



County of Orange

Audit Oversight Committee

Revision to AOC Agenda Item No. 2

Note: This supplemental agenda is updated to show items that have been added, continued, deleted or modified. No new supplemental items will be added to the agenda following close of business on Tuesday.

Item:

2. No change to the agenda title or recommended action.

Page 2, item 3, paragraphs 2 & 3, replacing "unqualified" with "unmodified."

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 19, 2015, 2:00 p.m.

HALL OF ADMINISTRATION
333 W. Santa Ana Blvd., 5th Floor
Conference Room A
Santa Ana, California 92701

Mark Wille, CPA
Chairman, Private Sector Member

Supervisor Lisa A. Bartlett
Fourth District
Member

Eric Woolery, CPA
Auditor-Controller
Member

Michael Giancola
County Executive Officer
Member

Dr. Dave Carlson
Private Sector Member

Shari L. Freidenrich, CPA
Treasurer-Tax Collector
Vice-Chair

Supervisor Todd Spitzer
Third District
Member

Philip Cheng, CIA
Performance Audit Director
Member

Sarah J. "Sally" Anderson, CPA
Private Sector Member

Gary Caporicci, CPA
Private Sector Member

ATTENDANCE: Mark Wille, AOC Chairman; Shari Freidenrich, Treasurer-Tax Collector and AOC Vice Chair; Supervisor Todd Spitzer; Eric Woolery, Auditor-Controller; Proxy Frank Kim for CEO Michael Giancola; Proxy Paul Walters for Supervisor Lisa Bartlett; Philip Cheng, Performance Audit Director; Dr. Dave Carlson, Sally Anderson, and Gary Caporicci, Private Sector Members

EXCUSED: None

ABSENT: None

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

10:00 A.M.

1. Roll Call

AOC Chairman Wille called the meeting to order at 10:00 a.m.
Attendance of AOC members are noted above.

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2. **Approve Audit Oversight Committee (AOC) regular meeting minutes of December 11, 2014.**

Motion: Caporicci, Second: Anderson. All in favor, none opposed. The item carried.
Approved as Recommended with amendments by Member Supervisor Spitzer.

Supervisor Spitzer requested changes in the regular minutes of December 11, 2014, page one, Opening Comments, first sentence, to strike “and rejected by a vote from 3-2,” and add language in second sentence, “the motion to approve the proposal failed and instead the Board unanimously requested...”

Additionally, Ms. Anderson stated there were grammatical and spelling errors throughout the minutes and requested a more thorough review.

3. **Receive and file Required Communication of the 2014 Comprehensive Annual Financial Report (CAFR) and receive status of the Single Audit Report from External Auditors, Macias, Gini & O’Connell (MGO)**

Motion: Caporicci, Second: Woolery. All in favor, none opposed. The item carried.
Received and filed as Recommended.

Directive: The Auditor-Controller to report any open external auditors’ findings to the AOC as a standing item at future meetings. Motion: Ms. Anderson, Second: Mr. Woolery. All in favor, none opposed. The Item carried.

Ms. Linda Hurley, Engagement Partner, MGO summarized the results for the Fiscal Year 2014 CAFR. The CAFR was issued on time on December 18, 2014. An ~~unqualified~~ **unmodified** opinion was issued by MGO and she said it was the highest level of assurance provided to the County of Orange.

Ms. Hurley stated the financial statements were presented in accordance with Generally Accepted Accounting Principles. MGO also issued ~~unqualified~~ **unmodified** opinions on four other reporting entities.

Ms. Hurley stated that there were four Governmental Accounting Standards Board (GASB) pronouncements adopted by the County of Orange during the fiscal year. Two out of the four pronouncements impacted the County of Orange.

Ms. Hurley said that due to the implementation of GASB Statement No. 65, Items Previously Reported as Assets and Liabilities, certain assets and liabilities were evaluated for reclassification. The implementation resulted in a prior period restatement. She stated the restatement was as a result of a change in accounting principles and not due to an error. She said it was not significant.

The County of Orange implemented GASB Statement No. 67, Financial Reporting for Pension Plans, an amendment of GASB Statement No. 25. Ms. Hurley stated the County of Orange directly administers a small extra-help defined benefit pension plan and was required to implement the standard as it related to that specific pension plan. There was no change in terms of liability being added to the balance sheet for the reporting period.

Ms. Hurley stated that in the next reporting year the County of Orange would be required to implement GASB 68. The implementation will include the extra-help defined benefit pension plan plus the Orange County Employees Retirement System (OCERS) liability portion for the County of Orange and would be added to the balance sheet.

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Ms. Hurley stated MGO did not encounter significant difficulties in dealing with management in performing and completing the audit.

She stated the standards require MGO to communicate any uncorrected misstatements/passed audit adjustments. They related to timing differences and were immaterial.

She reported there were no disagreements with management during the engagement. She said management provided the appropriate representation letters at the end of the engagement indicating they accepted responsibility for the financial statements.

Ms. Hurley reported some prior year deficiencies were presented in the audit. She stated certain policies and procedures needed revision to meet Generally Accepted Accounting Principles. She stated the County of Orange made significant progress in addressing the issues raised in their recommendations. Management was actively monitoring the revisions being made to the policies and procedures and substantial progress was being made.

MGO identified 13 major programs in various departments that would be presented in the Single Audit Report. The departments include OC Community Resources, Sheriff-Coroner, Health Care Agency, Social Services Agency, Child Support Services and John Wayne Airport. Ms. Hurley reported they were on target to meet the statutory deadline to complete the Single Audit Report by March 31, 2015.

Supervisor Spitzer requested clarification for the standard for materiality, such as does the definition of material mean \$5 million or more. Ms. Hurley responded that materiality varied based on several groupings known as Opinion Units. She stated that a dollar amount was estimated for materiality from 1%-5% of either assets or revenues that would drive a particular activity. Supervisor Spitzer asked that if something didn't fall in the materiality definition, where it was disclosed. He asked how the numbers were tracked of those that were considered substantial but not material. Ms. Hurley stated, in terms of auditing standards, a threshold determined by MGO was that they would require an adjustment if it was 5% of the calculated materiality amount. She stated that although something does not meet the materiality threshold individually and there were other known systemic problems in an area, MGO would review the adjustments in the aggregate and consider reporting on that issue. Supervisor Spitzer then asked what area within the financial statements and audits provided by MGO would note such information. Ms. Hurly stated there were limitations within the financial statements audits and what the external auditor would focus on.

Mr. Wille stated the standards do not allow the external auditor to be a part of the internal control structure within the County of Orange and therefore the information Supervisor Spitzer was seeking would not be under the purview of the external auditor. He said he believed the information being sought by Supervisor Spitzer would most likely be found in the reports of the internal auditor, performance auditor or Auditor-Controller (A-C).

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Mr. Caporicci asked Ms. Hurley if the external auditors discussed the passed audit adjustments with County staff. Ms. Hurley responded MGO would discuss and present the information to the A-C for his evaluation and review. Ms. Anderson stated that if MGO determined materiality was \$100,000, MGO would post anything over \$5,000 to the summary sheet of errors which was a lower number. She said the list provided by MGO to the A-C would be fairly detailed and may reveal one department with multiple small errors. It would be at that point where one would examine why the errors were occurring in that department.

Supervisor Spitzer asked what the thresholds were within the departments and stated that he recognized that they would vary. He stated the Board of Supervisors (BOS) would be pleased to receive and review the information given to the A-C by external auditors. Ms. Anderson encouraged Supervisor Spitzer to seek internal audits in the areas with specific departments.

Supervisor Spitzer stated he would like to discuss the use of internal and performance audit by the BOS and issues such as splitting contracts that arose through allegations of a fraud hotline. He wants to have discussion and evaluate indicators revealed to management from the external auditors for consideration for inclusion in the audit schedule. Supervisor Spitzer said he wants to review any audit schedule that is developed by a methodology, logic and deduction as to why and how the audits are being presented and considered. He said he is aware that audits may be reprioritized within the year and would like to know ramifications when the audit schedules change.

Mr. Woolery stated he plans to empower his staff to flag contracts and/or payments submitted to the A-C's office for processing that appear to be attempting to circumvent internal controls so that he can be alerted to conduct his own internal investigation to identify any breakdown. He said he would report such items to the BOS.

Ms. Hurley said that if MGO identified something considered small from the population of data they've selected, they would evaluate it to determine if the item is systemic. She said MGO, in due diligence, considered various factors and also would consider expanding their review of the issue, if necessary, to determine if it is much larger than it is.

Mr. Wille recommended the A-C to report any open external auditors' findings to the AOC as a standing item at future meetings. Mr. Woolery requested clarification if findings from prior years should be included. Mr. Wille suggested for the A-C to review the open items and present what he felt necessary and to coordinate with Internal Audit and Performance Audit, if necessary. Mr. Woolery agreed. Ms. Anderson motioned the recommendation by Mr. Wille. Seconded by Mr. Woolery. All in favor, none opposed. The item carried.

- 4. Approve OC Internal Audit Department FY14-15 2nd Quarter Status Report for the period July 1, 2014 through December 31, 2014 and approve 2nd Quarter Executive Summary of Audit Finding Summaries for the period July 1, 2014 through December 31, 2014.**

Motion: Freidenrich, Second: Caporicci. All in favor, none opposed. The item carried.
Approved as Recommended.

Directive: The Auditor-Controller to develop a written communication presenting best practices and lessons learned information to all County departments of audit activity from the offices of the A-C and the BOS' Internal Audit and Performance Audit Departments and return to the AOC for review. Motion: Caporicci, Second: Mr. Woolery. All in favor, none opposed.

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Dr. Hughes stated the quarterly status reports were designed for the AOC to track the audit plan and related activity. He said he anticipated the audit plan would be completed on schedule with a few exceptions. Dr. Hughes stated one audit was discontinued due to the need to redirect hours scheduled for audits to support investigations resulting from the Fraud Hotline.

Dr. Hughes said the executive summaries of audit activity report could be used for department heads as lessons learned. Supervisor Spitzer asked how departments receive the valuable insights of the summaries and said Internal Audit could make presentations at department head meetings.

Mr. Frank Kim (CEO Proxy) said the County Executive Office (CEO) office had been responsive to Internal Audit findings. He stated he quickly directed for the County Procurement Office (CPO) to provide countywide training on ethics and contract splitting in response to findings presented to the BOS related to OC Parks. Mr. Kim stated that the CPO also increased the frequency of compliance reviews of procurement files to annual rather than bi-annually. Mr. Kim stated he actively reviewed audits and incorporated policy changes if necessary to improve processes under his responsibility.

Supervisor Spitzer recognized the efforts made and stated that the exposure of the high profile issue warranted swift corrections and changes. He stated, however, the control findings identified by Internal Audit that were not confidential would provide beneficial information to all County departments.

Discussion followed about the various department head and other administrative services meetings that could provide forums for the information to be disseminated. Mr. Wille stated it was important that the information affect applicable processes to have the greatest benefit.

Mr. Wille recommended the three audit functions of A-C, the Internal Audit Department and the Performance Audit Department coordinate to provide a newsletter or something similar once or twice a year for department heads that communicated the external, internal and performance audit issues. Mr. Woolery agreed. Mr. Caporicci encouraged the communication. Mr. Wille requested the communication be presented to the AOC for review. Mr. Caporicci motioned the recommendation made by Mr. Wille. Seconded by Mr. Woolery.

Ms. Freidenrich stated the Treasurer's office uses a spreadsheet that rates the findings by category of significance. She suggested a similar tool or summary for the AOC or County departments and agencies.

5. Approve 2nd Quarter FY14-15 External Audit Activity Quarterly Status Report for the Quarter Ended December 31, 2014.

Motion to approve the item as recommended: Caporicci; Second: Woolery. All in favor, none opposed. The item carried.

Approved as recommended.

Dr. Hughes explained the external audit and independent audit activity throughout the County. He stated there were no new material items identified for the reporting period.

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6. Revised Title: **Review and discuss on the matter of Restructuring the Internal Audit Department Under Auditor-Controller** (BOS Directive, November, 25, 2015, Item 43) **and consider establishing an AOC Subcommittee consisting of Members Todd Spitzer, Eric Woolery, Mark Wille, and Dave Carlson, and staffed by Peter Hughes, for a limited term of six months to review the internal audit functions of the County of Orange and report back to the AOC.**

Motion: Dr. Carlson. Second: Supervisor Spitzer. All in favor, none opposed.

Approved the establishment of an AOC Subcommittee for six months to review the internal audit functions of the County of Orange as recommended.

Mr. Wille read the revised agenda item recommended action for the AOC to consider establishing an AOC Subcommittee to review the internal audit functions of the County of Orange. He discussed the differences and changes in the audit functions of the County of Orange since the AOC was created and opened the discussion to the AOC members.

Ms. Freidenrich stated she supported the establishment of the AOC Subcommittee for proper evaluation.

Dr. Carlson stated he is enthusiastic about participating in the process.

Ms. Ann Fletcher, County Counsel, stated that the six month term could be reassessed if needed to allow for more review by the AOC Subcommittee.

Mr. Woolery stated he supported the AOC Subcommittee to review the audit functions and noted the issue was very important to any organization.

Ms. Anderson was supportive of the AOC Subcommittee and felt the process would work well.

Mr. Cheng stated he supported the AOC Subcommittee and said the changes in the auditing standards, audit profession, risk management and governing structure were important to consider.

Mr. Frank Kim (Proxy for CEO) stated he supported any process that fully engages the group of experts in auditing practices and believed that it would be a benefit in getting this information to the CEO's office and the Board of Supervisors for their consideration.

Mr. Paul Walters (Proxy for Supervisor Bartlett) stated Supervisor Bartlett was supportive of the AOC Subcommittee. He asked why an even number of members were recommended for the subcommittee as it would allow for a voting draw on any certain issues. He asked how the subcommittee would report back to the AOC. Mr. Wille responded the subcommittee would report its activity at the quarterly AOC meetings. He stated he was not opposed to adding an additional member and felt confident the subcommittee would reach to a near unanimous conclusion.

Supervisor Spitzer stated that his past experience and current position as a County Supervisor gave him the perspective of being protective of the accomplishments set in place when the bankruptcy occurred in 1994. He stated he felt that where the Internal Audit Department reports would have great implication and deserved a thorough discussion and review. He stated that the BOS carefully deliberated over the issue 20 years ago. Supervisor Spitzer wanted to be certain that the BOS was able to fulfill its stewardship responsibility and balance its responsibilities with other elected positions. He said he was supportive of the AOC Subcommittee and its purpose.

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Dr. Hughes stated that due to the County's bankruptcy 20 years ago, it was once held out to the world as the "poster child" of poor governance but now the County of Orange is being held out throughout the world as a "poster child" of good governance. He said he was supportive of the AOC Subcommittee.

Mr. Wille asked if an additional AOC member wished to serve on the AOC Subcommittee. None responded. Mr. Woolery clarified that the product of the AOC Subcommittee was to provide a report for the AOC Subcommittee to consider and not necessarily something that would be voted on. He stated that if a difference of opinion occurred during the AOC Subcommittee review, all perspectives would be presented.

Supervisor Spitzer stated the White Papers presented by the A-C and Internal Audit Department were valuable. The differences of opinions were on record and was where the subcommittee discussion should focus. He stated that ultimately the BOS would make the decision.

Mr. Carlson motioned the revised recommended action to create an AOC Subcommittee comprising of Supervisor Spitzer, Auditor-Controller Eric Woolery, Dr. Dave Carlson and Mr. Mark Wille for six months to review the audit functions of the County and report back. Seconded by Supervisor Spitzer. All in favor, none opposed.

6A. ***Supplemental Item: Receive and file Orange County Board of Supervisors' Fraud Hotline Annual Activity Report for the period January 1, 2014 through December 31, 2014 (Audit No. 1403-B, Issued February 3, 2015).***

Motion: Spitzer, Second: Caporicci. All in favor, none opposed. The item carried.
Approved as recommended.

Dr. Hughes stated the Internal Audit Department has operated the OC Fraud Hotline since 1996 under the authority of the BOS. He stated the fraud hotline allows one's ability to report suspicions and concerns of possible misconduct by County employees or vendors. The OC Fraud Hotline and resulting investigations also serves as a means of removal of suspicions surrounding an employee's integrity when complaints were found to be unsubstantiated.

Dr. Hughes stated that approximately 70% of investigations conducted by the Internal Audit Department were found not substantiated during the reporting period. Dr. Hughes reported 48 completed investigations during the reporting period. He said 15 of those investigations were substantiated. The cases included minor employee misconducts to significant issues that required employee interviews, the examination of numerous documents and close coordination with several County departments. In three of the major investigations, policy and internal control weaknesses were identified that affected the entire department or county-wide. Dr. Hughes stated Internal Audit reports on such weaknesses to management and tracks the items until appropriate corrective action is taken.

Supervisor Spitzer provided a one page document related to employee complaints that he handed out to the BOS at its recent meeting. He said there were two issues regarding employee complaints raised by Internal Audit Department investigations that were important to him.

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The first issue was the Carlos Bustamante incident where very serious allegations were made related to the initial handling of the complaints pertaining to Mr. Bustamante. As a result, he believes a different set of processes need to occur when allegations are directed towards a high profile person. He said the reaction to the Bustamante incident by the County at the time was to hire an outside counsel to provide objective outside investigation. Supervisor Spitzer stated that he and another Supervisor suggested the County conduct an initial determination on specific allegations raised about a high profile person to be performed internally rather than utilize an outside investigator. The concern was that there might be mischief behind the allegation. Supervisor Spitzer feels that Human Resources should conduct a preliminary prima fascia review to determine merit. Following any merit, then an outside investigator should be utilized.

Supervisor Spitzer stated the BOS will revisit the hotline issue. He welcomed input and discussion regarding the OC Fraud Hotline. He stated the oversight and management of OC Fraud Hotline is a major issue for the AOC Subcommittee to weigh in. He said he believes having competing hotlines for the same type of complaints would cause confusion.

Supervisor Spitzer stated the second issue referred to the one page document he handed out that related to procurement practices. He stated the CEO's office was working on the issue. He stated a recent elected department head requested to outsource sworn investigators which was something he believed had not been done before. Subsequent information related to the request by the elected official revealed that there was preexisting relationships between the vendor and the person recommending the contract. It was also revealed that the vendor was a former county employee and there was a public policy (California Public Employees' Pension Reform Act (PEPRA)) related to that. Supervisor Spitzer informed the AOC that he recommended to the BOS that CEO procurement require that a disclosure of prior professional relationships be provided on such contracts for BOS consideration.

Supervisor Spitzer said the role of the BOS over other elected officials, the OC Fraud Hotline, and the BOS stewardship responsibilities should be clarified. He stated there was a belief by some elected department heads that the BOS holds no oversight responsibilities over their departments. He stated the BOS cannot control how the elected offices were run day-by-day, but certainly the BOS holds oversight responsibilities.

Supervisor Spitzer stated the County was finally drawing near the end of the bankruptcy debt and was concerned that the loss of perspective and institutional history could result in the County forgetting the importance of several critical reforms made to its governance. He wants the AOC to remind the County as a matter of public policy that the work being done was on-going and was critical to good governance and not just as a temporary fix associated with the bankruptcy.

Mr. Wille stated there was a prior subcommittee of the AOC that reviewed ethics and the fraud hotline. He said the triage process of directing callers, allegations and complaints through the OC Fraud Hotline to the appropriate other hotlines would also be reviewed.

Supervisor Spitzer motioned to receive and file the item. Second: Caporicci.

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7. **Nominate and appoint Chairman and Vice-Chairman for the 2015 Audit Oversight Committee**

Mr. Carlson nominated and motioned Mr. Mark Wille as 2015 AOC Chairman for another one year term and Mr. Gary Caporicci as 2015 Vice-Chairman as allowed by the AOC Bylaws. Second: Anderson. Mr. Wille and Mr. Caporicci accepted the terms of office. All in favor, none opposed. The item carried.

PUBLIC COMMENTS: None.

AOC COMMENTS:

Mr. Woolery introduced Ms. Toni Smart, Accounting and Financial Reporting Manager, Auditor-Controller's (A-C) office to provide an update to the AOC concerning the upcoming GASB 68 pronouncement implementation.

Ms. Smart informed the AOC of the GASB 68 requirement to add the Net Pension Liability to the basic financial statement (CAFR) for the County of Orange beginning in FY 14-15. She stated the A-C's office had been preparing for the implementation. There had been coordination with Orange County Employee's Retirement System (OCERS) staff. Ms. Smart reported the A-C was on target to meet the requirements of GASB 68 for the FY14-15 CAFR. The GASB 68 implementation will include the OCERS administered Pension Plans and Extra-Help Defined Benefit Plan administered by the County of Orange.

Ms. Smart stated the OCERS plans had multiple employers and multiple rate groups. There was a methodology in determining the County of Orange's proportionate share of the Net Pension Liability which was based on the contributions made during the calendar year. As part of due diligence, the A-C will confirm the contribution amounts in the rate groups being provided by the actuary to determine the correct share of the County of Orange's liability. The process will allow the payroll records to match against the appropriate funds.

Ms. Smart stated the A-C's office was preparing performance statements and Question & Answer communications related to the GASB 68 implementation. She stated the A-C's office would plan a presentation to the Financial Managers Forum (FMF) group as well as to the Internal CAFR Review Committee. She stated that MGO was also the independent external auditors for OCERS.

Mr. Wille stated the percentage of the additional liabilities was important. Mr. Caporicci stated that allocations were also important to understand. Dr. Carlson asked if there were any entities that had early implementation. Ms. Smart stated she was not aware of any entity that implemented GASB 68 early. Ms. Anderson asked if the bond rating would be affected. Mr. Kim (Proxy for CEO) stated he had conversations with rating agencies and it was uncertain.

ADJOURNMENT: 11:49 a.m.

NEXT MEETING: May 7, 2015, 10:00 a.m.