

# 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, September 2, 2009, 1:00 p.m.*

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

TELECONFERENCE LOCATION: IHS, Inc.  
15 Inverness Way E  
Englewood, Colorado 80112

**Supervisor Patricia Bates**  
Member

**Supervisor Janet Nguyen**  
Member

**David Sundstrom**  
Chairman

**Thomas G. Mauk**  
Member

**Dr. David Carlson**  
Vice Chairman  
Public Member

**Chriss Street**  
Ex-Officio Member (non-voting)

ATTENDANCE: David Sundstrom, Chriss Street, Tom Mauk, Bob Franz (Proxy), Dr. David Carlson

EXCUSED: Pat Bates, Janet Nguyen, Tom Mauk

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

**1:08 P.M.**

1. Roll Call

Internal Audit Department: Peter Hughes, Eli Littner, Mike Goodwin, Autumn McKinney, Alan Marcum, Camille Gackstetter, Ken Wong; Auditor-Controller and staff: David Sundstrom, Shaun Skelly, Nancy Ishida, Ila Patel, Megan Nguyen, Christina Young, HCA/Accounting: Kim Engelby, Howard Thomas; Health Care Agency: Bob Wilson, Treasurer-Tax Collector and staff: Chriss Street, Paul Gorman; County Executive Office: Tom Mauk, Bob Franz (Proxy received for Tom Mauk); County Counsel Office: Ann Fletcher; Public Member: Dr. David Carlson (Teleconference participation); Vavrinek, Trine, Day & Co.: Roger Alfaro; Kevin Pulliam, Fifth District: Don Hughes; Second District: Lindsay Brennan; Grand Jury: John Cole, Rich McCarthy;

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2. Approve Audit Oversight Committee Minutes of May 27, 2009  
VOTE: Motion-Carlson, Second-Franz (proxy for Mauk), Sundstrom-Yes, Hughes-abstain (proxy for Bates), Nguyen-abstain  
**Approved.**

NOTE: Date correction on the agenda to read: Approve Audit Oversight Committee Minutes of May 27, 2009.

3. Receive SAS 114 Required Communication from External Auditors Vavrinek, Trine, Day & Company, LLP  
**Received**

Mr., Kevin Pulliam addressed the committee as required by the Statement of Auditing Standard 114 to keep the AOC inform of the external auditor's activities. Page 1 detailed the three auditors with in-charge auditor responsibilities over the audit. Pages 2 and 3 detailed the scope of services for the audit being performed. Mr. Pulliam stated the external auditors were required to outline their responsibility under the Generally Accepted Auditing Standards (GAAS) that they provide reasonable but not absolute assurance for the entities that they audit. They consider the internal controls in the areas they audit but do not provide an opinion over internal controls. As noted on page 4, VTD would express an opinion on compliance that was applicable over programs for OMB Circular A-133. On Page 5, all disclosures would be provided at the end of the audit.

Dr. Hughes asked for an example of a qualitative aspect of accounting policy. Mr. Pulliam stated that within that communication if there was a significant footnote disclosure within the annual financial statements such as a new standard adopted or a retroactive impact from a prior year adjustment, VTD would have to address it in their letter to the Board at the end of the audit.

Dr. Hughes asked if VTD would bring to the AOC's attention if a situation where a choice of policy or interpretation would have a material impact on the financial statements where there were options available to the external auditor. VTD stated things were fairly defined within the standards within the new pronouncements coming up. If there were something where an option was there, they would make it known. If VTD was silent on it, it would be assumed that they were following the technical pronouncements that GASB prescribed.

Dr. Hughes asked VTD to speak about SAS 99 and Management override in terms of controls. Mr. Pulliam stated they assessed risk and design the audit testing to address identified concerns.

Mr. Pulliam stated page 6 detailed the timeline. Page 7 provided detail of interim and final status related to the Single Audit.

Mr. Alfaro offered to provide highlights from the AICPA National Governmental Update related to the American Reinvestment and Recovery Act dollars hosted in Washington DC. The AOC agreed to receive the information.

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Mr. Alfaro stated VTD attended the event to hear directly from the standard-setters themselves related to the American Recovery and Reinvestment Act Boards (ARRA Funds). Specifically for the June 30, 2009 audit, there were significant amount of changes related to the recovery dollars as a component over VTD's overall audit planning process. A key point from the Federal perspective over the recovery act funds (RAF) funds was that they would have unprecedented level of accountability and transparency to the public. The Federal government had set up various and variety of websites over time that accumulate data to present to the public at a very detailed level the types of projects occurring in their communities and surrounding cities and within the state in general. The Inspector General's office was already conducting reviews of certain governmental agencies to see how the federal dollars were being spent. The secondary component to the Recovery Act related to reporting. The reporting will be structured in phases. VTD would bring an opinion on compliance for major federal programs for the single audit, but in addition RAF established a reporting for agencies that received RAF funds for the first quarter ending September 30, 2009. Government had 10 days to report use and dollars for expenditures of the program (1512 reporting). There would be no waiver for the time line. The federal government stressed that by not filing the 1512 reporting, it would be considered a violation of the grant agreement. It was expected that the agencies that received the program funds report on them according to the new deadlines.

Mr. Alfaro stated their audit prospective impact was that the federal program established new program codes taking existing programs and added RAF funds to them and in addition they did grouping of programs known as clusters. The federal established any RAF funds within any of the flows would be considered high risk. Therefore, it increased program areas in the risk assessment process and those programs were subject to audit for the year.

Mr. Alfaro stated the federal government was sending information frequently. New guidelines for auditors to consider were recently published in terms of planning and conducting audits under the single audit act ending June 30, 2009.

Mr. Sundstrom asked if most of the information provided was perspective being that they were going into the next year, reporting on last year. Mr. Alfaro stated that with regards to the RAF funding there was a portion of the funds awarded as of June 30, 2008 and there may not had been any expenditures incurred on those funds, but because of the new 1512 reporting period those funds would be subject to that reporting.

Mr. Pulliam added that the reporting would be done quarterly and rules had not been established for the auditors for the 063009 audit had to take a look at quarter taking place after 063009. Mr. Pulliam stated it was clear that the policies and procedures and rules drafted were by no means done. By the time they get to the 063010 audit, they expect new policies where the external auditors would have to go back and look at the quarterly reporting. It should also be noted that the quarterly reporting was cumulative and not the specific quarter end. Also, because no waivers were being granted, they understood it may take a few quarters to get the quality of data where they want it. Additionally, it was expected that prior quarters may need to be cleaned up.

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Mr. Pulliam stated the discussion led to perspectives and the uniqueness of the dollars and there would be unique rules and how they would be recorded and ultimately governed. He stated that it was clear that within the schedule of the federal expenditures or awards that where some RAF funds were attached a separate line item that specified with an ARRA after it had to be detailed because they were reinvestment funds and would need to be identified.

Mr. Sundstrom stated it was obvious that expediting the reporting of the dollars was paramount to everything they were doing.

4. Receive Status of the Structured Investment Vehicles (SIV) Held in the County's Investment Pool (continued from AOC 9/17/08, Item 6, 5/29/08, Item 5, 2/28/08, Items 6 and 8, 12/11/09, Item 3, 3/25/09, Item 4, 5/27/09))

**Status Received.**

Mr. Street introduced Paul Gorman, Assistant Treasurer, to provide the status of the Structured Investment Vehicles (SIV). Mr. Gorman stated since the last AOC meeting just a few SIV's remained that matured in June 2009. K2 (USA) LLC holding of \$25 million matured June 9, 2009 with all principal and interest paid. Tango Finance Corporation holding of \$50 million matured June 10, 2009 with all principal and interested paid. Whistlejacket was restructured to a new entity named Serpentine Funding Limited in May 2009 instead of settling for a recovery of 80% on the dollar. There was no receiver associated with Serpentine Funding Limited which was managed by Goldman Sachs. Unrecovered principal is \$51,558,961. Mr. Gorman stated monthly payments were based upon the County's share of the collections of the underlying investments of Serpentine.

5. Receive, discuss and approve response from AOC on Compliance Audit of Board's Audit Oversight Committee as of May 209 (Audit No. 2807-13)

VOTE: Motion-Carlson, Second-Sundstrom, Franz (proxy for Mauk)-Yes, Bates-yes, Nguyen-yes

**Approved**

NOTE: Mr. Sundstrom moved to accept Dr. Hughes report responding to item 1 to perform a self-assessment. In the response to item 1, he would use the Internal Audit report and the audit oversight committee matrix that Mr. Sundstrom prepared in order to make the self assessment.

Dr. Hughes discussed the background of the audit. He stated a number of professional associations put out advisories, guidelines and recommendations based on audit committee structures. In the course of discussing the Bylaws, Charter and administrative rules with the new AOC members, it was timely to assess the compliance of the AOC with its own Bylaws, resolutions, charter and applicable administrative rules. Dr. Hughes noted that the audit found that the AOC had complied fully with its own rules. As an added tool and aide to the AOC compliance audit, a research study conducted by the Association of Government Auditors (AGA) integrated 5 different check lists for government entities for effective audit committees to consider. Eight recommendations were presented for the AOC to consider. They had not presented deficiencies or defect.

Dr. Hughes stated he worked with Mr. Sundstrom on the issue and that Mr. Sundstrom would provide a self-assessment using the Government Finance Officers Association

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(GFOA) template. Dr. Hughes stated for the most part he was in agreement with what Mr. Sundstrom provided and that the AGA study had included most aspects of the GFOA template already.

Mr. Street asked if there were standards established. Dr. Hughes stated there were none; only recommendations and best practices from various associations. He stated they all converged on common issues but no specific standards were required of the AOC.

Dr. Carlson stated the authoritative reference in the transmittal letter was troublesome if the Association of Government Auditors (AGA) research report was not approved by a standards or governance body.

Dr. Hughes stated the AGA was not a standards setting body any more than the GFOA or the Association of Local Government Auditors (ALGA). The choice of the word authoritative was meant to say the professionals that contributed to the research study felt the results were best practices for consideration only. Dr. Hughes stated there was no authoritative body dictating to any entity what must be the characteristics of an audit oversight committee.

Mr. Sundstrom stated that in terms of auditing standards, we were dealing the government accountability office and the institute of internal audits and his view was as an audit committee we are the governors and they are the governed so it was not appropriate for the governed to necessarily establish auditing standards. The AGA had large membership from the federal community and not the local community. By comparison the AGA report had little bits of this and that rather than having a system. He felt the GFOA more closely represented his views and interest and found a recommended practice for audit committees with the most recent revision in 2008. He felt it was up to the audit committee to select which items would most benefit them. Mr. Sundstrom prepared a matrix based upon the GFOA document and also took what Dr. Hughes presented in his report and added some of it. Mr. Sundstrom felt as a committee, it should set itself up against some set of standards and make choices of how its charter should read. He felt it should all be on the table even if they aren't selected to look at the items and make some decisions. Mr. Sundstrom added some views of the AICPA because they are a group that sets auditing standards.

Mr. Sundstrom handed out the GFOA Best Practice for Audit Committees document. He also distributed an Elected Officials Guide to Audit Committees along with a matrix with highlights for the committee to use to evaluate where the AOC was against its recommended guidelines. Mr. Sundstrom requested a special meeting be scheduled to consider the material distributed presented at length. Following the special meeting to consider a charter, a draft charter would be brought back to the AOC contained the agreed upon changes for further discussion and approval.

Dr. Hughes felt most items from Mr. Sundstrom's matrix went hand-in-glove with his audit findings and AGA. He added the yellow observations that Mr. Sundstrom highlighted were mostly addressed in concept in the 8 recommendation of the audit report. Dr. Hughes felt Mr. Sundstrom's matrix added more detail and was a useful stand alone document. Dr. Hughes stated he selected AGA so as not to be prescriptive of only 1 set of guidelines. Rather he felt presenting 5 different templates would show common themes among them all.

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He added he fully supported the Board in doing a self-assessment against Mr. Sundstrom's matrix and that one of his recommendation in the audit report was for the Board to conduct its own a self-assessment.

Mr. Sundstrom recommended accepting Dr. Hughes report responding to item 1 to perform a self-assessment. In the response to item 1, he would use the Internal Audit report and the audit oversight committee matrix that Mr. Sundstrom prepared in order to make the self assessment.

Mr. Carlson moved the recommendation and Mr. Sundstrom seconded the motion. None opposed.

Mr. Chriss Street asked for any input from the outside auditor. Mr. Alfaro stated it would be interesting to see the process move forward and offered to review the charter from the committee requested and that he certainly would assist in any way they can.

Ms. Bates asked if there were legislative mandates that may require a certain set of standards. Mr. Sundstrom stated there were none and that the GFOA made it clear that law trumps anything they have.

6. Receive and file Internal Auditor's Annual Report Fiscal Year 2008/2009  
VOTE: Motion-Bates, Second-Nguyen, Yes-Carlson, Yes-Franz (proxy for Mauk), Yes-Sundstrom  
**Approved**

Dr. Hughes stated the summary report was provided for the fiscal year's activity. Dr. Hughes stated there was an audit presence in 17 of the 23 departments. He stated 5 audits were completed at the request of the AOC or the Board; 46 other audits were conducted in addition to the special requests and 40 IT projects were also completed. The information presented was timely. The IT projects were primarily over the CAPS+ implementation in accordance with an MOU between the CAPS+ Steering Committee and Internal Audit.

Dr. Hughes stated a highlight was the reporting structure to the Board. The Board receives every report in a two ways: as the report was issued and on a monthly basis. Findings were ranked at their request as material, significant or other reportable conditions. To date, there was 1 material control weakness occurred in the past 3 years, less than 6% significant. He noted that the others, while important, were detected before they elevated to significant or material breakdowns. It was important to underscore the value of identifying any problems early. The audit reports were fact driven as presented. He stated we were at about 85% implementation of correction within one year of issuing the reports. If the areas were complex, it possibly took additional time. Dr. Hughes stated they never leave the field unless there was an interim corrective action in place for any material finding. Fortunately, there was only one to date. Significant findings required corrective action within 30 days. Other control weakness findings required implementation within 6 months. He added the success and timing of all correction action was reported to the Board.

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Mr. Sundstrom thanked Internal Audit for the CAPS+ work. The work was greatly appreciated and very much value added. Mr. Sundstrom personally thanked Autumn McKinney for an exceptional job. The Steering Committee was unanimous in their support of Internal Audit's efforts and very pleased with their contribution.

7. Approve OC Internal Audit Department Status Report for Period July 1, 2008 through June 30, 2009, and Executive Summaries of Audit Finding Summaries for the Period July 1, 2009 through June 30, 2009  
VOTE: Motion-Bates, Second-Nguyen, Sundstrom-Yes, Franz (proxy for Mauk)-Yes, Carlson-Yes  
**Approved**

NOTE: Community Facilities District Audit was added to the Audit Plan

Dr. Hughes presented the IAD Status Report for period July 1, 2008 through June 30, 2009. Every project had a budget of hours with comment section. He noted that some audits were postponed or canceled as well as some audits that were carried over to the next year. Dr. Hughes noted that the lease audits generated large amounts of money for the County. Dr. Hughes also presented the Executive Summaries of Audit Findings and discussed the detail presented.

Supervisor Bates requested for Internal Audit to conduct an audit of the CFD's. She provided a memorandum from her office dated September 2, 2009, Re: Review of Community Facilities District. Supervisor Bates stated the request was the result of inquiries that reached press level. Questions were raised on whether they were fair and whether they should have been the actual fees assessed at the tax rate that was reflective of each of the CFDs and the projects that were being financed through those. This affected much of the unincorporated areas significant in the fifth district.

Supervisor Bates stated that Peter had indicated it would not require a lot of resources and/or expenditures. It was something the folks out there are asking about and it would be helpful to show that we do provide good oversight of the area and give due diligence in the assignment of a tax rates but more importantly over the where the money is going in terms of the projects that were part of the original contract of the development agreements.

Dr. Hughes stated it was the appropriate forum to raise a request for an audit. It was within the Internal Audit Department's authority and expertise to conduct the audit. Dr. Hughes stated he would like to commit resources to do this and needs the AOC approval to proceed. Supervisor Nguyen moved the item.

Mr. Sundstrom added that there were approximately 75 to 100 CFDs. He asked if each one would be evaluated or more specific CFDs or a sample basis. Supervisor Bates stated that when discussion began there were 14 or 15 in Ladera Ranch. It is where potential misinformation regarding what we are doing when we approve a tax rate and what it means to them. And, whether in fact if the money they are paying goes toward public facilities in Ladera Ranch and what is included in those development fees. Supervisor Bates stated there was a suggestion that if the information is easily accessible then possibly review all of them; however if it was overwhelming, a sample list and those in the fifth district should be included. She stated the Fifth District did hand out a fact sheet on Mello-Roos.

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Supervisor Bates noted there have been presentations by County finance and public hearings, but there was still concern. The obvious concern over money because many don't have enough money to pay property tax let alone Mello-Roos assessment and it will be raised. Property values have gone down by huge margins. She noted this audit would show the County is doing the job required to do based on what was contracted through Mello-Roos and those development agreements.

Mr. Sundstrom certainly understood the Ladera Ranch problem because their rates go up when their valuation goes down because the County has to collect the same amount of money. He stated he would provide the necessary documentation to Dr. Hughes as requested. He suggested identifying the CFD's of Ladera Ranch unless other areas where identified lead to inclusion. Dr. Hughes agreed with the suggestion.

Supervisor Bates thanked Mr. Sundstrom for his services of three years ago for a different area but on the same issue regarding whether the funds that were being collected were in fact going to the actual public facilities developments. She stated the A-C did a great job. Mr. Sundstrom stated how the bonds were funded in the first place were somewhat out of his scope.

Mr. Street stated he had been in a similar situation in Colorado where there were misunderstood issues about term certainty and maintenance and other issues. He stated many of the Mello-Roos bonds are coming to maturity and people feel it is the end of their payments and he doesn't see that happening. He added that when the bonds were issued there was no policy as to if dollars didn't get spent when they came in at less for the cost of the facilities, what happened to the reserve. He personally felt it should reduce the current taxes but the policy was that it went to sinking the debt at the end of the term. The problem was when the term end if there was maintenance. He added that it may be revealed under the audit that when some of the projects with significant dollars that comes into maturity may need to be extended because of maintenance issues. Mr. Sundstrom stated it would be to protect the bond holders. Mr. Street stated it was a complex issue and recommended policy be established along the way because many are joint and because there may be no capacity for payments in many cases. He made various suggestions.

Regarding a recent newspaper article citing property taxes, Mr. Street stated there were 120,000 homes that were assessed downward. It was discovered 22,000 that were a mistake and need to be reassessed upward. Refunds were sent out on the first mistake and when the errors were discovered a bill was issued requesting the refund and the supplemental bill both be paid. In those that call, all are confused and he offers to waive their interest and penalties if they can payoff their requirements. Regrettably no payment plans are permitted unless in default.

Mr. Sundstrom stated Dr. Hughes would consider all the feedback of Mr. Street when conducting the audit. Supervisor Bates moved the item and Supervisor Nguyen seconded the motion. The request to add the audit to the audit plan passed unanimously.

Supervisor Nguyen commented on page 3, item 7 – employee vendor address match where it was stated as of June 10, 2009 one was a valid match and 6 were not in conflict. She requested clarification about the conflict. Dr. Hughes introduced Autumn McKinney to address the question.

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Ms. McKinney stated the since the date of the report all the matches were resolved and none were in conflict. She added typically the reason was employees were doing work for the County on their own time. An example was the Clerk-Recorder was in need of voice-over recordings on their automated phone system and hired an employee from outside their agency and the work was done during non-business hours. They in turn received a vendor payment for their outside work. Supervisor Nguyen asked if we were paying employees for doing extra-work outside and giving them an extra paycheck. Autumn stated it was a vendor payment. Mr. Sundstrom stated that was a problem. Supervisor Nguyen asked why it was not considered a conflict.

Ms. McKinney stated when the matter was discussed with HR, it was conveyed that it was the County's policy that employees can do work for the County outside of their normal work hours. As an example, there was HCA employees that do work for SSA as a psychologist during non-business hours on weekends and provided counseling for abused children. Supervisor Nguyen stated she was curious to see the list of 26 as stated in the report. She noted she understood psychologists but not full-time employees of the County. Ms. McKinney stated some were retired employees that came back and contracted to the County. Supervisor Nguyen stated she also understood hiring retirees for their expertise and asked if it was a common practice.

Mr. Sundstrom asked Ms. McKinney to contact Mr. Leblow if there was a violation on federal policy for Medicare payments for these employees doing additional work. Mr. Sundstrom stated the policy didn't seem right to him. Mr. Street agreed and added it sounded like overtime.

Supervisor Nguyen asked about item 10. She wanted to know what was the IT Business Council. She had dissolved a council with the same name recently. Ms. McKinney responded that it was a new group created as part of the IT strategic planning and they don't regularly meet and Mr. Ajmani stated as the need arises they meet but had not met recently. Mr. Sundstrom stated it was a fundamental IT group. Mr. Sundstrom stated the difference was Supervisor Nguyen's committee was a high level group that discussed policy issues and this group was lower level tactical group discussed technical issues.

Mr. Sundstrom stated he would like to bring an audit charter back to the committee for his own auditing group and how it could report to the AOC so that a full picture of all audits going on and not just Internal Audit Department.

Dr. Hughes stated there may a number of large agencies that had their own compliance audit groups and he asked them in the past to present a report to the AOC once a year. He added he would query other agencies for such groups and where appropriate ask them to present to the AOC a summary of their work.

8. Approve External Audit Coverage 4th Quarter Status Report FY 08/09  
VOTE: Motion-Franz (proxy for Mauk), Second-Carlson, Sundstrom-Yes, Bates-Excused, Nguyen-Excused  
**Approved**

For the quarter presented there was one new material issue noted. Ms. McKinney stated HCA had representatives present to address the issue. Mr. Bob Wilson addressed the committee and provided background on the issue.

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Mr. Wilson stated it was part of the mission of the Board that the State Healthcare Agency provided patient services, a variety of medical services, provided through staff or contractors. Many services provided were eligible for MediCal and Medicare reimbursement from the State. Currently OC HCA billed approximately 50-60 million annually. At the conclusion of each fiscal year, HCA was required to submit a cost report to the State of California. The report was then discussed between the agency and the state and finalized by the end of the following calendar year. After that, the State had approximately 3 years to audit any cost report. Mr. Wilson stated the present issue was related to a cost report for the year 2003-2004.

**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.*

**No comments.** Dr. Carlson stated that a notice of the meeting was posted at the building for the teleconference location. Dr. Carlson further stated that no public members were in attendance at the teleconference location.

## **AOC COMMENTS & ADJOURNMENT:**

### **AOC COMMENTS:**

**ADJOURNED:** The meeting adjourned at 2:58 p.m.

### **NEXT MEETINGS:**

The following meetings were scheduled post September 2, 2009.\\:

October 14, 2009, 10:00 a.m., Special Meeting  
November 12, 2009, 2:00 p.m., Regular Meeting