

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, March 30, 2017, 10:00 a.m.
HALL OF ADMINISTRATION
333 W. Santa Ana Blvd., 5th Floor
Conference Room A
Santa Ana, California 92701

Dr. David Carlson (District 3)
AOC Chairman, Private Sector Member

Mark Wille, CPA (District 2)
AOC Vice Chair, Private Sector Member

Supervisor Michelle Steele
Second District, Board Chairwoman
Member

Supervisor Andrew Do
First District, Board Vice Chair
Member

Frank Kim
County Executive Officer
Member

Drew Atwater (District 1)
Private Sector Member

Robert Brown (District 5)
Private Sector Member

Peter Agarwal (District 4)
Private Sector Member

Present Non-Voting Members

Treasurer-Tax Collector:
Auditor-Controller:
Performance Audit Director:

Shari Freidenrich, CPA
ABSENT
VACANT

Present Staff

Director of Auditor-Controller Internal Audit: Toni Smart, CPA
Deputy County Counsel: Mark Servino
Clerk: Maribel Garcia

ATTENDANCE: David Carlson, AOC Chairman, Private Sector Member; Mark Wille, CPA, AOC Vice Chair, Private Sector Member; Drew Atwater, Private Sector Member; Robert Brown, Private Sector Member; Natalie Medvedev, Proxy for Supervisor Michelle Steele; Frank Kim, County Executive Officer; Chris Gaarder, Proxy for Supervisor Andrew Do; Peter Agarwal, Private Sector Member

10:00 A.M.

1. Roll Call

AOC Chairman Dr. Carlson called the meeting to order at 10:00 A.M.
Attendance of AOC members is noted above.

2. Approve Audit Oversight Committee regular meeting minutes of January 26, 2017

Dr. Carlson asked Ms. Garcia if there were any comments regarding the minutes from the January 26, 2017 meeting. Ms. Garcia stated that on page three, paragraph seven, the sentence should read, "...bylaws back to the subcommittee and Mr. Wille called the question."

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Dr. Carlson asked for a motion to approve the minutes, noting the change. Mr. Brown made a motion, Mr. Atwater seconded.

All in favor, none opposed. The item carried.

Approved as recommended.

3. Receive Oral report on Comprehensive Annual Financial Report; and Required Communications with Those Charged with Governance

Ms. Hurley from MGO (Macias Gini & O'Connell) stated the CAFR (Comprehensive Annual Financial Report) was now on the County website. Ms. Hurley stated the opinion was an "unmodified opinion," the highest level of assurance that the county financial statements are presented in accordance with generally-accepted accounting principles.

Ms. Hurley stated she wanted to highlight two emphasis of matter paragraphs in the CAFR. The first one related to a new accounting standard implementation, GASB Statement 72, the Fair Value Measurement and Application. This accounting standard did not impact the financial statements in terms of reporting of investments at fair value but it did have a significant impact on the disclosures. Ms. Hurley stated there were changes to the definition of fair value and how it is measured. Ms. Hurley stated the Treasurer-Tax Collector's (T-TC) office prepared those disclosures, and MGO worked with T-TC to update the CAFR for that standard.

Ms. Hurley stated second emphasis of a matter item was the Net Pension Liability because the number is significant and impacts management decision-making. The measurement period was December 31, 2015, based on OCERS' (Orange County Employees Retirement System) Fiscal Year End. The liability that was included this year was roughly \$4.4 billion.

Mr. Agarwal asked Ms. Hurley if this liability was unfunded. Ms. Hurley stated it was Net Pension Liability; any total liability less any assets that have been set aside in a trust. Mr. Wille asked Ms. Hurley what the delta was, as it has been between three and seven [billion]. Ms. Hurley stated she did not have that information with her, and that the Net Pension Liability is measured annually and significant changes in assumptions could change that number. Ms. Hurley stated that the current discount rate is 7.25%, and that OCERS adopts assumptions annually and the Board of Retirement is responsible for those assumptions.

Mr. Wille asked Ms. Hurley if she could provide data regarding the delta at the next AOC (Audit Oversight Committee) meeting. Ms. Hurley stated that she could and that she could put it on the topics list for the OCERS audit starting soon.

Mr. Agarwal asked Ms. Hurley when this number becomes a material weakness to the financial statements. Ms. Hurley stated that MGO added this in an emphasis of matter paragraph because they wanted to call attention to it. MGO's responsibility is to look at the reasonableness of the measurement and ensure that it is materially correct. Ms. Hurley stated the liability has to be considered by county management when determining how this will be funded over time, and that that the county is meeting the actuarially-determined contribution on an annual basis.

Ms. Freidenrich stated there are new mortality tables, and that those have been taken into account. Mortality tables for the public sector are not available yet but it has been found that there are differences between the private industry and public sector. The updated mortality rates caused an increase in the Net Pension Liability, and increased interest rates will affect the 7.25% rate. Ms. Freidenrich stated that in 2015, the assumed interest rate of 7.25% was not met but that it is spread over five years. This year, the assumed interest rate has exceeded 8%, which will offset

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some of the losses. Ms. Freidenrich stated that as of December 31, 2015, the county was 67% funded on a market value basis and close to 70% on an actuarial basis.

Mr. Godsey from MGO stated it is very unlikely that the county would be unable to make their annual contribution in the 12-15 months following Fiscal Year End. Ms. Hurley stated that at the current rate of 7.25%, there is a \$4.4 billion liability. If the rate were decreased to 6.25%, the liability would be around \$6.2 billion. If the rate were increased to 8.25%, the liability would be around \$2.9 billion.

Mr. Agarwal asked if the discount rate was the internal rate of return. Mr. Godsey stated that this was correct. Mr. Agarwal asked how many years the rate of 7.25% was not achieved. Ms. Freidenrich stated there is a chart with the rates in the OCERS financials, and that the rate has always been over or less than 7.25%. Ms. Freidenrich stated the discount rate is set based on asset allocation.

Dr. Carlson asked Ms. Freidenrich if the asset allocation was public information. Ms. Freidenrich stated it was and that she could bring it back to the AOC. Dr. Carlson stated that was not necessary. Mr. Kim stated that all the information is on ocers.org, and that the county's ability to make the pension payment is unquestioned, however, the financial impact is that money for services would go down.

Mr. Agarwal asked if OCERS has asked the county to increase contributions. Ms. Freidenrich stated that the actuary prepares a report that has all the rates and is approved and reviewed before being sent to plan sponsors. The county is meeting all of the increases, and there are no phased-in increases. Mr. Agarwal requested this topic be a standing item on the AOC Agenda. Dr. Carlson asked Mr. Kim if he would be comfortable with adding it to the AOC Agenda. Mr. Kim stated he does not feel it is the responsibility of the AOC, as there is an OCERS Board, but that it would be appropriate to return to the AOC with an update once actuarial reports are complete, to determine if it is relevant to the AOC.

Ms. Hurley stated that the Single Audit Report and Federal Audit Report were issued. MGO tested eight federal programs and issued unmodified opinions on compliance for all eight. There was one minor finding, and Ms. Hurley stated that she would present the Management Letter and entire Single Audit at the next AOC meeting.

Ms. Moynihan stated the County's net position improved by \$108 million. Ms. Moynihan stated that although there was a \$495 million increase in the Net Pension Liability, the County improved overall. With the GASB 68, there are deferred inflows and deferred outflows; the County's deferred outflow of resources increased by almost \$450 million. Ms. Moynihan expressed appreciation towards MGO, her own staff, county departments, and Treasurer-Tax Collector staff for their assistance, feedback, and work on the CAFR.

4. Discuss county-wide Committee of Sponsoring Organizations (COSO) training & partnership with MGO

Ms. Smart stated MGO would be putting together a 1-hour countywide training on the COSO Model. Ms. Smart stated she would like Mr. Kim and the representatives from the Board offices to encourage key managers to attend. Ms. Smart stated that she would like to do the training on a yearly basis, and invited members of the AOC to attend the training as well.

Mr. Kim stated departments have been frustrated with understanding the process and scope of audits, and that having management understand the process, expectations, and resource requirements will make the process go much smoother.

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5. Approve AOC Bylaws and direct CEO to present Bylaws to the Board of Supervisors for final approval

Dr. Carlson asked for a motion to address this item. Mr. Wille made a motion, Mr. Brown seconded.

Dr. Carlson stated that after the item was tabled at the January 31, 2017 meeting, the subcommittee met on February 24, 2017. During that meeting, the subcommittee clarified some of the language in Article 2.

Mr. Rosen from the Auditor-Controller's office stated there were no concerns regarding the independence of the Auditor-Controller. Additionally, regarding Paragraph 7.8, Oversight of Fraud Hotline, there were no privacy concerns for people who utilize the hotline.

Mr. Agarwal stated that he was happy with the document being put forth.

All in favor, none opposed. The item carried.

Approved as recommended.

6. Appoint an Ad Hoc Committee to review AOC Training and Internal Controls

Dr. Carlson appointed Mr. Atwater as the chair of the subcommittee, and Mr. Brown, Mr. Wille, and himself as members of the subcommittee to review AOC Training and Internal Controls.

7. Receive Oral report from Health Care Agency (HCA) on HCA's Compliance Program

Dr. Rajalingam stated year-to-date, there were 34 compliance issues and 21 privacy issues. Dr. Rajalingam stated this was a slight uptick from last year, attributed to more staff training. In February 2017, HCA staff and Dr. Rajalingam conducted 15 sessions in which they went over what Compliance does and reasons to contact them. Compliance contact cards were issued to all HCA staff to encourage people to contact Compliance when there are issues.

8. Receive Oral report on status of hiring Director of Performance Audit

Mr. Kim stated a strong candidate was selected and a job offer was made, but the candidate selected a different organization. A third recruitment will be opened for the position.

9. Approve Auditor-Controller Internal Audit Division Internal Quality Assurance Self-Assessment as of February 28, 2017

Dr. Carlson asked for a motion to discuss the assessment. Motion by Mr. Wille, second by Mr. Gaarder, proxy for Supervisor Do.

Ms. Smart stated that the self-assessment helped look at conformance with the Institute of Internal Auditor's standards, and also looked at efficiency and effectiveness of the audit function. Ms. Smart stated she identified some areas that could be improved and some will be addressed today, such as using more data analytics in audits. Auditors are now taking audit objectives and determining how software can be used to evaluate the data.

Ms. Smart stated the countywide internal controls training was identified through the self-assessment process, as well as increasing staff's understanding of the standards and Code of Ethics auditors are bound by. Ms. Smart stated the self-assessment was provided to all staff before

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being finalized and they were asked to review the standards and report, and provide comments. Ms. Smart stated that in the upcoming fiscal year, the Policies & Procedures will be updated because they reflect the Internal Audit Department.

Dr. Carlson asked Ms. Smart if there were any material issues. Ms. Smart stated that there were no such findings. Ms. Smart added that the external assessment contract was approved and the external assessment team would be in the office starting April 24th. Ms. Smart stated that the external assessment team would probably conduct interviews with Board officers and management across the County regarding how the Internal Audit Division (IAD) is perceived and the value the division adds.

Mr. Agarwal stated Ms. Smart compared the County to a Fortune 500 company in the Internal Quality Assurance Self-Assessment, which puts some perspective into how complex the County structure is. Mr. Agarwal stated it was very important that Ms. Smart have the resources needed to conduct the audits.

All in favor, none opposed. The item carried.

Approved as recommended.

10. Approve Information Technology (IT) Audit Risk Assessment Strategy, Methodology and Plan for the development of the IT Audit Plan for FY 2017-18

Ms. Smart stated she and Ms. Stallworth decided to have a third party assist with the IT audits because the plan would need more insight and feedback from a consulting firm.

IAD solicited input from three different consulting firms: a top tier CPA audit firm, a mid-size CPA firm, and a local boutique consulting firm. Ms. Stallworth stated that the top tier CPA firm was cost-prohibitive and the boutique firm did not have the depth of knowledge to complete the audit. Ultimately, MGO was selected. MGO had the same strategy as the other firms and also knows a lot about the government sector.

Ms. Stallworth stated that Los Angeles County has been helpful in providing templates, and that IAD worked closely with the OC Chief Information Security Officer in developing the Risk Assessment. Ms. Stallworth stated that the first phase of the assessment included 24 identified Risk Indicators. The second phase would be evaluating the control environment.

Ms. Stallworth stated the IT Risk Assessment was not expected to be completed by the end of the 2016-17 Fiscal Year but by the beginning of the next fiscal year, there would be something useable to drive the IT Audit Plan.

Ms. Smart stated that based on the areas of risk that have already been identified, some audits will be added to the Audit Plan for AOC approval. Ms. Smart expects to have proposed changes to the IT Audit Plan in the following quarter.

Mr. Kim stated the Tevora contract mentioned in the attachment was going before the Board in April but there was an assumption that the Board would support the contract.

Mr. Wille asked Ms. Smart if the division had the budget to bring in the talent to complete these assessments. Ms. Smart stated the risk assessment drives the resources and that once this assessment is completed, there would have to be a determination of how much risk will be accepted. Ms. Smart stated there are currently three IT auditors. Ms. Smart's long-term plan is to have everyone be an IT auditor by rotating auditors and having them work under Ms. Stallworth.

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Ms. Smart stated the auditors in the division will be trained and when there are vacancies, the recruitment model will change to focus on more technical individuals. If there is a need for more people, then Ms. Smart will have a discussion with Mr. Woolery and Mr. Kim about the budget.

Mr. Wille stated that having MGO involved in an audit like this raises a question about independence and, as the audit moved along, there would need to be a memo addressing independence. Mr. Godsey stated that MGO would come back to address the issue.

Dr. Carlson stated that he would like this item on the agenda for the next AOC meeting.

All in favor; none opposed.

Approved as recommended.

11. Receive oral report on the request for proposals (RFP) for consultant services by a qualified, licensed certified public accounting firm to conduct independent auditing and related services for years ending June 30, 2018, 2019 and 2020 and appoint a subcommittee of AOC members who will comprise the RFP panelists for scoring the submitted proposal

Ms. Moynihan stated that the current Fiscal Year is the final year of the contract with MGO, and she asked the AOC Chairman to establish an RFP panel for selection of a new external auditor. Ms. Moynihan stated this year's RFP would also include Uniform Guidance Training to sub-recipients, program managers, and procurement managers. Additionally, she will be working with IAD to determine what kind of time commitment they could provide the external auditors, similar to the partnership between IAD and MGO.

Ms. Moynihan stated the current contract's RFP was issued in November 2012. The contract was for three years with an option to renew for a maximum of two years. Proposals were received from MGO and Vavrinek, Trine, and Day. The RFP subcommittee consisted of three AOC members and evaluated the firms on their experience in auditing governmental entities similar in size to the county, conducting audits of the CAFR, single audits, component units and enterprise funds, assisting governments in obtaining the Government Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting, and performing consent reviews for debt finances. The Auditor-Controller went to the Board in March 2013 to adopt the recommendation from the AOC and RFP evaluation panel. The contract with MGO was approved in May 2013.

Dr. Carlson asked Mr. Wille to Chair the RFP subcommittee, and Mr. Atwater and Mr. Brown to be members.

Mr. Brown asked Ms. Moynihan how many years the County has received the certificate for Excellence in Financial Reporting. Ms. Moynihan stated that the only year the County did not receive that award was the bankruptcy year. Mr. Brown asked Ms. Moynihan if having a firm that has expertise and experience in guiding municipalities through the process to get that certificate is important. Ms. Moynihan stated it was important because it validated the work done and was an additional element of prestige to financial reporting.

Ms. Freidenrich stated there is a compliance audit that is required annually, and suggested the possibility of adding an option to include that audit as part of the bid. Ms. Moynihan stated she was open to discussing it further, and adding it as an optional part of the contract.

Dr. Carlson asked for a status update at the next AOC meeting.

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12. Approve Auditor-Controller Internal Audit Division's FY 2016-17 2nd Quarter Status Report for the period October 1, 2016 through December 31, 2016 and approve 2nd Quarter Executive Summary of Findings for the period October 1, 2016 through December 31, 2016

Dr. Carlson asked for a motion to approve the item as recommended. Mr. Wille made a motion, Mr. Brown seconded.

Ms. Smart stated several audits would be postponed and picked up in next year's audit plan but there were no cancelled audits. Ms. Smart stated that she spoke to Ms. Freidenrich and the SunGard Quantum upgrade would be started before the end of the fiscal year. Regarding the ePages system, a request for a new system is going to the Board before the end of this fiscal year. Ms. Smart expects the implementation to start next fiscal year.

Ms. Smart stated that on the Internal Controls side, there would be a lot of carryover into next year. The two postponed audits are Dana Point Harbor Procurement, and Billing of Law Enforcement Services to Dana Point Harbor and John Wayne Airport.

Mr. Wille asked Ms. Smart to speak about two audits that were over budget (Ocean Institute and Dana Point Harbor Fund 108). Ms. Smart stated an allegation was received through the Fraud Hotline by way of County Counsel because it had a financial component, and it was decided that internal controls should be a part of the Fund 108 audit. Mr. Wille asked Ms. Smart if there was an expansion of scope. Ms. Smart said there was. Mr. Wille asked Ms. Smart if a report had been issued. Ms. Smart stated it was in draft form and IAD was waiting for management responses. Ms. Smart stated the auditor working on the Ocean Institute audit left the division and a new person had to be hired to complete it, and Ocean Institute had turnover of key managerial positions.

All in favor; none opposed.

Approved as recommended.

13. Approve 2nd Quarter FY 2016-17 External Audit Activity Quarterly Status Report for the Quarter Ended December 31, 2016

Mr. Wille made a motion to approve the agenda item, Mr. Atwater seconded.

Dr. Jeff Nagel, Director of Operations – Health Care Agency (HCA), Behavioral Health Services, stated the Department of Health Care Services (DHCS) does a yearly audit of the HCA Cost Report, and that this finding was from the Fiscal Year (FY) 2009-10 Cost Report and a carryover from FY 2008-09. Dr. Nagel stated DHCS audits so far in arrears that HCA cannot make certain corrections. Dr. Nagel stated HCA anticipated the finding would be approximately \$600,000 of the \$49 million in reported costs. The total cost of the finding was \$789,000.

Mr. Lopez stated HCA went through a formal appeal for the FY 2008-09 finding. The majority pertains to the manner in which the Administrative Cost Allocation is calculated. Mr. Lopez stated that the finding was anticipated for the FY 2009-10, and the formula for Administration Cost Allocation was changed for FY 2010-11.

Ms. Smart asked Mr. Lopez to further describe the issue with the allocation formula and what has changed. Mr. Lopez stated the auditors were using the Gross Cost method and HCA was using the direct cost through a Job Billing method. Mr. Lopez stated that during appeals, state auditors indicated the HCA billing method was not approved by the DHCS.

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Mr. Wille asked Mr. Lopez why HCA does not switch to an approved method. Mr. Lopez stated that the appeals process for the FY 2008-09 finding was wrapped up in early 2016 and that an approved method was used starting with the FY 2010-11 period.

Dr. Nagel stated DHCS issues instructions on an annual basis but their audits occur four to five years behind the instructions. Mr. Lopez stated the draft report showed \$8.6 million in findings but the administrative manager overseeing this cost report audit fought the finding and it was reduced to \$789,000.

Dr. Carlson asked Ms. Hurley how this finding was incorporated into the work done by MGO, if at all. Ms. Hurley stated that external reviews are included in the risk assessment. Ms. Hurley stated MGO may focus in on areas resulting in those same types of findings, however, those external audits are very narrow and may not be material to the financial statements or to the overall compliance of programs. Ms. Hurley stated, from a Single Audit perspective, the point is to take a broad look within a defined framework to get an overview of what is happening, as opposed to the program-specific audits that focus on areas of interest.

Dr. Carlson asked Ms. Hurley if there were any issues of materiality with the total of the finding. Ms. Hurley stated that for MGO's single audit reports, if the findings is under 5% of the total expenditures, it would not be a strong consideration. Dr. Nagel stated the finding was less than 2% of the overall expenditures.

All in favor; none opposed.

Approved as recommended.

Public Comments – Ms. Smart requested the next AOC meeting be moved from June 22nd to June 1st. This would allow enough time to have the AOC approve the Audit Plan, and to present it to the Board in July. Ms. Smart stated if the meeting was in late June, the Audit Plan would not be presented to the Board until August. All agreed to the date change requested.

AOC COMMENTS & ADJOURNMENT

AOC COMMENTS: None

*AOC Chairman,
Dr. Dave Carlson*

ADJOURNMENT: 11:26 A.M.

NEXT MEETING: Regular Meeting, June 1, 2017