MEMORANDUM

TO: Mary Ann Borgeson, Chair, Douglas County Commissioner
Clare Duda, Vice-Chair, Douglas County Commissioner
Mike Boyle, Douglas County commissioner
Marc Kraft, Douglas County commissioner
PJ Morgan, Douglas County Commissioner
Chris Rodgers, Douglas County Commissioner
Pam Tusa, Douglas County Commissioner

CC: Thomas Cavanaugh, Douglas County Clerk/Comptroller
John Ewing, Douglas County Treasurer
Jim Tourville, Director Douglas County Health Center
Kathleen Hall, Chief Deputy Douglas County Clerk/Comptroller
Tim Cavanaugh, Chief Deputy Douglas County Treasurer
DeDe Will, Director of Finance Douglas County Health Center
Jerry Prazan, Finance Administrator Douglas County Clerk/Comptroller
T. Paul Tomoser, Audit Committee Chair
Jack Armitage
Ron Bucher
Joni J. Davis
Kathleen Kelley, Chief Administrative Officer
Joe Lorenz, Director of Budget and Finance
Patrick Bloomingdale, Deputy County Administrator
Fred Weber

FROM: Mike Dwornicki, Internal Audit Director

DATE: April 27, 2011

SUBJECT: Year- End Financial Statement Findings Follow-Up

Background

The Douglas County, June 30, 2010 report on internal control over compliance per OMB Circular 1-133 prepared by Hayes & Associates identified two material weaknesses and two significant deficiencies. The June 30, 2010 proprietary report on the Douglas County Health Center prepared by Seim Johnson identified two material weaknesses. In response to the findings, the audit committee requested a follow-up audit to determine what steps have been taken by accounting management to ensure that the findings are not repeated. The findings mentioned above appear in the Original Finding sections in the report below as they appeared in the Hayes & Associates and Seim Johnson reports.

Objective

The objective of the audit was to determine if accounting management has implemented appropriate procedures to ensure that:

- All accounts are appropriately adjusted to properly reflect the County's year-end financial results, including any necessary prior period adjustments.
- Cash balances maintained by the Treasurer are properly reconciled to Oracle.
- Bank accounts under the custodianship of the County are adequately tracked to ensure that all cash accounts are adequately insured or collateralized.

Scope

The audit covered an assessment of the procedures that were in effect as of the end of fieldwork on April 8, 2011. The audit included an analysis of the bank reconciliations from September 2010 to January 2011.

Methodology

The evidence gathering and analysis techniques used in order to meet the audit objectives included, but were not limited to:

- Examination of written policies and procedures.
- Interviews and correspondence with accounting and management personnel of the Douglas County Treasurer, Clerk/Comptroller, Health Center and other departments.
- Examination of bank reconciliations for proper preparation, review, and timeliness.
- Examination of the most current listing of cash accounts to determine if the County was at risk of not being properly insured or collateralized.
- Examination of documentation from prior year-end analysis and financial statement preparation meetings.

Findings

Material Weaknesses Identified by Hayes & Associates (Italicized text is from original Hayes and Associates report.)

Finding 2010-01: Material Journal Entries

Condition: The County's basic financial statements originally contained material misstatements in the following accounts: due from other governments, accounts payable, prepaid assets, capital assets, and lodging tax revenues. A material adjustment to due from other governments was required to reverse a modified accrual entry recorded by the County to book a receivable under the Federal Drug Forfeiture grant. The nature of the Federal Drug Forfeiture grant is such that the money is received up front and the recording of future receivables is not appropriate. A material journal entry was made to accounts payable for an invoice paid after

Douglas County's review timeframe. A material adjustment to prepaid assets was required to record payments made related to the County's health and dental plan. A material adjustment to capital assets was required to record previously unidentified capital assets; the existence of these assets was discovered during the test of capital outlay expenditures. A material adjustment to lodging tax revenues was required to consistently record the treatment of lodging tax payments made to the City of Omaha. The County's basic financial statements originally contained material misstatements in due from other governments, accounts payable, prepaid assets, capital assets, and lodging tax revenues.

Criteria: An entity should establish internal controls over financial reporting to ensure the basic financial statements are free of material misstatements. These controls should include ensuring that information necessary to record year-end adjustments is captured and recorded accurately and completely.

Cause: The County's controls were insufficient to accurately capture all necessary adjusting entries to ensure that the basic financial statements were free from material misstatements.

Effect: Material audit adjusting entries were required to correct misstatements in the County's basic financial statements.

Recommendation: The County should implement internal controls, including further review of year end journal entries recorded to convert the County's accounting system from the cash basis of accounting to the modified accrual and full accrual basis of accounting, to ensure that the basic financial statements are free from material misstatements.

Management Response: Management concurs, and will continue to improve controls, within the budgetary limits imposed as regards staffing.

Current Condition: The nature and explanations of why the material adjustments were needed were discussed with accounting personnel. The accountants understand the nature of the adjustments and have appropriate procedures to properly account for future occurrences of similar transactions. The Clerk's office is currently attending various committee meetings that will help ensure it is aware of issues that could affect accounting transaction treatment. Updated procedures for accounts payable include an extension of the search for invoices through September. Prior procedures included a review of adjusting entries by an internal auditor. The current plan calls for assigning the duties to other personnel within the department and for establishing a more exact schedule for double-checking the entries. There will also be regular weekly meetings to review and discuss adjusting entries throughout the audit period. The procedures for reviewing the adjusting entries and holding the weekly meetings had not yet been formally drafted.

Next Steps to Fully Implement the Recommendation: The following items are recommended to further ensure that all year-end transactions are captured and reported completely and accurately:

- Solicit input from elected officials and department heads regarding non-routine services received prior to year-end that may have not been billed as well as information related to subsequent events that may need to be disclosed.
- Extend the search for significant invoice accruals through the end of the external auditor's fieldwork.
- Require that adjusting entries above a predetermined threshold receive additional scrutiny and approval from appropriate accounting management.
- Consider confirming final, adjusted grant balances with appropriate grant recipient personnel.

Management Response: The annual Revenue Questionnaire that goes to all elected officials and department heads after close of fiscal year has already been adjusted to add questions regarding unbilled services. The Clerk/Comptroller's office has adjusted the process to extend the search through end of external auditor's field work. The Clerk/Comptroller's office has adjusted the process for review of adjusting entries. Confirmation of final, adjusted grant balances with appropriate grant recipient personnel occurs on continuing basis and a formal sign off will be implemented for the current fiscal year.

Finding 2010-02: Prior Period Adjustments

Condition: There were material prior period adjustments required to appropriately restate the beginning fund balance and net assets.

Criteria: An entity should establish internal controls over financial reporting to ensure the basic financial statements are free of material misstatement and in accordance with generally accepted accounting principles.

Cause: The County re-evaluated the treatment of a an account established in a prior year and required under Nebraska state statute to ensure funds are available for the closure and post-closure costs associated with the County's landfill. This account was not previously recorded in the County's financial statements. Upon further evaluation, it was determined that the account, while restricted, belonged to the County and represented assets to be presented on the County's' financial statements.

Several infrastructure assets were annexed by another government in a previous year. The County has determined that annexation represents a change in ownership. Therefore, when infrastructure assets are annexed by another government, the County has concluded that ownership then passes to the other government. Beginning net assets were restated to reflect the disposal of infrastructure assets annexed in prior years.

Effect: Material restatements to the beginning fund balance and net assets were required in order to present the basic financial statements in accordance with generally accepted accounting principles.

Recommendation: The County should implement internal controls over financial reporting to ensure that each line item and footnote disclosure in the basic financial statements is free of *material misstatements. The treatment of account classifications and inter-governmental relationships should be investigated and periodically readdressed to ensure that the County's basic financial statements are in accordance with generally accepted accounting principles and are free from material misstatement.*

Management Response: Management concurs, and will continue to improve controls, within the budgetary limits imposed, as regards staffing.

Current Condition: In the Auditor's opinion, the Clerk's office has taken the appropriate steps to fully comply with the audit recommendation. The Clerk's office has identified the specific conditions leading to the prior period adjustments. The appropriate accounting treatment of the post-closing trust account had been established and similar transactions will be treated similarly. A project that makes full use of the GIS system to identify the proper classification of County infrastructure including annexations has been completed.

Significant Deficiencies Identified by Hayes & Associates

Finding 2010-03: Bank Reconciliation and Other Transactions

Condition: The cash balances maintained by the Treasurer were not reconciled to the County's Oracle accounting system in a timely manner. The reconciled cash balances did not agree to Oracle due to activities accounted for in QuickBooks, without consideration to post these activities into Oracle.

Criteria: The Treasurer's internal controls should include matching the reconciled bank balances to the book balance in the Oracle accounting system, and proposing adjustments if necessary to properly report the County's basic financial statements.

Cause: The Treasurer did not have internal controls in place to perform a reconciliation of the accounts in its ownership or custodianship to the cash balances in the Oracle accounting system, and to propose adjustments for reconciling items at year end.

Effect: The reconciliation process is intended to identify material reconciling items, bank errors, and other misstatements or frauds. Not reconciling bank accounts to the Oracle cash balance in a timely fashion increases the risks that these errors or misstatements may not be identified on a timely basis.

Recommendation: The Treasurer's department should implement controls to ensure reconciled cash balances agree to what the County's general ledger states, and the department should implement a process to book transactions that are not loaded through their INOVA system separately into Oracle for financial statement reporting. The Treasurer should have a summary schedule showing reconciled bank accounts compared to the Oracle general ledger balances to communicate and document that they are in balance.

Management Response: The Treasurer's Office is aware of the fact that the reconciled cash balances must agree to the County's general ledger. This was an intended consequence when implementing the QuickBooks accounting software. The significant reconciling items under discussion are monies received via ACH into a special account designated for this purpose. Withdrawals from this account (1) require two authorized individuals to complete the transaction and (2) are only electronic transfers from this account to the main account.

The Treasurer's Office notifies the county office(s) once the monies are received into this bank account. The monies are processed into the accounting system as soon as our office receives instructions as to how the monies should be processed from that(those) county office(s).

We will formalize the process of reconciling the reconciled cash balances to the County's general ledger. As well, we will implement an additional procedure that will include processing these items that experience delayed processing while we await instructions from other county offices. That procedure will include booking these pending items into the County's accounting system at month end.

Current Condition: The Treasurer’s Department has drafted the procedures that include how the cash account reconciliations will be reconciled back to Oracle. However, the department has not yet implemented the process. The bank account reconciliations for the sixteen accounts under the control of the Treasurer were reviewed for the period September 2010 through January 2011. The reconciliations were properly prepared and included few reconciling items. However, eleven of the seventy-six reconciliations reviewed had outstanding reconciling items for more than two months. Two of the accounts still had outstanding reconciling items as of the end of January. Of these two, only the DOT.Comm account had a significant amount of reconciling items - $15.8 thousand dollars, $4 thousand of which dated back to October of 2010.

Next Step to Fully Implement the Recommendation: Reconcile the cash accounts back to Oracle beginning with the March or April reconciliations. Performing the procedures through the remaining months of the current fiscal period will help ensure that any problems encountered in implementing the new process will be addressed prior to the fiscal year-end. Include in the reconciliation all appropriate documentation to needed to properly explain the status of all reconciling items.

Management Response: The Treasurer’s Office will reconcile the cash accounts to Oracle, beginning with the March, 2011 reconciliations. Appropriate supporting documentation will be included with the reconciliations.

Finding 2010-04: FDIC and Collateralization (PY Comment)

Condition: The County’s processes to track whether bank accounts owned by the County or under its custodianship are adequately covered by insurance or collateral was not sufficient to evaluate whether accounts were adequately insured/collateralized.

Criteria: The County should evaluate its deposit balances against FDIC coverage and collateral to comply with the state statutes. If deposits exceed current FDIC coverage limits, steps should be taken to further to insure /collateralize all of the entity's deposit balances.

Cause: Adequate internal controls were not in place to monitor the bank balances in relation to current FDIC insurance and pledged collateral.

Effect: By not evaluating the adequacy of insurance/ collateralization of bank deposits, the County increases the risk of losses in if a bank in which the County holds deposits were to fail.

Recommendation: The County should implement internal controls to routinely compare its deposit balance with maximum FDIC coverage limits, current pledged collateral, and current insurance/collateral regulations. The County should have a summary schedule of the accounts owned or under its custodianship with the coverage amounts that communicates and documents it's compliance.

Management Response: The Treasurer's Office believes we need a County Board resolution in order to fully comply with this recommendation. We will formalize the process of reviewing our FDIC coverage by preparing a summary schedule which will include accounts under our control. The review will occur quarterly or according to the written information provided by the bank.

Current Condition: The Treasurer's Department has written the procedures for tracking the adequacy of insurance or collateral coverage for cash accounts under its control or custodianship. However, the department has not yet implemented the process. As noted in the Management Response section above, the Treasurer did not feel that he had the authority to enforce coverage monitoring for accounts that were not under his direct control. Consequently, a Board Resolution has been drafted requiring all Douglas County elected officials and department heads to abide by the procedures drafted by the Treasurer's office.

Unlimited FDIC insurance coverage for non-interest bearing accounts through 2012 has greatly reduced the risk associated with deposit accounts. Further interviews and examination of the most current account listing indicated that other departments have limited coverage risk or have procedures in place to track their coverage. However, current financial conditions warrant close supervision and the need to tighten procedures for monitoring insurance and collateral coverage.

Next Step to Fully Implement Recommendation: The Treasurer's Department should distribute the procedures for assessing insurance/collateral coverage for cash to all County departments, and verify that the procedures have been followed pending approval of the Board Resolution.

Management Response: The Treasurer's Office will distribute the procedure for assessing the adequacy of insurance/collateral coverage to all county departments after the County Board approves the board resolution. The Treasurer's Office will verify the procedure is being followed.

Material Weaknesses Identified by Seim Johnson (Italicized text is from original Seim Johnson report.)

Original Finding - Management Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimations and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements. As part of the audit, we reviewed the following significant estimates made by management:

- *The allowance for uncollectible accounts from third-party payors, patients, and others*
- *Estimated third-party payor settlements*

Management performed an analysis of the estimated collectability of total patient accounts receivable using an aggregated historical average rate of collection by individual payor type. This methodology did not necessarily consider differences in revenue collected versus outstanding revenue by probable payor type, changes in collection rates; and differences in collection amounts based on aging categories. As part of our audit procedures, additional tests of the allowances for uncollectible accounts from third-party payors, patients and others were performed which resulted in audit adjustments.

Management also performed an analysis of the estimated third-party payor settlements based upon reimbursement and settlements received from third-party payors on a cash basis only. In reviewing management's estimation process, we noted activity for the year was not completely analyzed to properly estimate a third-party settlement on an accrual basis in the financial statements. As part of our audit procedures, additional tests of the estimated settlement were performed which resulted in an audit adjustment.

We recommend management continue to monitor and improve its current estimation process to compute appropriate allowances for uncollectible accounts from third-party payors, patients, and others, and to compute estimated third-party payor settlements.

Management's Response: Management will enhance its estimation process to more accurately recognize third-party payor settlements and allowances for uncollectible accounts receivable.

Revenue Recognition

The revenue recognition principle is composed of two overarching concepts under generally accepted accounting principles. Revenue is to be recognized when it is (1) realized or realizable, and (2) earned, no matter when cash is received. During the year under audit, it was noted that revenue generated from services performed in the final month of the year was not properly recognized and recorded in the general ledger. As part of the tests performed during the audit, we identified that the June 2010 revenue earned was improperly excluded from the general ledger and resulted in an audit adjustment.

We recommend the Health Center improve its current process of recognizing and recording revenue to ensure all revenue earned is recognized in the general ledger of the Health Center.

Management's Response: Management will assess their current method of recognizing revenue and implement measures to ensure revenue is recognized and recorded on an accrual basis as required by generally accepted accounting principles.

Current Condition: The Auditor reviewed the newly proposed procedures for recognizing revenue and estimating third-party payor settlements and allowances for uncollectible accounts receivable. The proposed procedures incorporate the same or similar methodologies used by the Health Center's external auditors to assess the prior year's financial statements. The methodologies are sound and can be relied upon to report accurate revenues and receivables. However, the procedures were not yet available in formal written procedures.

Next Step to Fully Implement Recommendation: Prepare formal written procedures documenting the steps to recognize all revenue sources and the estimation process for third-party payor settlements and uncollectible accounts receivable.

Management Response: Management has subsequently prepared formal written procedures documenting the steps to recognize all revenue sources and the estimation process for third-party payor settlements and uncollectible accounts receivable.

Audit Standards

Internal Audit conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that the audit is planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. Internal Audit believes that the evidence obtained provides a reasonable basis for its findings and conclusions based on the audit objectives.

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Internal Audit has reviewed this information with the Douglas County Treasurer, Douglas County Clerk/Comptroller and Director of the Douglas County Health Center. Their responses are included in this report. Internal Audit appreciates the excellent cooperation provided by management and staff. If you have any questions or wish to discuss the information presented in this report, please contact Mike Dwornicki at (402) 444-4327.