the CEO ensure that ARC transfers are made regularly and timely to the 401(h) trust (Trust) account at OCERS.

CEO Response to Recommendation #3:

Concur. Due to the irrevocable nature of deposits into the Trust, a thorough review of the contributions made through the payroll system each pay period is performed to help ensure accuracy. During the time period covered by this audit, there was turnover in the staff involved in the review process. CEO has recently cross trained staff and streamlined the review process to ensure the transfers to the 401(h) Trust are made every two to four payroll cycles.



ATTACHMENT B: County Executive Office Responses (continued)

CEO Response to Audit Report No. 1316 on the County of Orange Retiree Medical Plan
August 27, 2014
Page 2

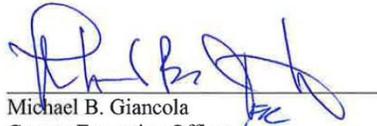
Recommendation #4:

We recommend that the CEO ensure that reconciliations and recording of the trust account activities are done monthly as required by the CEO Administrative Procedural Manual.

CEO Response to Recommendation #4

Concur. CEO currently reconciles the balances of the Trust monthly. Multiple monthly reconciliations are then combined into one journal voucher for purposes of recording the monthly financial activity to the County's accounting records. CEO intends to continue reconciling the Trust balances monthly but combine monthly reconciliations and prepare journal vouchers quarterly. CEO will revise its policies and procedures to reflect preparation of journal vouchers at least quarterly.

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



Michael B. Giancola
County Executive Officer

cc: Frank Kim, Chief Financial Officer
Michelle Aguirre, CEO Budget Office
Suzanne Luster, CEO/Public Finance
Louis McClure, CEO/Public Finance