

S U M M A R Y M I N U T E S

REGULAR MEETING OF THE AUDIT OVERSIGHT COMMITTEE
ORANGE COUNTY, CALIFORNIA



Wednesday, May 22, 2013, 1:30 p.m.

HALL OF ADMINISTRATION
333 Santa Ana Blvd., 3rd Floor
CEO Main Conference Room
Santa Ana, California 92701

Supervisor Shawn Nelson
Chairman

Dr. David Carlson, Public Member
Vice-Chairman

Supervisor Pat Bates
Member

Jan Grimes, CPA
Auditor-Controller
Member

Michael Giancola
County Executive Officer
Member

Shari L. Freidenrich, CPA
Treasurer-Tax Collector
Member

Philip Cheng
Performance Audit Director
Ex-Officio Member (non-voting)

Sarah J. "Sally" Anderson, CPA
Public Member

Bruce Hughes, CPA
Public Member

Mark Wille, CPA
Public Member

ATTENDANCE: Shawn Nelson, Don Hughes as Proxy for Pat Bates, Jan Grimes, Shari Freidenrich, Michael Giancola, Bruce Hughes, David Carlson, Philip Cheng

EXCUSED: Mark Wille, Sally Anderson

PRESENT: Director of Internal Audit Dr. Peter Hughes, CPA
County Counsel: Ann Fletcher
Clerk: Renee Aragon

1:30 P.M.

1. Roll Call

Attendance of AOC members is noted above.

Internal Audit staff – Mike Goodwin, Dave Wiggins, Michael Dean; Auditor-Controller Staff –Denise Steckler, Victoria Ross, Nancy Ishida, Toni Smart; External Auditors Vavrinek, Trine, Day – David Showalter, Kevin Pulliam, Roger Alfaro

2. Approve Audit Oversight Committee regular meeting minutes of February 27, 2013

Motion-Carlson, Second-B. Hughes, Yes-Nelson, Yes-Grimes, Yes-Freidenrich, Yes-Giancola, Yes-Don Hughes (Proxy for Bates), Excused-Wille, Excused-Anderson

Approved as Recommended

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3. **Receive Required Communication from External Auditors Vavrinek, Trine, Day & Company, LLP**

Motion-Grimes, Second-Carlson, Yes-Nelson, Yes-Giancola, Yes-B. Hughes, Yes-Freidenrich, Yes-Don Hughes (Proxy for Bates), Excused-Wille, Excused-Anderson
Approved as Recommended

Mr. Kevin Pulliam, Partner, Vavrinek, Trine & Day (VTD), discussed the Management Letter and Single Audit Report (SAR). Mr. Pulliam stated that for Fiscal Year 11-12 the County had approximately \$624M in expenditures of federal funds. Mr. Pulliam referenced the Summary of Audit Results (SAR) on page 27 of 46, item 3. He stated there were two opinions. The first was the unqualified opinion for the CAFR of Internal Controls over Financial Reporting. There was no material weaknesses identified. There was one significant deficiency that was discussed at the AOC meeting on February 27, 2013 that related to cash and investments and reported in the financial statement.

Mr. Pulliam stated the second opinion in the report was an unqualified opinion over federal grants. No material weaknesses were identified. There were some significant deficiencies and some instances of non-compliance. The findings summary specified the federal FDA number and specific information and detail regarding formulas, criteria, condition, cause and effect. Findings 2 through 12 had instances of non-compliance. The Summary of Programs listed the grants tested for the FY11-12 SAR. Because of the \$625M in federal expenditures, the County was identified as a Type A program. Also, the County was considered a low-risk auditee.

Mr. Pulliam stated an important element in determining the low-risk status was because the County filed its reports on time. He said if the County filed late, it would have automatically been classified as a high-risk auditee. The penalty would have been significant because of the size of the County. There was a requirement to test 25% of overall federal expenditures as a low-risk auditee. If the County had been classified as a high-risk auditee, the testing requirement would have been increased to 50%.

Supervisor Nelson asked if VTD was satisfied that the County was addressing the significant deficiencies they reported upon. Mr. Pulliam stated he was. He said the next auditor has a requirement to follow-up on each of the prior year findings and report on any activity.

Mr. Pulliam said the Management Letter contained additional findings and management responses were provided for those findings.

Dr. Carlson asked VTD if there were any items of material concern related to the information presented. Mr. Pulliam stated there were no material weaknesses identified in the Single Audit Report or the Management Letter. Dr. Carlson asked if there were any ad hoc material issues. Mr. Pulliam stated there were none.

Mr. Pulliam thanked the Audit Oversight Committee members for allowing VTD to be of service over the last few years. He notified the AOC that it was their last meeting they will attend as the external auditors for the County.

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4. **Receive and file the Internal Auditor's Annual Report for Fiscal Year ended June 30, 2012.**

Motion-Carlson, Second-Grimes, Yes-Nelson, Yes-Giancola, Yes-B. Hughes, Yes-Freidenrich, Yes-D. Hughes (Proxy for Bates), Excused-Anderson, Excused-Wille
Received and Filed.

Dr. Hughes presented the Internal Auditor's Annual Report for Fiscal Year ended June 30, 2012. Dr. Hughes stated the Internal Audit Department made a concerted effort to have a presence in all county departments on a rotational basis. Starting with areas identified as high risk through the annual risk assessment. He said the audit coverage was broad and diverse in financial, information technology, internal control, compliance and revenue audits. 40 audits were completed including eight special requests by the Board. Internal Audit performed an exhaustive review of the Sheriff's cost accounting system as a special request by the AOC. The system was used to bill 12 different cities for police services. The review was complex because of State statutes with prohibitions and mandates to ensure there would be no over-billing or under-billing of services.

Dr. Hughes also stated John Wayne Airport completed a \$543M airport expansion that was on-time and under budget. The Change Order approval process was audited and there were no exceptions found. He said approximately \$60M in Change Orders were submitted during the course of the expansion. The change orders were accurate, legitimate and defensible. Mr. Giancola suggested standards from JWA be used in other departments such as OC Public Works and OC Waste & Recycling for their Change Order processes. Dr. Hughes felt John Wayne Airport had a high 5 rating for their processes. Dr. Carlson stated the seven-page Follow-Up Audit Report had several recommendations and wondered if JWA was truly deserving of a perfect 5. Dr. Hughes stated he would concede to 4.9. He said JWA had a formal self-critique process that identified deficiencies and corrected them where needed.

Dr. Carlson stated the audit was first requested 15-18 months prior when there was yet another \$150M to be spent on the expansion. He said the audit covered processes for the largest project in the history of the County and unfortunately there was no chance for any of the findings of the audit to have any impact on the way the County spent any of the \$543M. He said there may be a combination of lack of resources and the prioritization of those resources and asked Dr. Hughes to comment. Dr. Hughes said when he first started in 1999 Internal Audit had 22 FTEs and was down to 15 now. Through a variety of budget cuts, Internal Audit had realized a loss of approximately 30% of staff. Internal Audit worked harder and smarter as a result of the losses however cannot do the impossible. There were competing demands on audit resource time and often with time sensitive pressures. Because of the recent issues with the VLF, Internal Audit along with all other County departments was faced with an additional 5% budget cuts. For Internal Audit it equated to another loss of 1 FTE. Dr. Carlson stated he was happy the audit did not reveal, after the fact, weaknesses in controls.

Dr. Carlson asked how the lessons learned were transferrable to future projects and who would own the transfer. Dr. Hughes stated the full audit report was routed to every department head as well as being posted on the Internal Audit Department website for easy access. Additionally, Dr. Hughes stated the Follow-Up audit process ensured corrective action was taken. Dr. Carlson asked the new CEO, Mr. Giancola, if he had any comment. Mr. Giancola stated he, as a department head, would look at the audits circulated to what was applicable to his organization.

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He said formalizing process improvements was a best practice from lessons learned. Supervisor Nelson stated the County should capture the staff and model from the positive results of the John Wayne Airport expansion and use it for other large construction efforts countywide. He stated it could be an opportunity for success from lessons learned. Mr. Giancola stated as a department head of OC Waste & Recycling, in his first four years over the department 9 of 10 Program Managers left and had to be replaced due to retirement. He said discussion groups that included OC Public Works, Sheriff-Department, and John Wayne Airport got together to examine best practices and standardization. The project manager tasks were very similar. Dr. Hughes stated that JWA had both solid controls and competent personnel to enforce them.

Supervisor Nelson stated that if a critical person over a key County system was forecasted to retire because of age 55 or 33.33 years of service management should be alerted to identify succession planning timely. His concern was the County had key vulnerabilities that may not be obvious in time triggers. Dr. Hughes stated a component of the Internal Audit risk assessment was to examine key personnel turn-over in management positions.

Dr. Carlson thanked the Members for the thoughtful and responsive dialogue to his questions.

5. Approve the Internal Audit Department's Audit Plan and Risk Assessment for FY 13-14.

Motion-Carlson, Second-B. Hughes, Yes-Grimes, Yes-Nelson, Yes-Giancola, Yes-D. Hughes (Proxy for Bates), Yes-Freidenrich, Excused-Anderson, Excused-Wille
Approved as Recommended

Dr. Hughes explained the annual risk assessment and audit plan process. He said Internal Audit evaluated materiality in terms of dollars and exposure. He said Internal Audit incorporated some small dollar audits into the plan but not at the exclusion of large dollar audits. He explained the high, medium and low ratings of the risk assessment as well as prior audit coverage. Mr. Bruce Hughes asked if risk factors were discussed with departments after or during the risk assessment process. Dr. Hughes stated communication was shared during and after the process.

Mr. Bruce Hughes asked if departments ever disagreed with risk factors. Dr. Hughes stated Internal Audit had not received any disagreement and felt departments were well informed during the process and were understanding of what the process was about. Dr. Hughes stated departments welcomed reoccurring audit presence. Dr. Hughes noted that departments were requesting audits more frequently and recognize the valuable resource available to them. Mr. Giancola said a good portion of the audits listed in the audit plan were from department requests. He said the County was self-policing and invited internal audits and performance audits. Ms. Freidenrich asked if a department audit request from a low-risk area was accommodated over another audit in a higher risk category. Dr. Hughes stated Internal Audit would not budget audit resources for an audit that they didn't feel was a priority. Audit judgment and discretion was used with other competing areas when planning the audit coverage each year. Dr. Hughes stated the whole process was a shared collective effort. He stated all requests for audits were weighted against competing risks and ranked accordingly.

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6. **Receive and file the Auditor-Controller's Internal Audit Charter and Audit Plan for Auditor-Controller Mandated Audits FY 2013-14.**

Motion-B. Hughes, Second-Freidenrich, Yes-Grimes, Yes-Giancola, Yes-Nelson, Yes-Carlson, Yes-D. Hughes (Proxy for Bates), Excused-Anderson, Excused-Wille
Received and Filed.

Ms. Grimes discussed the Auditor-Controller's Internal Audit Unit Charter and FY 13-14 Audit Plan. She explained the Auditor-Controller Internal Audit Unit focused on the mandated audits as required by government code. She stated the audit plan detailed a scope and what would be included in their reviews of the Treasury audits, Probation Trust Funds and compliance auditing. Also attached was the estimate of hours for their plan.

Ms. Freidenrich stated the Auditor-Controller's Treasury Audit Review was requested by the Treasury Oversight Committee approximately 5 years ago. She stated the Internal Audit Department was contracted to perform the Annual Compliance Audit. She stated initially the TOC requested a monthly review from the Auditor-Controller's office for their review but it was changed to a quarterly basis a year ago.

Mr. Bruce Hughes asked for clarification of the Auditor-Controller Internal Audit Unit and the Internal Audit Department reporting to the Board of Supervisors. Chairman Nelson stated Orange County was different. He stated the organizational structure of the Internal Audit Department, Performance Audit and County Counsel all reported to the Board of Supervisors and had countywide authority on behalf of the Board. He said the Auditor-Controller's Internal Audit Unit reported directly to the elected Auditor-Controller.

Mr. Cheng asked if it was the first time the Auditor-Controller was presenting their Charter and requested clarification of the A-C presence in County operations. Ms. Grimes stated she reviewed her Charter annually and the scope of work was mandated by California Government Code and included areas of the Treasurer's office, Probation Department and other areas of the County. She stated their reports were distributed to the Audit Oversight Committee as well as the Board of Supervisors to address the reporting relationship.

7. **Discuss and consider changing ex-officio membership of Performance Audit Director to become a voting member (prior AOC meeting November 7, 2012)**

Motion-Nelson, Second-Giancola, Yes-Carlson, Yes-Grimes, Yes-D. Hughes (proxy for Bates), Yes-B. Hughes, Yes-Freidenrich, Excused-Anderson, Excused-Wille
Directive: Amend AOC Bylaws to reflect membership change to make Performance Audit Director a voting member and return to the next AOC meeting for approval.

Chairman Nelson motioned to change the Performance Audit Director as a voting member of the Audit Oversight Committee and return to the next AOC meeting with amended Bylaws for approval. Mr. Giancola seconded the motion. No opposition.

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8. **Approve OC Internal Audit Department FY 12-13 3rd Quarter Status Report for the period July 1, 2012 through March 31, 2013 and approve 3rd Quarter Executive Summary of Audit Finding Summaries for the period January 1, 2013 through March 31, 2013**

Motion-Nelson, Second- B. Hughes, Yes-Carlson, Yes-Grimes, Yes-D. Hughes (proxy for Bates), Yes-Giancola, Yes-Freidenrich, Excused-Anderson, Excused-Wille
Approved as Recommended

9. **Approve 3rd Quarter FY 12/13 External Audit Activity Quarterly Status Report for the quarter ended March 31, 2013**

Motion-Nelson, Second- D. Hughes (proxy for Bates), Yes-Carlson, Yes-Grimes, Yes-Giancola, Yes-B. Hughes, Yes-Freidenrich, Excused-Anderson, Excused-Wille

10. **Receive and file Summary Highlights of Audit Reports Issued by Month for July 1, 2012 to April 30, 2013**

Motion-Nelson, Second-Giancola, Yes-Carlson, Yes-Grimes, Yes-D. Hughes (proxy for Bates), Yes-B. Hughes, Yes-Freidenrich, Excused-Anderson, Excused-Wille

PUBLIC COMMENTS: None

AOC COMMENTS: None

ADJOURNMENT: 2:40 P.M.

NEXT MEETING: September 4, 2013, 1:30 p.m. REGULAR MEETING