

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

REGULAR MEETING OF THE AUDIT OVERSIGHT COMMITTEE
ORANGE COUNTY, CALIFORNIA



THURSDAY, February 20, 2014, 11:30 a.m.

HALL OF ADMINISTRATION
333 Santa Ana Blvd., 5th Floor
Conference Room A
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

Sarah J. "Sally" Anderson, CPA
Public Member

Bruce Hughes, CPA
Public Member

Mark Wille, CPA
Public Member

ATTENDANCE: Shawn Nelson, Jan Grimes, Michael Giancola, Mark Wille, Shari Freidenrich, Dave Carlson, Philip Cheng, Sally Anderson, Don Hughes as Proxy for Pat Bates

EXCUSED: none

ABSENT: Bruce Hughes

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

11:30 A.M.

1. Roll Call

Attendance of AOC members is noted above.

Internal Audit staff – Mike Goodwin, Alan Marcum, Michael Dean, Dave Wiggins; Auditor-Controller Staff – Denise Steckler, Victoria Ross, Autumn McKinney, Toni Smart, Tonya Burnett, Nancy Ishida; External Auditors Macias, Gini, O'Connell – Jim Godsey, Linda Hurley

2. Approve Audit Oversight Committee regular meeting minutes of December 4, 2013

Motion: Giancola, Second: Freidenrich. None opposed, item carried.

Approved as Recommended

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3. **Receive the Required Communication from External Auditors Macias, Gini & O'Connell (MGO)**

Received required communication as recommended.

Mr. Jim Godsey, Partner and Linda Hurley, Engagement Partner addressed the Audit Oversight Committee (AOC).

Ms. Hurley provided an update on the audit process. MGO had issued the Comprehensive Annual Financial Report (CAFR), Successor Agency, OC Waste & Recycling (OCWR) and John Wayne Airport (JWA) Financial Statements. The JWA report was issued in December 2013 and the other three were issued in January 2014. An "unmodified opinion" was issued for all of the reports. This is the highest level of assurance. The former term "unqualified opinion" was replaced with the term "unmodified opinion" under the new AICPA Standards. There were no modifications made to the opinion. MGO provided the opinion that the financial statements were materially in accordance with Generally Accepted Accounting Principles. The 2013 Single Audit is in process, and was anticipated they would complete the audit by the federal deadline of March 31, 2014.

Included in the packet was the required communications letter for 2013. Page 1, first section referred to four accounting standards that the County evaluated and implemented during FY 2013. Two of the standards which referred to GASB 60 and 62 had no significant impact on the financial statements. Under GASB 61, the County discovered that CalOptima was not included in the financial statements in accordance with GASB 14. The omission was technically an error. Therefore, it was restated in the CAFR but there was no impact on the County's general operations. Because of the dollar amount and the size of CalOptima it was considered a restatement. The criteria that triggered the presentation was that the County Board of Supervisors could impose its will over the organization in their authority to appoint and remove Board Members of CalOptima. The omission of CalOptima was a "reportable transaction" to the State Board of Accountancy. It was reported in its own column as a discretely presented component unit and has no impact on the financial statements. There were no plans by MGO to issue an audit finding as it was immaterial. There were other Counties across the State that also had the same issue regarding Board control.

GASB Accounting Standard Changes issued guidance on evaluating accounting for and reporting on Pensions and their liabilities. The presentation today was in preparation for a new accounting standard that will be implemented in 2014. There will be changed terminology. "Net assets" will now be called "net position." The County will evaluate certain transitions recorded as assets and liabilities. They would then place those transactions in new sections on the Statement of Net Position define them as "Deferred Outflows of Resources" and "Deferred Inflows of Resources."

Under the new pension requirement the actuarial determined unfunded liabilities must be reported in the financial statements whereas before they were just mentioned in a footnote. The motive behind this change is to make this liability more transparent to the elected and their constituents.

Significant estimates in the financial statements and basis for those estimates were highlighted on page 2 of the report.

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MGO reported on adjustments to the financial statements and stated corrected and uncorrected misstatements were noted on page 3. Several adjustments were identified during the audit but none of them were considered **material**. They were corrected or recorded in the financial statements. The adjustments related to capital assets, accreted interest on capital appreciation bonds and several year-end accrual items. One reclassification was noted related to capital assets and managements analysis of capital assets that was not recorded in the financial statements. Management identified capital assets that were not owned by the County when they performed extensive analysis on capital asset activities. The capital asset balance was appropriately reduced. The offset of that entry was a reduction to current year expenditures. Some items were acquired in prior years and the correct entry would have fallen under beginning net position. MGO did not consider it material and it did not affect their opinion.

MGO reported on Internal Controls. MGO did not identify any **material** weaknesses in internal control or material non-compliance. MGO obtained more information during the audit process since reporting at last AOC meeting. The results of their investigation found that the issues did not rise to the **material** level. Four “significant deficiencies” in internal controls were identified. One of the significant deficiencies was related Capital Assets including timely recording of asset transfers to outside agencies, completion of Capital Assets and when they are transferred to depreciable category, and ownership of Capital Assets and timely capitalization of qualifying expenditures. They did not result in a **material** misstatement. If not corrected, another evaluation will be conducted.

Mr. Wille motioned the Capitol Asset deficiencies identified be placed on the agenda for monitoring by the AOC until the external auditors (MGO) were satisfied that management had addressed the issues. The motion was seconded by Dr. Carlson. None opposed, the motion carried.

MGO extended their appreciation to the Auditor-Controller and staff for their assistance during the audit.

4. **Receive and file the Semi-Annual OC Fraud Hotline Activity Report for the Period July 1 to December 31, 2013**

Received and filed as recommended.

Dr. Hughes introduced Dave Wiggins, OC Fraud Hotline Manager. Mr. Wiggins stated the purpose of the hotline was to prevent and detect fraud, waste, and abuse Countywide.

Mr. Wiggins reported the use of the hotline was expanding considerably. 178 reports in six months were doubled from the prior year reporting. General discussion was held concerning employee frustrations over protracted contract negotiations with the unions and the County’s fiscal inability to offer larger pay increases as a possible explanation of increased complaints regarding management. Media and blogs lead employees to believe the County was anti-employee when in fact the County’s resources do not enable it to both cover the rising cost of health and pension benefits and large pay increases too. It was noted actionable items and substantiated claims had significantly increased. Dr. Hughes stated fraud that involved theft was rarely reported. The increase in the numbers of complaints was not an indication of “out of control” situations in the County. Not one of the complaints involved theft of County assets. Many calls were referred to other agencies in the County. Referrals were generally directed toward welfare fraud or white-collar crime. Often, human resources issues were referred to Human Resource Services or the EEO office. Coordination was handled between IAD and those offices. General explanation

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was given concerning pending investigations. Approximately half of the pending items were closed since January 1, 2014.

Mr. Wille requested clearer categories to capture anonymous reporting versus the situation where the complainant identified themselves but requested to be kept anonymous.

Supervisor Nelson would like IAD to continue to track trends and expressed a belief that the number of Hotline complaints about management would decrease once contracts acceptable to the unions were agreed upon.

5. **Receive AOC Subcommittee on Ethics and Fraud Recommendations as follows: A)** Receive and file AOC Subcommittee on Fraud and Ethics meeting notes of December 23, 2013, **B)** Recommend that the Director of Internal Audit seek County Counsel input on the following: 1) Any proposed name change; 2) How best to ensure confidentiality of hotline complaints and associated supporting documentation; 3) Determine if any legal requirement exists to investigate anonymous complaints; and 4) Discuss the above results with the Compliance Oversight Committee, **C)** Discuss with other County departments that administer their own hotlines their interest and possible benefits in the consolidation of all contract services with one vendor; and **D)** Recommend that the Director of Internal Audit test a proposed name change of the OC Fraud Hotline and report results at a future AOC meeting.

Approved as recommended.

Motion: Carlson, Second: Anderson. None opposed, item carried.

The AOC Subcommittee reported on their meeting activity and recommended the name change from **OC Fraud Hotline** to **Fraud, Compliance and Ethics Hotline**. Internal Audit will report back on a future date the progress of the recommendations.

6. **Receive Open Item of Audit Recommendations not Implemented from Second Follow-Up Internal Control Audit of OC Public Works Countywide Fleet Management and Recommend Memo to Audit File.**

Received as recommended.

Dr. Hughes explained what the follow-up process was for all recommendations identified in the audits. For most items where a recommendation was not implemented, circumstances may be more involved or the issue more complex taking more than the usual six to 12 month implementation follow-up period. In such matters, after the second follow-up audit was performed, any open items were brought back to the AOC for discussion per their direction. Dr. Hughes stated the purpose of bringing forward to the AOC all unimplemented audit recommendations was to ensure no weakness would go uncorrected due to insufficient oversight and county support.

Mr. Silsby, Director of OC Public Works, stated that five of the seven recommendations in the audit were implemented. He noted two recommendations were outstanding items. In 1989, County policy stated centralized Fleet Services was under the General Services Agency, however that agency no longer exists. The subsequent actions of County reorganizations over the years placed the Fleet Services responsibility under the current OC Public Works Director. In response to the outstanding recommendations, Mr. Silsby stated OCPW would collaborate with the CEO office to present a memo to all Department

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Heads to restate the CEO's expectation. A subsequent memo would be issued by OCPW to Department Heads delegating authority for all assignments of staff to vehicles and actions thereafter. Mr. Silsby explained that currently Fleet Services is centralized under OCPW. He stated OCPW would set clear specifications of vehicles makes and models, purchase vehicles and maintain the vehicles as much as possible. Revised policy would allow better training of mechanics and appropriate stocked equipment and parts for maintenance of vehicles. The revised policy would prevent the purchase of vehicles not identified in specifications that would require outsourcing for maintenance or parts.

It was noted that the Performance Audit Department was conducting an audit of the same subject and was examining standardization, utilization and procurement. PAD would provide further recommendations as necessary. It was stated by the AOC that the open items were addressed and the risk was managed and no further report to the AOC was required.

7. Receive Open Item of Audit Recommendations not Implemented from Second Follow-Up Financial and Internal Control Audit of Treasury Cost Allocations to Pool Participants and Recommend Memo to Audit File.

Received as recommended.

Ms. Shari Freidenrich, Treasurer-Tax Collector (TTC), addressed the open audit recommendations. The audit issued was related to FY 08/09. Thirteen total findings and recommendations were presented in the audit. Three of the thirteen were directed toward the CEO. The three open items were cost allocation process, documentation of that process and the timeliness of the process. It was reported good progress was made on establishing a complete, reasonable, and auditable cost allocation process on the fee charged to all investment pool participants. It was reported the system processes were no longer vulnerable to errors that created over or under charges of the investment fee required to be reconciled from estimate to actuals annually. An independent firm was selected from a competitive bid process to conduct a fee study. It was estimated the fee study would be completed in several months. TTC was in the process of completing their policies and procedures of the complex cost allocation process for all fees. It was stated that upon completion the remaining open items would be resolved by IAD in normal course of their scheduled audits.

8. Receive Verbal Status of Internal Audit Department Peer Review.

Received Verbal Status.

Professional and government standards require that the Internal Audit Department receive a peer review every three years. As part of the California Counties Audit Chief's Committee Peer Review group, Fresno County agreed to conduct the quality assessment. Fresno County was a little delayed because of their CAFR issues. The peer review was 70% near completion.

Fresno County planned interviews of selected AOC members and the Board of Supervisors in March or April 2014. It was anticipated the final peer review would be completed by April 2014 and provided to the AOC and BOS this May.

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9. **Approve OC Internal Audit Department FY13-14 2nd Quarter Status Report for the period July 1, 2013 through December 31, 2013 and approve 2nd Quarter Executive Summary of Audit Finding Summaries for the period July 1, 2013 through December 31, 2013.**

Motion: Wille; Second: Grimes. None opposed. Item carried.

Chairman Nelson requested Dr. Hughes to address the topic and transition at the next meeting.

It was reported the Public Administrator Public Guardian audit was terminated due to reorganization. In accordance with standards, IAD provided a Termination Letter that included ten preliminary findings. Although the audit was not completed, IAD was responsible to bring the issues to management's attention to pursue and or confirm or correct.

Dr. Carlson stated the preliminary findings in the audit termination letter related to information technology with significant limitations, 176 backlogged court accountings, lost assets associated with warehouse relocation, and the handling of firearms. Dr. Carlson noted that the Termination Letter stated the inventory clerk had minimal training and that multiple staff had access to the vault; there were not any policies and procedures for physical inventory counts and there were no reconciliations of records. Dr. Carlson stated the lapses noted in the processes for handling firearms and physical inventory reconciliation to the records was his main concern.

Chairman Nelson stated the District Attorney's (DA) office would be handling the Public Administrator's (PA) role and felt comfort that the investigators had extensive training with firearms and that the concerns expressed in the Termination Letter would be addressed. He noted that the Board of Supervisors had just transferred the PA responsibilities for reasons expressed in the Termination Letter and other concerns. The DA has an intricate system for maintaining evidence for such cases as related to murder. The new system of the PA under the DA was yet to be determined because the transfer was still in process.

Dr. Hughes stated IAD was coordinating with the DA, Health Care Agency (HCA), and PAPG offices to facilitate the transition and would follow through with the issues raised.

Mr. Wille asked how long before the new systems would be in place. It was speculated half a year or more. Dr. Hughes stated it would be a work in process. Mr. Wille suggested a review be placed on the audit plan in six to twelve months.

Dr. Carlson felt waiting twelve months for an audit was too long. He expressed strongly that internal audit and management must secure the safety of the firearms immediately and not in weeks or months. Chairman Nelson clarified that a re-audit in a year did not mean "nothing" was being done immediately to secure the safety of the firearms. Dr. Carlson said that at this point in time there was no one in the DA office that was accountable for the firearms in the vaults today and it seemed the vulnerabilities still remained.

Mr. Giancola explained the Public Administrator (PA) function was transferring to the DA and the Public Guardian (PG) function was transferring to the Health Care Agency (HCA). A team that consisted of IAD, PG, and HCA was in place for the transition. He stated all the preliminary findings on the letter would be addressed as part of the transition. He stated when the PA function transfers to the DA, IAD will also be part of that transition team so that all preliminary findings would be addressed.

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Dr. Carlson stated his concern was over the weaknesses that now existed and not what will happen in the future. Mr. Giancola stated there wasn't a definitive date for the transfer completion. He stated he wasn't sure when a future audit should be done. Dr. Carlson stated it wasn't a future audit issue; it was an issue of the weakness present "right now."

Dr. Carlson requested the record reflect that a weakness he felt to be important enough to bring to some next level of immediate action which was not supported by the Chairman for further discussion. Chairman Nelson did not agree with Dr. Carlson's comment and said that was not what he meant. He stated that each preliminary finding would change with the transition and that although they could not provide an exact date of resolution, it would be done quickly. Dr. Carlson stated he had not heard the word "quickly." Chairman Nelson stated that is what he meant in his discussion and that he expected the DA to resolve the "security" concerns of the firearms "quickly" with this clarification.

Chairman Nelson requested Dr. Hughes to address the topic with the DA and HCA immediately and report back to AOC at its next meeting.

10. Approve 2nd Quarter FY 13-14 External Audit Activity Quarterly Status Report for the Quarter Ended December 31, 2013.

Motion: Freidenrich; Second: Giancola. None opposed, item carried.

Mr. Michael Dean reported the last quarter had 117 audits and five audits were added for the reporting quarter. Also 13 audits were dropped leaving 109 audits for the quarter. Of the 109, 30 were from MGO, 60-70 by federal and state audits, and 10 audits by IAD. Fifteen audits were completed on the quarter. There were no material items.

11. Receive and file Summary Highlights of Audit Reports Issued by Month for FY-13-14 July 1 to January 31, 2014.

Receive and file as recommended.

12. Nominate and appoint Chairman and Vice-Chairman for the 2014 Audit Oversight Committee.

Appointed Mark Wille, Public Member, as 2014 AOC Chairman and appointed Shari Freidenrich, Treasurer-Tax Collector, as 2014 AOC Vice-Chair.

Ms. Sally Anderson nominated Mark Wille as 2014 AOC Chairman. Mr. Wille accepted. Second: Giancola. None opposed,

Dr. Carlson nominated Shari Freidenrich as 2014 Vice-Chair, she accepted. Second Giancola. None opposed.

PUBLIC COMMENTS: *At this time members of the public may address the AOC on any matter not on the agenda but within the jurisdiction of the AOC. The AOC may limit the length of time each individual may have to address the Committee*

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AOC COMMENTS: None

ADJOURNMENT: 1:03 p.m.

NEXT MEETING: June 3, 2014