OCTA

September 25, 2013

To: Finance and Administration Committee

From: Darrell Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit Department

Subject: Review of Flexible Spending Account Program

Overview

The Internal Audit Department has completed a review of oversight controls and contract compliance related to the employee Flexible Spending Account Program administered by Discovery Benefits, Inc. under Agreement No. A21662. Based on the review, controls over employee enrollment, termination, and invoice review are adequate; however, the Internal Audit Department made one recommendation to address inadequate controls related to reconciliation of employee bi-weekly payroll payments and the $40,000 custodial account maintained with Discovery Benefits, Inc.

Recommendation

Direct staff to implement recommendation provided in the Review of Flexible Spending Account Program, Internal Audit Report No. 13-525.

Background

The Flexible Spending Account Program (FSA) allows employees to divert salary earnings on a pre-tax basis to cover out-of-pocket medical, dental, vision, and/or dependent care expenses. The Orange County Transportation Authority (OCTA) maintains Agreement No. A21662 (Agreement) with Discovery Benefits, Inc. (Discovery Benefits) for administration of the FSA. The Benefits Section of the Human Resources and Organizational Development Division is responsible for oversight of the FSA.

OCTA is responsible for ensuring that employees are accurately and timely enrolled and terminated from the FSA, that payroll deduction amounts are accurately and timely transmitted to Discovery Benefits, that invoices received are accurate and in compliance with the Agreement, and that the custodial account is properly reconciled at the end of the plan year.

Discussion

During the year, the third-party provider receives and applies bi-weekly payroll payments and provides detailed reports of FSA account balances by employee. In addition, OCTA maintains $40,000 on deposit with the third-party provider for the purpose of paying eligible medical FSA claims prior to receipt of employee payments. At the end of each year, the third-party provider sends an accounting of the excess or deficit of funds in the deposit account.

At the time of review, there were inadequate controls in place to reconcile bi-weekly payroll payments and the annual statement of deposit account; Internal Audit noted differences between the deposits recorded in individual FSA accounts versus the bi-weekly payroll payments recorded in the OCTA payroll system for the calendar years 2010 and 2011.

Prior to report issuance, management reconciled the deposit account for calendar years 2010, 2011, and 2012, noting one unidentified difference of $50 for 2011.

Internal Audit recommended that management implement controls to ensure reconciliation of bi-weekly payroll payments and the annual statement of deposit account. Management agreed and indicated that written procedures have been developed and reconciliations performed.

Summary

Based on the procedures performed, controls over employee enrollment, termination, and invoice review are adequate; however, Internal Audit made one recommendation to address inadequate controls related to reconciliation of employee bi-weekly payroll payments and the $40,000 custodial account maintained with Discovery Benefits.

Attachment

A. Review of Flexible Spending Account Program, Internal Audit Report No. 13-525

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Approved by:

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ATTACHMENT A

ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT

OCTA

Flexible Spending Account Program Review

Internal Audit Report No. 13-525

September 13, 2013

Internal Audit Team: Janet Sutter, CIA, Executive Director
Gabriel Tang, CPA, Principal Internal Auditor

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Conclusion

The Internal Audit Department (Internal Audit) has completed a review of oversight controls and contract compliance related to the employee Flexible Spending Account Program (FSA) administered by Discovery Benefits, Inc. (Discovery Benefits) under Agreement No. A21662.

Based on the review, controls over employee enrollment, termination, and invoice review are adequate; however, there were inadequate controls in place to ensure accurate and complete recording of employee payments and to reconcile the $40,000 custodial account maintained by Discovery Benefits.

Background

The FSA allows employees to defer salary earnings on a pre-tax basis to cover out-of-pocket medical, dental, vision, and/or dependent care expenses. The Orange County Transportation Authority (OCTA) maintains Agreement No. A21662 (Agreement) with Discovery Benefits for administration of the FSA. The Benefits Section of the Human Resources and Organizational Development Division is responsible for oversight of the FSA.

OCTA is responsible for ensuring that employees are accurately and timely enrolled and terminated from the FSA, that payroll deduction amounts are accurately and timely transmitted to Discovery Benefits, that invoices received are accurate and in compliance with the Agreement, and that the custodial account is properly reconciled at the end of the plan year.

There are three types of FSA accounts; a Medical FSA to cover qualified medical, dental, and vision expenses; a Limited Medical FSA to cover qualified dental and vision expenses; and a Dependent Care Account to cover expenses incurred for the care of a qualifying dependent. The following chart reflects FSA activity from January 1, 2010 through June 30, 2013:

Plan Year	Number of FSA Accounts	Fee for Program Administration	Payroll Deductions (Dependent Care)	Payroll Deductions (Medical, Dental, and Vision)	Total Payroll Deductions
2010	228	$ 13,499.20	$ 69,839.11	$ 311,474.58	$ 381,313.69
2011	216	12,890.00	70,129.11	287,518.24	357,647.35
2012	174	8,937.00	50,427.00	234,679.91	285,106.91
2013 (Jan - Jun)	166	4,693.50	18,521.87	70,822.45	89,344.32

Medical FSA Accounts

Medical FSA accounts are subject to a "use it or lose it" rule, meaning any contributions by an employee for which a qualified expense is not incurred are forfeited at the end of the year and retained by OCTA. Likewise, employees may claim expenses equal to their entire annual contribution prior to funding the full election amount through payroll deductions. If an employee separates from service, he or she does not have to repay the money to OCTA. For this reason, OCTA maintains $40,000 on deposit with Discovery Benefits. At the end of the plan year, OCTA receives an accounting of the amounts deposited versus claims paid and will receive a check for forfeited amounts or an invoice to restore the account to the agreed-upon $40,000.

Objectives, Scope and Methodology

The objective was to evaluate oversight controls and contract compliance related to the FSA.

The review methodology included, but was not limited to, the following:

- Interview of applicable personnel to obtain an overview of the FSA program and related contract oversight;
- Review of the Agreement between OCTA and Discovery Benefits to identify key contract requirements;
- Review of FSA desk procedures to identify controls;
- Review of a sample of employee enrollment and benefit election change transactions to determine accuracy and compliance with regulatory threshold amounts;
- Review of general ledger reconciliation of FSA program payments;
- Review of a sample of invoices to determine accuracy, compliance with key contract provisions, and evidence of proper approval;
- Review of documentation related to bi-weekly payment reconciliation and year-end reconciliation of the deposit held by the third party administrator.

The scope was limited to employee FSA program activity from January 2012 through April 2013, and the year-end close-out process for 2010 through 2012.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Internal Audit believes the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Comment, Recommendation, and Management Response

Reconciliation of Deposit Account and Bi-Weekly Payroll Deductions

During the year, the third party provider receives and applies bi-weekly payroll payments and provides detailed reports of FSA account balances by employee. In addition, OCTA maintains $40,000 on deposit with the third party provider for the purpose of paying eligible medical FSA claims prior to receipt of employee payments. At the end of each year, the third party provider sends an accounting of the excess or deficit of funds in the deposit account.

At the time of review, there were inadequate controls in place to reconcile bi-weekly payroll payments and the annual statement of deposit account. Internal Audit obtained the annual statements for the years 2010 and 2011, and noted differences between the deposits recorded in individual FSA accounts versus the bi-weekly payroll payments recorded in the OCTA payroll system. The 2012 statement had not yet been received.

Before this report was finalized, staff received the 2012 statement and reconciled all three annual statements, noting an unidentified difference of $50 in 2011.

Recommendation 1:

Internal Audit recommends that management implement controls to ensure reconciliation of bi-weekly payroll payments and the annual statement of deposit account.

Management Response:

Management agrees that the controls in place to reconcile the bi-weekly payroll payments and the annual statement of deposit account were inadequate. Management has created an FSA Reconciliation Desktop Procedure which outlines the purpose and the written process to reconcile bi-weekly payroll payments and the annual statement of deposit account.

Management has created a report that is updated on a bi-weekly basis that will be used to document the reconciliation process for the payroll payments. The report includes the bi-weekly payroll deductions, the amounts received by Discovery Benefits, the date reviewed and reconciled, and the person who verified the process. This report was prepared and data has been confirmed beginning January 1, 2012, to the present.

Management has created a report to document the annual statement of deposit account. The annual statements for Plan Years 2010, 2011, and 2012 have been reconciled.