

# 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, February 23, 2011, 2:00 p.m.*

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

**Supervisor Bill Campbell**  
Member

**Supervisor John Moorlach**  
Member

**David E. Sundstrom**  
Vice-Chairman

**Thomas G. Mauk**  
Chair

**Dr. David Carlson**  
Public Member

**Shari Freidenrich**  
Ex-Officio Member (non-voting)

**Steve Danley**  
Ex-Officio Member (non-voting)

ATTENDANCE: David Sundstrom, Tom Mauk, David Carlson, John Moorlach

EXCUSED: Bill Campbell

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

**2:00 P.M.**

1. Roll Call

Auditor-Controller staff: Shawn Skelly, Nancy Ishida, Christine Young, Ila Patel, James Christiansen; Third District staff: Louis Bronstein, Fourth District staff: David Zenger; Fifth District staff: Brian Probolski; Internal Audit Department – Eli Littner, Alan Marcum, Autumn McKinney, Mike Goodwin, Lisette Free, Mike Steinhaus; Performance Audit Department staff: Ian Rudge; Vavrinek, Trine, Day & Co.: Kevin Pulliam, Roger Alfaro and David Showalter

2. Approve Audit Oversight Committee Regular Meeting Minutes of December 2, 2010  
VOTE: Motion-Sundstrom, Second-Carlson, Mauk-Yes, Moorlach-Abstain, Campbell-absent  
**Approved**

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3. Receive SAS 114 Required Communication from External Auditors Vavrinek, Trine, Day & Company, LLP  
VOTE: Motion-Carlson, Second-Sundstrom, Mauk-Yes, Moorlach-Yes, Campbell-absent  
**Approved**

Kevin Pulliam of Vavrinek, Trine and Day addressed the Committee, as required by the standards. Mr. Pulliam provided a hand-out of information related to one finding discussed later. The information in the package addressed four reports as follows: the Comprehensive Financial Report of Accounting, the Orange County Development Agency, John Wayne Airport, and OC Waste & Recycling. Mr. Pulliam stated they would express an opinion, planned the audit to give reasonable assurance and noted the single audit was still in-process. He stated under significant audit findings they discussed the qualitative aspects of the accounting practices and reported that the County adopted GASB Statement 51 and a restatement was required as a result of the implementation of that audit standard. He reported the letter noted the key significant estimates within the financial statements.

4. Receive, discuss and consider recommending approval to the Board of Supervisors proposed Audit Charter for the Auditor-Controller Internal Audit Unit.  
VOTE: Motion-Moorlach, Second-Sundstrom, Mauk-No, Carlson-Yes, Campbell-absent  
**Approved to present to the Board for final approval**

David Sundstrom addressed the Committee about the proposed Auditor-Controller Internal Audit Unit Audit Charter. He stated he started the Internal Audit Unit within the Auditor-Controller's office primarily to perform his mandated audits in the Treasurer's Office and Probation Department.

Mr. Sundstrom said he would like to conduct Internal Audits of his activities. Initially the concept was to allow the Auditor-Controller's office the opportunity to do specific smaller audits of issues that rate on his risk assessment conducted annually that would not rate high enough to be audited by the Board's Internal Audit Department. He stated that he has three staff assigned to do this work and is not seeking to increase the size of the staff. To ensure the quality of the work remains at the highest level possible, it's his intent to move forward to use the standards of the Institute of Internal Auditors (IIA). Those standards require that an audit charter be established and approved by a board. The charter delineates the responsibilities of the internal auditor in performing his or her work.

Mr. Mauk asked for clarity of the scope of work. He asked if the proposed charter related to internal auditing within the A-C department or also a countywide basis. Mr. Sundstrom stated it would do both and said he would audit in areas over which he has delegated responsibility. He said his responsibility was over the control structure especially in areas where he direct responsibilities in certain departments. He stated those areas were in his five satellite units that included OC Community Resources, Social Services Agency, Health Care Agency, OC Public Works, CEO/Public Finance and primarily over those duties that were performed by those units specifically with no intent of moving further.

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Mr. Sundstrom stated he didn't want to duplicate effort or try to audit other county activities now because he didn't have staff to do so. Mr. Mauk asked for clarification on staffing. Mr. Sundstrom stated at this time there was no intent to add people. There could be audits of revolving funds where the central office has discovered potential problem areas. The unit also has responsibility for reviewing cash shortages. The concept is to give the audit committee full exposure to the work being performed as to eliminate the possibility of duplication of effort. Mr. Mauk inquired about the staffing. Mr. Sundstrom reiterated that he has three staff and has no intention of increasing staffing either now or into the future.

Supervisor Moorlach asked which auditing standards would be used. Mr. Sundstrom responded that he is intending to use the standards of the IIA, however, those standards may not be used until the unit undergoes a quality assurance or peer review, and the peer review guidelines recommend that the unit have a charter. Mr. Moorlach asked whether a template is provided. Ms. Ishida responded that examples were provided. In response to a further question from Supervisor Moorlach, Mr. Sundstrom stated that if approved by the AOC, the charter would be submitted to the Board of Supervisors for approval.

Supervisor Moorlach moved item. Mr. Sundstrom seconded.

Mr. Steve Danley said he felt the charter was vague as to the full extent of the audit authority Mr. Sundstrom was seeking. He referenced first paragraph, second line regarding management consulting services as an example. Mr. Sundstrom stated that reference was within his own office. Mr. Danley recommended adding those references for clarity in the charter. Mr. Sundstrom stated they had provided help in OCCR reviewing sub-recipients and he didn't want to be limited or be prohibited from providing assistance in the future to any department in the county should they request it and therefore did not want to restrict his auditor to just his department. He stated that if consulting services were not noted in the charter, it could imply that he was not authorized to perform the services. Mr. Mauk asked if he provided managerial assistance, not audit, currently without the charter. Mr. Sundstrom stated yes, he did provide management service without the charter. He further stated that he is not soliciting work, but felt he cannot deny services if requested to perform them. Mr. Danley pressed that there was some ambiguity in the charter. Mr. Sundstrom mentioned that the charter calls for an audit plan to come before the AOC for approval, at which time the AOC could express its concerns if they felt the auditor was expanding beyond the charter's scope.

Mr. Mauk asked Peter Hughes, Director of Internal Audit, to comment on the proposed charter on how it would work with his audit plan. Dr. Hughes stated he held the same concerns that Mr. Danley raised. He felt approving the A-C IAU audit charter would then allow the A-C to compete with the Internal Audit Department which was not authorized to do so now.

Dr. Hughes stated the Auditor-Controller's current mandated audits were conducted by the Yellow Book standards and those standards do not require a charter or expanded scope of work to pass a peer review to assert compliance. He indicated that he felt approving the A-C IAU audit charter would in essence create a third Board approved internal audit department with countywide authority but one that now reported to just the A-C and not to the Board. Dr. Hughes added that unless the A-C IAU had broad county-wide authority, the unit would not be able to pass a peer review.

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Mr. Sundstrom responded that the IIA allows for audit organizations that do not have broad entity-wide scope. Dr. Hughes asked whether the charter needed the approval of the Board of Supervisors. Mr. Sundstrom replied while board approval may not be necessary, it would help to ensure the independence of the operation. Dr. Hughes stated he currently had the responsibility of auditing the A-C satellite facilities and was working on a CFD accounting audit in one of the A-C's satellite operations and asked if Mr. Sundstrom would then begin to perform those audits? Mr. Sundstrom responded he wanted the ability to audit those areas. Dr. Hughes stated he felt it would be in direct competition with the Board's Internal Audit Department. Mr. Sundstrom stated that he would not be in competition.

Mr. Sundstrom stated he saw no conflict because he did not have the funding or staffing to do more than his two mandated audits. He added there were flare-ups in his department where he would like the ability to conduct performance audits according to IIA standards. He further stated that he has the legal responsibility to monitor the control systems of the county. Dr. Hughes said if the A-C felt it was important enough for the A-C to spend audit resources, than he felt that those budgeted funds and staff positions should go to the IAD which had already lost positions due to budget cuts.

Dr. Hughes stated he was concerned as to the practicality of coordinating with a new third internal auditing function that had countywide audit authority. Mr. Sundstrom said he felt his audit charter would be a compliment to and not in competition to the existing audit groups. Mr. Mauk asked Mr. Sundstrom if he heard correctly that A-C did not need the charter to conduct his types of audits. Mr. Sundstrom stated the charter was not needed however it would help his internal auditor gain more independence, more transparency and more visibility. Ms. Freidenrich asked if there would be any impact on the audits currently performed of the Treasury. Mr. Sundstrom responded that the report opinion would also cite IIA standards.

Supervisor Moorlach asked about the issue of independence in the A-C department and his internal auditor. Mr. Sundstrom stated that he has an organization separation as detailed in his organizational chart that provides segregation for his internal auditor. Supervisor Moorlach asked Dr. Hughes to comment as to why he did not support giving the A-C audit authority too.

Dr. Hughes responded that economy of scale, proper supervision, efficiencies, quality of the audit, and the concept of independence all concerned him during a time of tight budgets. He asked if the Board would rather accept an audit report from the A-C auditing his own satellite entities rather than a report from the IAD. Dr. Hughes stated he lost positions over the past two years along with freezes and was protective of his budget and did not see the business benefits of the A-C trying to create a third internal auditing department when the Board already had its own award winning one. Dr. Hughes stated the IAD had passed four peer reviews to-date and the A-C none. He stated by authorizing a third audit unit that was to be as small as the A-C proposed would carry certain administrative and supervisory inefficiencies and ineffectiveness due to its small size. If there were extra resources to do audits that aren't being done now, he'd like to garner those resources and do them himself.

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Mr. Danley stated the A-C IAU audit charter was open to interpretation on audits and could expand those audits but to an unknown extent. His preference would be for a more specific charter and with certain limitations. Supervisor Moorlach stated if expansion was sought by the A-C, those resources would be sought through the budget process and controls were in-place to address those issues.

Mr. Sundstrom responded that he only has the staff necessary to complete his mandates. He stated that without the additional resources, he cannot expand the role of the A-C audit unit. He stated further that it is his desire to bring the results of the A-C audits to the AOC and the work plan to the committee to provide the AOC with additional information concerning the internal control structure of the County. It's a matter of visibility and getting the best bang for the buck in terms of the work the A-C audit unit already performs.

Dr. Hughes stated when A-C decided to cancel his contract with IAD to perform the two mandated audits in order to do them himself the Board took away from Dr. Hughes and gave the A-C two of Dr. Hughes audit positions and the funding for them. He indicated he was concerned that the A-C would seek to transfer staff and funding from IAD to his department in order to do audits he would now have Board authority to do, with the difference that unlike IAD, the Board would not have any say in the audits the A-C could do. Mr. Sundstrom stated that his goal was only to add transparency and independence to the work already performed by the A-C audit unit.

Mr. Mauk expressed that it's not a good idea for an office to audit itself. Mr. Sundstrom responded that it's one of the ways his office is audited. Dr. Hughes expressed concern that the A-C audit units would be submitting audits in lieu of IAD's audits, competing and on a par with what his office performs. Mr. Sundstrom disagreed and that the charter calls for replacement of the work completed by the IAD.

5. Receive, discuss and approve external auditor services by Vavrinek, Trine, Day & Company, LLP, Contract #N1000010022 for the additional two fiscal years ending June 30, 2011 and June 30, 2012. Direct Auditor-Controller staff to present to the Board of Supervisors for final approval.

Motion-Sundstrom, 2nd-Carlson, Sundstrom-Yes, Moorlach-No, Mauk-Yes, Carlson-Yes; Campbell-Absent

**Approved to present to the Board of Supervisors for final approval.**

Mr. James Christiansen, Purchasing Manager in the Auditor-Controller's office, addressed the AOC. He stated in May 2008, the all funds and single audit contract was awarded by the Board to Vavrinek, Trine, Day and Company (VTD). It was a three-year contract with a renewal option for two additional years. He said it was currently in the third year and would expire on May 19, 2011. He was presenting the contract extension to the AOC for approval to present the contract to the Board for final approval.

Mr. Christiansen stated on February 7, 2011 they received a quote from VTD for next two years in the amount of \$540,441 per year. That quote was included in the package for the AOC review. He stated the quote was favorable because VTD was not charging the County for any additional work in the single audit program. Additionally they didn't include the five percent year-over-year cost of living fee increase that was included in the original proposal. Mr. Christiansen stated he felt the County would receive significant value by retaining VTD as the auditors for the next two years.

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Mr. Sundstrom said he received positive comments for the services of VTD. He stated they had been very competitive and were significantly lower than the next closest bid in 2008. He said that additionally, VTD lowered their price before the BOS approved contract reduction program. VTD did not charge for extended work performed related to stimulus package. VTD could have asked for \$10,000 for each package and there were 13 major programs and seven federal programs related to the audit. Mr. Sundstrom said they had provided exemplary services. He stated VTD had been responsive to the County's financial distress and sees no value in going out to bid.

Mr. Mauk asked how the five percent fee provision was being waved. Mr. Christiansen stated the quote eliminated the cost of living fee for the next two years. Supervisor Moorlach stated he would like to see the contract go out for RFP. He appreciated the price sensitivity however felt it should go out to bid.

Mr. Sundstrom stated they demonstrated their availability over their predecessor and timely reports. They had provided continuing education courses. He felt it was high quality work. Ms. Freidenrich asked who their other clients were. Mr. Pulliam stated similar clients to Orange County were of counties of Sacramento, Ventura, Yolo, San Bernardino as large county governments. Supervisor Moorlach asked why not go out with another RFP. Mr. Sundstrom stated time and expense for them and us and would do whatever the Board wishes. Mr. Christiansen stated the first year cost was \$549,000 with an additional five percent contingency and their competitor's first year cost was \$912,000, plus ten percent contingency.

6. Receive and approve Annual Internal Auditor's Report by Internal Audit Department for the year ending 06/30/10  
VOTE: Motion-Moorlach, Second-Mauk, Sundstrom-Yes, Carlson-Yes, Campbell-Absent  
**Approved**

Dr. Hughes presented the Internal Auditor's Annual Report. He referenced the year's accomplishments, balanced scorecard and customer satisfaction. Mr. Moorlach found two typos and requested corrections. Ms. Freidenrich complimented the Internal Audit Department on the successes. Mr. Sundstrom thanked Internal Audit for their involvement in CAPS+ implementation efforts.

7. Approve OC Internal Audit Department 2<sup>nd</sup> Quarter Status Report of FY 10-11 for Period July 1, 2010 through December 31, 2010, and approve 2<sup>nd</sup> Quarter Executive Summary of Audit Finding Summaries for the Period July 1, 2010 through December 31, 2010  
VOTE: Motion-Moorlach, Second-Sundstrom, Mauk-Yes, Carlson-Yes, Campbell-Absent  
**Approved as amended.**

Dr. Hughes reported on the status report coverage into half the year. He stated a substitution was made. He anticipated completion on time with exceptions noted. He stated one request for a Control Self-Assessment (CSA) from the Treasurer Tax Collector was added to the audit plan. He sought approval from AOC for the changes and addition of the CSA. Dr. Hughes explained the confidentiality of the CSA process and results specific to the agency of the CSA. He stated the CSA was not an audit and formal reports were not issued other than that workshops were conducted. The comments captured at CSA workshops from department staff were not validated or substantiated and opinions were not rendered by the auditors. Mr. Mauk said there was a change of Board policy in 2004 for those agencies reporting directly to the CEO. The CEO would receive the confidential CSA results of departments reporting directly to him to evaluate and determine if the Board should be made aware of certain information. Dr.

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Hughes did recall the change in Board policy. Mr. Sundstrom stated the success of the CSA was when the group wrote their own corrective action plan and addressed the issues in that plan.

8. Approve External Audit Coverage 2nd Quarter Status Report FY 10/11  
VOTE: Motion-Moorlach, Second-Sundstrom, Mauk-Yes, Carlson-Yes, Campbell-Absent  
**Approved**

Dr. Hughes stated there was lots of audit activity occurring throughout the County. There were no material issues to identify. Mr. Moorlach asked when IAD was last in PAPG. Mr. Goodwin stated IAD was currently reviewing the case management and accounting systems. Mr. Sundstrom recalled a Grand Jury report related to pension spiking in the PAPG and the Board asked IAD to follow up to determine if same situation existed in other departments. Mr. Moorlach asked when an agency gets media attention if that rises to IAD to include in audit coverage. Dr. Hughes stated IAD does evaluate media coverage over agencies and when to bring items of concern to AOC or Board to consider adding to the audit plan or conduct a review.

9. Nominate and appoint Chairman and Vice-Chairman for 2011 Audit Oversight Committee

Mr. Moorlach motioned to keep the Chairman Tom Mauk and Vice-Chairman David Sundstrom for another year term. Dr. Carlson seconded the motion.

**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.*

**None**

## **AOC COMMENTS & ADJOURNMENT:**

**AOC COMMENTS:** Dr. Carlson, public member, stated he would contact Dr. Peter Hughes to do additional work on John Wayne Airport Change Orders for the construction project and would propose allocated hours in that area after the next meeting.

**ADJOURNED:** The meeting adjourned at 3:20 p.m.

**NEXT MEETING:** April 27, 2011, 10:00 a.m.