COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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J. TYLER McCAULEY
AUDITOR-CONTROLLER

May 14, 2002

TO: Supervisor Zev Yaroslavsky, Chairman
Supervisor Gloria Molina
Supervisor Yvonne Brathwaite Burke
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley
Auditor-Controller

SUBJECT: **AUDIT REPORT ON COUNTY FISCAL OPERATIONS**

In conjunction with the annual audit of the County's financial statements, a review is made of the County's systems of financial internal control. Enclosed is the independent accounting firm's internal control report on Los Angeles County's operations for fiscal year 2000-2001. The audit report on the financial statements was previously sent to your Board.

The County departments' responses are included and recommendation implementation will be tracked as part of our established follow-up system.

Submission of this report to your Board completes the County's financial audit requirements for 2000-2001.

JTM-JN-leh
Admin\management letter 00-01
Enclosure

c: David E. Janssen
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April 30, 2002

CONFIDENTIAL

The Honorable Board of Supervisors
County of Los Angeles, California

Dear Members:

We have audited the general-purpose financial statements of the County of Los Angeles, California (the County) for the year ended June 30, 2001 and have issued our reports thereon dated December 7, 2001. In planning and performing our audits of the general purpose financial statements, we considered the County's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control structure. We have not considered the internal control structure since the date of our report.

We did not audit the financial statements of the Los Angeles County Employees' Retirement Association (LACERA) and the Children and Family First Commission (CFFC) as of and for the year ended June 30, 2001. These component unit financial statements were audited by other auditors whose report thereon has been furnished to us, and our report, insofar as it relates to the amounts included for LACERA and CFFC, are based solely on the report of such other auditors. In addition, the Community Development Commission of the County (CDC) was audited separately as a component unit. Accordingly, our study and evaluation of the internal control structure did not include, and the other observations reported herein do not cover LACERA, CFFC or CDC.

During our audit, we noted certain matters involving the internal control structure and other operational matters that we are presenting for your consideration. These comments and recommendations, all which have been discussed with the appropriate members of County management, are intended to improve the internal control structure or result in other operating efficiencies and are summarized in the following pages.

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PROCUREMENT AND DISBURSEMENT

Fixed Asset Sales

Observation

During our review of fixed asset sales, we identified three fixed asset sales, totaling approximately $1.7 million in revenue that these sales related to Sheriff Auto Auction Sales. We determined that some, if not all of the autos sold during the auction, were not properly removed from the County's Fixed Assets records at year-end. We understand that the Sheriff's Department did not submit the appropriate documentation to the Accounting Division to identify the historical cost of the autos sold or the corresponding equipment numbers to properly record the sale of the assets. As such, the Accounting Division was unable to identify the corresponding fixed assets on the Fixed Asset Accounting System (FAAS) for deletion. We understand that some of these autos may have already been deleted from FAAS if the County Department submitted the required paperwork separately, however, the Auditor-Controller Accounting Division has no mechanism to identify which autos/equipment numbers were associated with these sale transactions. The proceeds of fixed asset sales were properly recorded, however, the corresponding assets related to the sales may not have been removed from County records prior to fiscal year-end.

Recommendation

We recommend that County Departments, in association with the Auditor-Controller review its mechanism of identifying fixed asset equipment numbers associated with auto sales to ensure fixed asset sale transactions are recorded in their entirety and ensure that all autos associated with these transactions were deleted from the FAAS. Appropriate information regarding the sale or retirement of the County's fixed assets should be transmitted on a timely basis to the Auditor-Controller Accounting Division for appropriate year-end reporting. In order to comply with Government Accounting Standards Board Statement No. 34 "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments", it is imperative for the County to maintain accurate fixed asset information.

Auditor-Controller Department Response

We agree with the recommendation. The Auditor-Controller will expand the procedures in this area and reemphasize to the County departments that property sale transactions must be reported in a timely manner. The Auditor-Controller will utilize various monitoring tools such as

the Fixed Assets Exception report and review minutes of the Board of Supervisors to ensure that transactions are reviewed and recorded accurately.

Proper Capturing of Fixed Assets

Observation

During our review of fixed asset sales, KPMG identified four fixed asset easement sales, totaling approximately $768,000. Upon further review, KPMG noted that these easements were not originally captured in the Capital Asset Information System (CAIS). As the properties were not originally captured in the CAIS, no adjustment was deemed necessary. However, KPMG notes that the Auditor-Controller may not be capturing all County easements in the CAIS or recognizing these assets in the financial statements.

Recommendation

We recommend that the Auditor-Controller perform a review to ensure that all County easements are properly captured in the CAIS and in the financial statements.

Auditor-Controller Department Response

We agree with the recommendation and will evaluate the County's capitalization policies to record easements as part of our GASB Statement No. 34 implementation process for infrastructure retrospective reporting requirements.

Fixed Asset Revenue Exception Report

Observation

During our review of Fixed Asset Sales, KPMG reviewed an exception report, which lists all fixed asset revenue posted to CAPS. The Auditor-Controller utilizes this report to identify fixed asset sales to ensure that the corresponding fixed asset on the Capital Asset Information System (CAIS) or the Fixed Asset Accounting System (FAAS) are removed. In reviewing this report, KPMG noted that there were approximately 320 items in this report, with corresponding fixed asset revenues totaling approximately $1.6 Million. We understand that a portion of the revenues were from installment and easement sales, in which the Fixed Asset is not reported on the CAIS or FAAS. However, we also noted that without extensive investigation, identification of fixed

assets on the CAIS and FAAS associated with the fixed asset revenue on the exception report could not be determined, and therefore, fixed assets reported as June 30, 2001 may have been sold, but not removed from the CAIS or FAAS.

Recommendation

We recommend that the Auditor-Controller use this exception report as a tool to identify fixed asset sales. The Auditor-Controller should then investigate whether the fixed asset revenue identified on this report are associated with fixed assets reported in the CAIS or FAAS and remove assets related to these transactions.

Auditor-Controller Department Response

We agree with the recommendation. The Auditor-Controller is currently using the exception report on a monthly basis as a tool to assist in researching and investigating whether the fixed assets reported in the CAIS or FAAS should be removed.

Construction in Progress Classifications

Observation

During our review of construction in progress classifications, KPMG identified three completed capital projects, totaling $3,498,792, that were completed prior to fiscal year end that remained classified as Construction in Progress on the Capital Asset Information System (CAIS). We understand that there is no formal procedure or policy for County Departments to notify the Auditor-Controller when a project is completed. Accordingly, we note that completed capital projects might not be properly classified as Buildings & Improvements in the CAIS or in the financial statements.

Recommendation

We recommend that the Auditor-Controller distribute a formal policy requiring departments to notify the Auditor-Controller of completed capital projects and to submit required documents on a timely basis. In order to comply with *Government Accounting Standards Board Statement No. 34 "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments"*; it is imperative for the County to correctly classify completed capital projects as Buildings & Improvements.

Auditor-Controller Department Response

We agree with the recommendation and will work with the appropriate County Departments to develop a policy or procedure to notify the Auditor-Controller of the completed capital projects.

RISK MANAGEMENT

Estimation of Self Insurance Liabilities

Observation

During our review of the Chief Administration Office (CAO) Risk Management Division's calculation of County's self-insurance liabilities, KPMG noted that the Risk Management Division utilizes budgeted estimates of payouts to be made in fiscal year 2001-02 to determine current liabilities as of June 30, 2001. However, these estimates are based on payment estimates provided by the insurance administrator in August 2000; as such, the reported current liabilities are not reported based on current case information. Current liabilities may not be accurately stated as case status on existing claims may change or new claims may be incurred, as such, use of budgeted information approximately ten months prior to fiscal year end may not be an accurate estimate of current liabilities.

Recommendation

We recommend that the County utilize the insurance administrator's year-end review of all cases to determine which cases have an estimated payout in the following year to ensure current liabilities are accurately reported in the financial statements.

CAO Management Division - Department Response

We concur with the recommendation and will use the payment estimates provided by Carl Warren at fiscal year-end to determine the current liabilities for the following year. (Utilize June 2002 payment estimates to determine current liabilities for fiscal year 2002-03.)

Worker's Compensation Actuarial Report

Observation

During our review of Workers' Compensation Liability, KPMG reviewed the Workers' Compensation Actuarial reports dated May 20, 1999 and an update letter dated June 21, 1999 estimating future liabilities for the 2000 and 2001 fiscal year. Based on this review, KPMG concluded that the actuarial report might not provide the best estimate of projected liability at fiscal year end as the analysis was based on Workers' Compensation information captured through 1998. Projected liabilities at fiscal year end may not be an accurate estimate of future liabilities.

Recommendation

As there have been many recent changes in the workers compensation environment, as well as a large rise, in most recent years, of the estimated worker's compensation liability, KPMG believes that the Workers' Compensation actuarial projection should be performed annually, or at least biennially, to provide accurate estimates of worker's compensation liability.

Human Resources Department Response

We agree with the KPMG recommendation and will obtain Workers' Compensation actuarial projections biennially. The next actuarial projection will commence using Workers' Compensation information captured through June 30, 2002.

HUMAN RESOURCES

Restricted Access to CWTAPPS

Observation

During our review of Human Resource functions at the Sheriff Department, KPMG identified nine employees who had ability to both update and delete personnel and payroll information on the County-Wide Timekeeping and Payroll Personnel System (CWTAPPS). Based on discussions with the Assistant Director of the Sheriff's Personnel Administration, these employees' duties did not require them to have such capabilities. As such, the Assistant Director immediately restricted these employees' access to only allow the individuals to update personnel

information. Access to update both personnel and payroll information in County Departments could allow an employee the opportunity to add fictitious employees to the CWTAPPS and time input fictitious work hours.

Recommendation

We recommend that the County ensure that CWTAPPS profiles granted to employees are justified, based on employee duties, to maintain the integrity of timekeeping process.

Sheriff Department Response

The Sheriff's Department agrees with the findings, and as the Auditor stated, we immediately revoked the ability of any one person to update and delete information on both personnel and payroll systems. At this time, we do not plan to authorize any one person to affect both systems.

PROVIDE AND MANAGE PATIENT CARE

LAC/USC Lack of Review of Encounter Forms

Observation

We noted that Encounter Forms generated for the Nursing staff to ensure that the diagnosis, and the services and prescriptions are accurately recorded at the Outpatient Clinic reviews outpatient visits. However, such Encounter Forms are only reviewed as time permits and on a sample basis. By not reviewing all Encounter Forms for accuracy and completeness, there is a risk that charges are not being properly captured, thereby resulting in the over/or understatement of patient service revenue and the related patient receivables.

Recommendation

Based on the observation and effect noted above, KPMG recommends that the County consider mandating the review of all Encounter Forms for accuracy and completeness of the diagnosis, and services and prescriptions to ensure that patient service revenue and related receivables are properly captured.

Health Services Department Response

We concur. We are currently compliant in those clinics where we have Medical Record coders abstracting directly from the Medical Record into Affinity. In addition, we are currently reviewing with current staff approximately 35% of the visits that require Encounter Forms. We expect to hire eight coders who are graduating from the East Los Angeles College Board-approved coding program. We anticipate this new staff will be hired and performing at required standards by August 1, 2002. This additional staff will allow us to attain 70% review of required Encounter Forms. We will continue efforts to recruit additional coders to attain 100% review, but this is contingent upon our ability to retain existing staff. Recruitment efforts have been hindered due to the lack of qualified coders in the industry.

LAC/USC Encounter Reconciliation Form Discrepancies

Observation

Nursing Managers are required to perform daily reconciliations of the Encounter Reconciliation Form, (which details, by clinic, the total number of patients scheduled, number of patients arriving, number logged out and not seen, patients logged out and seen and total encounters completed) to the Encounter Forms received to ensure that an Encounter Form was completed for all patients seen. However, KPMG noted that discrepancies noted during the reconciliation process are not researched on a daily basis as the control review was designed to detect. By not investigating the discrepancies on a timely basis, charges documented on the missing Encounter Forms are not being entered into the system, thereby resulting in the understatement of patient service revenues and related receivables.

Recommendation

Based on the observation and effect noted above, KPMG recommends that the County consider enforcing the control procedures to ensure that the reconciliation of the Encounter Reconciliation Form and the patient Encounter Forms is performed in a timely and effective manner in order to properly capture patient service revenues and the related receivables.

Health Services Department Response

We concur. We are developing a report to monitor by clinic, patients booked, seen, dispositioned, etc. This report will provide Administration and the Clinic Areas with a monitoring instrument that will identify outstanding Encounter Forms. We expect to have this report developed and

operational by March 29, 2002. Policy and Procedures will be revised to reconcile the Encounter Form Report within seven (7) calendar days of the visit. Procedures will also include responsibility to monitor and follow-up on missing Encounter Forms. Successful implementation of the reconciliation is contingent upon our ability to recruit and retain staff to perform this function.

Valuation of Private Pay and Insurance Revenues and Accounts Receivable

Observation

During our testwork performed on the valuation of revenues and accounts receivable for private pay and insurance accounts at June 30, 2001, we reviewed the method used for estimating these balances. The method consists of obtaining the total private pay and insurance amounts actually collected during the 12 months of the fiscal year, and adding an additional six months of estimated collections, the amount of which is based on the actual fiscal year's collections. Our discussions with management confirm this method has been used for a number of years and has not been evaluated recently for reasonableness with regard to comparison with actual amounts outstanding at year-end for these financial classes.

Using the described method could result in an over or under accrual of the related revenues and accounts receivable. As there has been no recent evaluation of the method comparing to actual outstanding balances, net of appropriate bad debt and contractual adjustment, the possible misstatement is unknown. The method assumes a level of days in accounts receivable for these financial classes of six months.

Recommendation

Based on the observation and effect noted above, KPMG recommends that the County perform an analysis of this method for estimating private pay and insurance revenues and accounts receivable by comparing the resulting additional six month accrual to the actual balances existing in accounts receivable, net of the appropriate bad debt and contractual allowance to assure the method results in a reasonable estimate.

Health Services Department Response

We concur. Finance staff will perform the recommended analysis when estimating balances for fiscal year 2001-02 and revise the current method as necessary.

Valuation of Medicare and MediCal Revenues and Accounts Receivable

Observation

During testwork performed on the valuation of revenues and accounts receivable for Medicare and MediCal accounts at June 30, 2001, we reviewed the method used for estimating these balances. The method consists of the preparation of a *Schedule of Accrued Revenue As of June 30, 2001 for Fiscal Year Services* (for years 2001, 2000, and prior) by management at each hospital location. Completion is based on written instructions sent to the hospitals by the Chief, Controller's Division of the Department of Health Services. We noted through discussion with the Controller's Division, amounts submitted by the hospitals are not verified or supported when submitted. During discussion with the Controller's Division and with staff at the hospitals participating in the completion of the forms, persons preparing the forms may interpret the instructions differently and the data used to complete the forms are derived from varying sources.

If instructions and methods of deriving data used to complete the forms used to estimate revenues and accounts receivable for Medicare and MediCal revenues and accounts receivable are not interpreted and completed in a consistent manner among the County hospitals, the resulting estimates for revenues and accounts receivable may not be reasonably stated.

Recommendation

Based on the observation and effect noted above, KPMG recommends that the County ensure that the method used to estimate Medicare and MediCal revenues and accounts receivable is interpreted and derived in a consistent manner for each County hospital. Additionally, it is recommended the Controller's Division of the Department of Health Services obtain and review the source data used in the completion of the accrual reports for accuracy and appropriateness.

Health Services Department Response

We concur. Finance staff will revise the accrual instructions issued to DHS facilities to ensure consistency in the methods used to estimate Medicare and Medi-Cal revenues and accounts receivable. Additionally, Finance proposes to review, on a sample basis, the source data of the Medicare and Medi-Cal revenue estimates. The revised procedures will be implemented for fiscal year 2001-02.

OMB CIRCULAR A-133

Sharing of Computer Passwords

Observation

In performing our Single Audit testwork of the Workforce Investment Act Programs, we noted that certain invoices were prepared and approved by the same individual. In this particular case, a supervisory employee (level 3 and 4) has allowed a subordinate employee (level 2 and 3) to approve expenditures up to $100,000 by providing the subordinate employee with the supervisor's computer password. From our discussions with Department management, they have instructed the supervisor to cease this behavior immediately.

Recommendation

We recommend that immediate actions be taken to enforce and establish strong controls over the invoice approval policies and process. Management risks unallowable expenditures to pass through the County's review process undetected.

Community of Senior Citizens Department Response

CSS agrees. We will reiterate to all accounting staff the County and Department policy concerning the sharing of passwords. Each staff member will be informed that such sharing is prohibited under all circumstances and appropriate disciplinary action will be taken against employees who do not comply. Responsible managers will take necessary actions such as performing periodic monitoring of payment voucher approvals to ensure compliance. These measures will be implemented immediately.

Lack of Timely Filing of Claim Reports

Programs Affected

Aging Cluster: *Department of Health and Human Services (DHHS)*, Title VII – Elder Abuse Prevention (CFDA #93.041), Title VII – Ombudsman (CFDA #93.042), Area Agency on Aging III F (CFDA #93.043), Area Agency on Aging III B (CFDA #93.044), Area Agency on Aging III CI & CII (CFDA #93.045), and *Department of Agriculture (DOA)*, Area on Aging III USDA CI & CII (CFDA #10.570).

Observation

Department of Community and Senior Citizens Services

Ten out of ten monthly claim reports that were selected for testwork were not submitted to the State of California within the required time frames. Lack of timely filing of monthly claim reports increases the amount of time it takes for the County to become reimbursed and could cause for reduced or terminated funding.

Recommendation

We recommend that the Department implement policies and procedures that would ensure the monthly claim reports are submitted in a timely manner to ensure that funding is not terminated.

Community and Senior Citizens Department Response

CSS agrees. We will issue written instructions to the responsible unit to adhere to all deadlines established by the State Department of Aging for submitting monthly claims for the Older Americans Act grant programs. Program Accounting Section managers will monitor for timely submission of the claims. We will also identify what barriers exist that impede the timely submission of claims and take appropriate corrective actions to remove those barriers. These actions will be completed by April 15, 2002.

Lack of Timely Filing of Quarterly Reimbursement Claim Reports

Program Affected

Alcohol Block Grant (CFDA #93.595)

Observation

Department of Health Services

Two out of four of the current year's Quarterly Reimbursement Claim Reports were not filed within the required time frames. Lack of timely filing of monthly claim reports increases the amount of time it takes for the County to become reimbursed and could cause for reduced or terminated funding.

Recommendation

We recommend that the Department implement policies and procedures that would ensure the monthly claim reports are submitted in a timely manner to ensure that funding is not terminated.

Health Services Department Response

We concur. The Department will implement procedures to ensure that the Quarterly reports are prepared in a timely manner to allow for review at the appropriate level prior to submission to the State Department of Alcohol and Drug Programs.

INFORMATION TECHNOLOGY

Disaster Recovery Plan

Observation

The County of Los Angeles utilizes two hot site locations to recover the IBM mainframe and UNYSIS environments. In addition, the County performs disaster recovery testing for the IBM mainframe once a year and twice a year for the UNISYS mainframe.

However, the County does not have a comprehensive Disaster Recovery Plan (DRP) that addresses recovery of other non – mainframe based systems located within the data center, key systems supporting the County that are outside the control of the Information Services Division and network connectivity.

Lack of a formal organization wide DRP, that includes key systems throughout the County and network connectivity, may hinder the County's ability to recover its operations during a disaster. Delays in the County's ability to recover its operations could have a significant impact on County operations and services provided by the County.

Recommendation

We recommend that a Countywide disaster recovery plan be developed, which includes recovery of all the critical systems within the County and related network connectivity.

As part of developing a Countywide disaster recovery plan, we recommend that the County perform a business impact analysis, identify alternative recovery strategies, define critical recovery resource requirements, develop disaster recovery plans and establish plan testing and administration processes.

Chief Information Office (CIO) Response

The office of the CIO, with support from the County's Internal Services Department (ISD), and other affected departments, will initiate actions to develop a comprehensive Disaster Recovery Plan/Process that is reflective of the above recommendations.

Information Security

Observation

The County has implemented formal security policies and procedures relating to computing resources (including various systems and network) within the purview of the Information Services Division. However, the County's data center is connected to departments throughout the County. Some of these Departments have their own information technology operations, which may have implemented varying levels of security. As a result, some of these departments may serve as a "backdoor" into the County's critical information assets under the security axiom that "you are only as secure as your weakest link."

Given the decentralized nature of the County, the connectivity between the data center and the various departments, and the overall lack of Countywide information systems standards, policies, and procedures for; there is an increased the risk that unauthorized individuals may gain access to the County's systems.

Recommendation

We recognize that the County has established a Cyber Terrorism Taskforce, which includes representation from various departments. We understand that this taskforce is responsible for identifying security strengths and best practices that are implemented in the County and develop Countywide security standards and policies for securing the County's information assets.

In addition to this taskforce, we recommend that the County consider establishing an enterprise wide security architecture that addresses the following areas:

- Security strategy that is in line with County's information technology and organization strategies
- Security program structure, resources, and skill sets
- Security policies, standards, and guidelines
- Security management, including operations and monitoring
- User management, including awareness programs
- Information asset security, which are specific to applications, databases, hosts, overall network, and perimeter
- Technology continuity

Chief Information Office Response

The County, as identified, has established a Cyber Terrorism Taskforce to deal with the areas of security addressed in the recommendation. Formal plans have been developed and monthly meetings chaired by the Office of the CIO are held to assess status and progress against stated objectives. Additionally, the CAO has approved hiring a Chief Security Officer who will have responsibility for coordinating and implementing a Countywide Security Program, including employee awareness training.

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A discussion of the limitations of this letter and the comments it contains is as follows:

NATURE OF THE LETTER AND ITS LIMITATIONS

As part of our audit of the general purpose financial statements, we performed a study and evaluation of the County's system of internal accounting controls to the extent we consider necessary to evaluate the system as required by generally accepted auditing standards. The purpose of our study and evaluation is to determine the nature, timing and extent of the auditing procedures necessary for expressing an opinion on the County's general purpose financial statements. Our study and evaluation is more limited than would be necessary to express an opinion on the system of internal accounting controls taken as a whole. County management is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments made by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss form unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of the changes in conditions or that the degree of compliance with the procedures may deteriorate.

A study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the system. Accordingly, an expression of an opinion on the system on internal accounting control taken as a whole cannot be made.

We would like to take this opportunity to acknowledge the courtesy and assistance extended to us by the personnel of the County of Los Angeles during the course of the audit. We would be pleased to discuss the comments in this letter with you at your convenience.

This report is intended solely for the information of and use by the Board of Supervisors, County management and other within the County.

Very truly yours,

KPMG LLP