

# Internal Audit Department

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

## Internal Control Audit: HEALTH CARE AGENCY FEE GENERATED REVENUE

For the Period March 1, 2010  
through February 28, 2011

High  
Impact  
Audit

During the audit period, the Health Care Agency generated approximately \$18.7 million in revenue from Board-approved, cost-recovery fees that are charged to the public for licenses, permits, franchises, and other charges for providing County services.

We audited the Health Care Agency's (HCA) Fee Generated Revenue process to evaluate the adequacy of internal controls over fee studies and fee development for establishing cost-recovery fees charged to the public for Licenses, Permits and Franchises and other County services that are subject to Board of Supervisors approval. We also evaluated compliance with County Accounting Manual revenue policy for preparing fee studies; the impact of Proposition 26 on HCA fee revenue; and to determine if the fee generated revenue process is efficient and effective.

Our audit found internal controls over HCA's fee generated revenue process are adequate, effective, and exemplary in the fact they have a well-structured and documented fee development process that can be considered a best practice for other County departments and agencies. However, HCA's ability to adjust certain fees to recover its program costs has been impacted by the economic downturn and a County political environment that is sensitive to raising fees for providing County services. We identified **one (1) Control Finding** to clarify County revenue policy requirements for submitting updated fee studies to the Board of Supervisors. HCA agreed with the finding and recommendation.

AUDIT No: 1024

REPORT DATE: AUGUST 30, 2011

**Director:** Dr. Peter Hughes, MBA, CPA, CIA

Deputy Director: Eli Littner, CPA, CIA

Senior Audit Manager: Michael Goodwin, CPA, CIA

Audit Manager: Lily Chin, CPA

**RISK BASED AUDITING**

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



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*

*Providing Facts and Perspectives Countywide*

**RISK BASED AUDITING**

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To access and view audit reports or obtain additional information about the  
OC Internal Audit Department, visit our website: [www.ocgov.com/audit](http://www.ocgov.com/audit)



**OC Fraud Hotline (714) 834-3608**



## Transmittal Letter



**Audit No. 1024 August 30, 2011**

**TO:** David L. Riley, Director  
Health Care Agency

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

**SUBJECT:** Internal Control Audit: Health Care Agency  
Fee Generated Revenue

We have completed an Internal Control Audit of the Health Care Agency's Fee Generated Revenue process for the period March 1, 2010 through February 28, 2011. We performed this audit in accordance with our *FY 2010-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. Our final report is attached for your review.

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 agency 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 document to facilitate our review.

Each month I submit an **Audit Status Report** to the BOS where I detail any critical and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the 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 5.

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Health Care Agency  
Fee Generated Revenue  
Audit No. 1024*

For the Period March 1, 2010 through February 28, 2011

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**Audit No. 1024**

**August 30, 2011**

TO: David L. Riley, Director  
Health Care Agency

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

SUBJECT: Internal Control Audit: Health Care Agency  
Fee Generated Revenue

## Audit Highlight

### Successes

The HCA Revenue Unit has established a comprehensive *Fee Study Procedures and Reference Guide*. Its fee studies are well structured and documented in detail. The HCA Revenue Unit is to be commended for coordinating efforts from Program and Program Support in proposing fees for cost recovery. HCA is also willing to share its fee study procedures with other County departments, and has done so with other departments where we are auditing the fee generated revenue process.

We found that internal controls are adequate, effective and are exemplary to ensure fee studies are prepared in compliance with departmental procedures and the County Accounting Manual.

We identified **one (1) Control Finding** with regards to clarifying the County's revenue policy for submitting updated fee study schedules for Board approval when there is a trend to reduce costs rather than increase fees charged to the public in the current economic environment.

## OBJECTIVES

In accordance with our *FY 2010-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors, the Internal Audit Department conducted an Internal Control Audit of the Health Care Agency's (HCA) Fee Generated Revenue process. Our audit included an evaluation of internal controls, testing compliance with HCA and County policies; and evaluating process efficiencies and effectiveness. Our audit was conducted in conformance with professional standards established by the Institute of Internal Auditors. The objectives of this audit were to:

1. Evaluate the adequacy of internal controls over fee development processes for establishing cost-recovery fees charged to the public for Licenses, Permits and Franchises, and Charges for Services subject to Board of Supervisors approval to ensure compliance with departmental and County policies.
2. Evaluate compliance with County Accounting Manual Nos. R-3 – *Revenue Policy, Requirements & Responsibilities*, and B-2 – *Billing Rates and Indirect Cost* for preparing fee studies, and the impact on fees from the recently passed State Proposition 26.
3. Determine if the process is efficient and effective (e.g., no backlogs, duplication of work, manual processes that could be automated).

## RESULTS

**Objective #1:** Our audit found internal controls over HCA's fee generated revenue are adequate, effective, and exemplary in the fact they have a well-structured and documented fee development process.

**Objective #2:** Our audit found HCA to be in compliance with County Accounting Manual Nos. R-3 – *Revenue Policy, Requirements & Responsibilities*, and B-2 – *Billing Rates and Indirect Costs*, and has sufficiently addressed the impact of Proposition 26 on the fee development process. However, HCA's ability to adjust fees to recover its program costs has been impacted by the economic downturn and a County political environment that is sensitive to raising fees for providing County services. We identified **one (1) Control Finding** to clarify County revenue policy requirements for submitting updated fee studies to the Board of Supervisors.

**Objective #3:** Our audit found the HCA fee development process is efficient and effective (e.g., no backlogs, duplication of work, manual processes that could benefit from automation).

# OC Internal Auditor's Report



The following table summarizes our finding and recommendation for this audit. See further discussion in the *Detailed Results, Finding, Recommendation and Management Response* section of this report. See *Attachment A* for a description of Report Item Classifications.

Finding No.	Finding Classification - see Attachment A	Finding	Recommendation	Concurrence by Management?	Page No. in Audit Report
1.	<b>Control Finding</b>	Certain fee studies were completed but not submitted to the Board of Supervisors for approval or put into effect. The County revenue policy is not explicit in its requirements of when or if <u>all</u> fee updates should be submitted to the Board.	Consult with the Auditor-Controller and County Counsel to obtain clarification of County revenue policy expectations pertaining to submitting updated fee schedules to the Board of Supervisors.	Yes	7



## BACKGROUND

HCA provides a wide range of services dedicated through four core services: community health, healthful environment, healthcare access and workforce development. HCA's mission is dedicated to "protecting and promoting the optimal health of individuals, families, and communities through partnerships, community leadership, assessment of community needs, planning & policy development, prevention & education, and providing quality services." HCA is composed of four service areas and divisions: Behavioral Health Services, Medical and Institutional Health Services, Public Health Services and Financial and Administrative Services. The **Financial and Administrative Services** provide internal support to HCA as well as interfacing with HCA's external community organizations, contractors, and stakeholders. Its **Financial and Program Support Services** division helps ensure that Federal, State, County and Agency policies, procedures, and guidelines for expenditures, claims, fees, rates, budget, and financial reporting are followed and that revenues are maximized to the extent possible.

The Financial and Program Support Services' **Revenue Unit** reviews cost recovery fees subject to approval by the Board of Supervisors. The Revenue Unit categorizes fees into Charges for Services and Fees Charged to the Public. The Charges for Services are fees fixed by statute and do not require Board approval. The Fees Charged to the Public are subject to Board approval. The following are HCA's **fourteen (14) fee studies requiring Board approval and consist of forty-seven (47) revenue codes** with sub-revenue codes assigned to record fee generated revenues. Each revenue code can consist of various fees charged to the public for a specific service provided, or may have only one specific service fee.

	Fee Study Description	Revenue for Audit Period
1	Emergency Medical Services Fees	\$276,399
2	Environmental Health Division Fees	\$16,126,441
3	Child Abuse Services Team Fees	\$35,012
4	Emergency Dental Fees	\$15,604
5	Employee Flu Shot Fees	\$693
6	Medical Marijuana Identification Card Fees	\$41,370
7	Public Health Laboratory Fees	\$170,094
8	Travel Immunization Fees	\$444,016
9	Alcohol and Drug Abuse Services Program Fees	\$373,167
10	Alcohol and Drug Abuse Diversion Program Fees	\$59,167
11	Drinking Driver Program Fees	\$892,826
12	Proposition 36 Substance Abuse and Crime Prevention Act Program Fees	\$21,637
13	Mental Health Clinic Fees	\$174,889
14	Custodian of Records Fees	\$18,731
<b>Total Revenue</b>		<b>\$18,650,046</b>

## Fee Development Process

The Revenue Unit has established and maintains the *Fee Study Procedures and Reference Guide* which contains comprehensive, detailed written procedures, sample documents, statutes and other pertinent reference materials. The fee study is a collaboration of Program, Program Support and Revenue Unit to ensure fees are established for full cost recovery in compliance with departmental and County policies. Procedures include determining scope of the fee study, legal authority in charging a fee, holding an initial kick-off meeting with Program and Program Support, developing timeline with specific activities, surveying other jurisdictions, determining appropriate calculation method, calculating estimated program cost based on historical cost data adjusted with other cost factors and other funding sources, calculating proposed fee to recover the cost, preparing narrative report for internal agency review, notifying external parties of proposed fees, obtaining letter of support when applicable, preparing agenda staff report for the Board, and submitting approved fees to Program for implementation.



The Revenue Unit prepares schedules detailing estimated cost calculations and cost elements, which include direct and indirect costs, documents the assumptions and methodologies used in fee studies, and determines proposed fees for cost recovery. The Revenue Unit also maintains a fee study tracking document to ensure all fee studies are conducted timely. Additionally, an annual limited review of each fee schedule is performed as part of the annual Fee/Rate Inventory required to be submitted to the CEO/Budget Office.

## **Impact of Proposition 26**

In November 2010, Proposition 26 was passed by California voters. Proposition 26 requires that certain state and local fees are approved by two-thirds vote. The impact of Proposition 26 expands the definition of a tax which classifies some fees and charges as taxes that the government formerly imposed with a simple majority vote. As a result, more revenue proposals, formerly fees but now taxes, require approval by two-thirds of the Legislature or by local voters. Prior to the passage of Proposition 26, elected officials at the state and local levels could legislate higher revenue proposals by classifying them as fees in order to pass with a simple majority instead of a two-thirds majority required by law for taxes. Our audit found that HCA evaluated its existing fees and made a determination that all HCA fees meet the exception to the proposition's definition of a 'tax'. This exception is noted in the Agenda Staff Report when submitting fee schedule for Board approval.

## **SCOPE AND METHODOLOGY**

We audited a sample of fee studies for fees charged to the public that are subject to approval by the Board of Supervisors. Our audit covered the period March 1, 2010 through February 28, 2011 and included:

1. Evaluating internal controls of the fee study process and compliance with HCA procedures and with requirements of the County revenue policy indicated in County Accounting Manual Nos. R-3 and B-2. We audited two fee studies (**FY 2010-11 Prop. 36 SACPA and FY 2010-11 Environmental Health Division**) to help in our evaluation of internal controls and compliance.
2. Determining if the assumptions and methodologies used in preparing the above two fee studies were supported with accompanying schedules, are accurate, and were reviewed by management. We also inquired about the impact and analysis of Proposition 26 on HCA fee development.
3. Evaluating efficiency and effectiveness of the fee development process for instances of backlogs, duplication of work, or manual processes that could benefit from automation.

## **SCOPE EXCLUSIONS**

Our audit did not include mandated fees fixed by statute as these are not subject to approval by the Board of Supervisors. We did not review internal controls in HCA's cash receipting process for collecting fees or budgetary controls in monitoring fee generated revenues. We did not assess the reasonableness of methodologies and assumptions used in estimating the cost and estimated revenue generated to recover the cost, but we did determine if they were supported, accurate and had management approval.

## **Management's Responsibilities for Internal Controls**

In accordance with the Auditor-Controller's County Accounting Manual No. 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 HCA's continuing emphasis on control activities and self-assessment of control risks.



## Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal 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 HCA's operating procedures, accounting practices, and compliance with County policy.

## Acknowledgment

We appreciate the courtesy extended to us by the Health Care Agency during our audit. If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at 834-5899 or Michael Goodwin, Senior Audit Manager at 834-6066.

## Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors  
Members, Audit Oversight Committee  
Thomas G. Mauk, County Executive Officer  
Vacant, Deputy CEO, Government & Public Services, CEO  
Bob Wilson, Assistant Agency Director, HCA  
Jeff Nagel, Ph.D., Deputy Agency Director & Chief Compliance Officer, HCA  
Janet Holcomb, Division Manager, Financial/Program Support Services, HCA  
Gina Denny, Manager, Revenue Unit, HCA  
Foreperson, Grand Jury  
Darlene J. Bloom, Clerk of the Board of Supervisors

# Detailed Results, Finding, Recommendation and Management Response



**Objective #1:** Evaluate the adequacy of internal controls over fee development processes for establishing cost-recovery fees charged to the public for Licenses, Permits and Franchises, and Charges for Services subject to Board of Supervisors approval to ensure compliance with departmental and County policies.

**Results:** Our audit found internal controls over HCA's fee generated revenue are adequate, effective, and exemplary in the fact they have a well-structured and documented fee development process. The documented policies and procedures ensure there is adequate segregation of duties and management review and approvals over the fee development and fee study process. The two fee studies we audited found that they were supported by comprehensive and detailed schedules, accurate and had appropriate management review. The process is designed to ensure compliance with County revenue policy, with one exception noted and discussed under Audit Objective #2.

**As such, we have no findings or recommendations for this audit objective.**

**Objective #2:** Evaluate compliance with County Accounting Manual Nos. R-3 – *Revenue Policy, Requirements & Responsibilities*, and B-2 – *Billing Rates and Indirect Costs*, and the impact on fee development from the recently passed State Proposition 26.

## Finding 1 – Clarification of County Revenue Policy Requirements for Submitting Updated Fee Studies to Board of Supervisors

### Summary

Although our audit found internal controls over HCA's fee generated revenue are adequate and effective, we found that HCA's ability to adjust fees to recover its program costs has been impacted by the economic downturn and a County political environment that is sensitive to raising fees for providing County services. Our audit found that certain fee studies were completed and not submitted to the Board because they were either put on hold, deferred, or a management decision was made not to submit them at the time. The County revenue policy, as stated in County Accounting Manual No. R-3 – *Revenue Policy, Requirements & Responsibilities*, is silent on whether fee studies and updates completed by departments/agencies must be submitted to the Board. **(Control Finding)**

### Details

We audited the FY 2010-11 Environmental Health Division fee study; however, the updated fee schedules were not submitted to the Board for approval based on a management decision by HCA. The Environmental Health Division Fees is the largest fee study in HCA and is conducted annually. The fees are divided into four main groups: Food & Pool, Hazardous Material Management including Medical Waste, Solid Waste and Water Quality. The largest fee revenue generating group is Food & Pool. The HCA Revenue Unit calculates an estimated cost and the proposed fees to ensure full cost recovery for each group. The proposed fee schedules, which are effective for one fiscal year, are submitted to the Board of Supervisors for approval and the fees are updated to reflect estimated costs.

We noted that the HCA Revenue Unit completed the estimated program cost and the proposed fees for FY 10-11; however, the updated fee schedules were not submitted to the Board for approval. They were not submitted based on executive management decisions to instead make internal reductions to estimated program costs by cutting positions, adjusting other minor costs, and by reducing service levels to ensure compliance for full cost recovery.



The HCA Revenue Unit maintains a list of fees for purposes of monitoring the timely completion of fee studies and noting their status of each fee study. We noted certain fee studies had comments about management making decisions to either not update the completed fee studies, defer, put on hold, or not pursue certain studies for various reasons. County Accounting Manual R-3 *Revenue Policy, Requirements & Responsibilities* requires all cost recovery revenue rates be updated at least once each year to reflect current cost or update no later than every third year if the study cost is excessive; however, **it does not explicitly require that updated fee schedules resulting in no fee increase be submitted to the Board for approval.**

As authored by Daniel Edds, "User Fees – Putting Policies and Structures in Place Now for the Future" *Government Finance Review*, April 2011, states that "while user fees cannot replace lost revenues, the current economic state of affairs provides a critical opportunity to review and update user fee policies, cost structures, policies, and internal procedural processes. By taking steps now, jurisdictions can be ready to make improvements as soon as economic recovery begins. Setting clear policies and procedures for cost recovery is a way to prepare for anticipated service needs and future growth."

### **Recommendation No. 1**

HCA consult with the Auditor-Controller and County Counsel to obtain clarification of County revenue policy expectations pertaining to submitting updated fee schedules to the Board of Supervisors.

### **Health Care Agency Management Response:**

**Concur.** HCA will consult with the Auditor-Controller and County Counsel and determine how the revenue policy pertaining to updated fee schedule requirements can be clarified or revised by February 1, 2012.

**Objective #3:** Determine if the process is efficient and effective (e.g., no backlogs, duplication of work, manual processes that could be automated).

**Results:** Our audit found the HCA fee development process is efficient and effective (e.g., no backlogs, duplication of work, manual processes that could benefit from automation). As noted above, the HCA Revenue Unit has comprehensive detailed procedures and an established fee development process that could be considered as a best practice for other County departments and agencies. They also have effective oversight of the 14 fee studies that require annual fee updates to ensure cost recovery. We commend HCA for the well established and documented fee development process to support its fee generated revenue.

**As such, we have no findings and recommendations for this audit objective.**



## 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:**

Audit findings or a combination of Significant Control Weaknesses that represent serious exceptions to the audit objective(s) and/or business goals. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

▶ **Significant Control Weaknesses:**

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

▶ **Control Findings:**

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.



## ATTACHMENT B: Health Care Agency Management Responses



*Excellence  
Integrity  
Service*

### COUNTY OF ORANGE HEALTH CARE AGENCY

OFFICE OF THE DIRECTOR

**RECEIVED**

AUG 26 2011

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August 25, 2011

### INTERNAL AUDIT DEPARTMENT

**TO:** Dr. Peter Hughes, CPA, Director  
Internal Audit Department

**SUBJECT:** Response – Internal Control Audit: Health Care Agency Fee Generated Revenue,  
Audit No. 1024

The Health Care Agency (HCA) has received the draft report of the Internal Control Audit of the Health Care Agency Fee Generated Revenue for the period March 1, 2010 through February 28, 2011, Audit No. 1024. As requested, the following narrative summarizes the one control finding and response from HCA.

#### **Finding 1 – Clarification of County Revenue Policy Requirements for submitting updated fee studies to Board of Supervisors**

##### **Recommendation No. 1:**

HCA consult with the Auditor-Controller and County Counsel to obtain clarification of County revenue policy expectations pertaining to submitting updated fee schedules to the Board of Supervisors.

##### **Health Care Agency Management Response:**

Concur. HCA will consult with the Auditor-Controller and County Counsel and determine how the revenue policy pertaining to updated fee schedule requirements can be clarified or revised by February 1, 2012.

HCA appreciates the collaborative approach taken by Internal Audit in finalizing the report. Should you have any further questions, please contact Gina Denny, Manager, HCA/F&PSS/Revenue Unit, at 714-834-5470.

  
David L. Riley, Director

DLR:gmd 11-074a

cc: Thomas G. Mauk, County Executive Officer  
Michael Goodwin, Senior Audit Manager, Internal Audit Department  
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