

# 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, January 25, 2018, 10:00 a.m.*  
HALL OF ADMINISTRATION  
333 W. Santa Ana Blvd., 5th Floor  
Conference Room A  
Santa Ana, California 92701

**VACANT**

AOC Chairman, Private Sector Member

**Drew Atwater (District 1)**

AOC Vice Chair, Private Sector Member

**Supervisor Andrew Do**  
**First District, Board Chairman**  
Member

**Supervisor Shawn Nelson**  
**Fourth District, Board Vice Chairman**  
Member

**Frank Kim**  
**County Executive Officer**  
Member

**Richard Murphy (District 2)**  
Private Sector Member

**Mark Wille, CPA (District 3)**  
Private Sector Member

**VACANT (District 4)**  
Private Sector Member

**Robert Brown (District 5)**  
Private Sector Member

**Present Non-Voting Members**

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

Shari Freidenrich, CPA  
Eric Woolery, CPA  
VACANT

**Present Staff**

Auditor-Controller Internal Audit:  
Deputy County Counsel  
Clerk:

Scott Suzuki, CPA  
Mark Servino  
Mari Elias

ATTENDANCE: Drew Atwater, AOC Vice Chairman, Private Sector Member; Richard Murphy, Private Sector Member; Robert Brown, Private Sector Member; Chris Gaarder, Proxy for Supervisor Andrew Do; Frank Kim, County Executive Officer; Supervisor Shawn Nelson; Mark Wille, Private Sector Member

**10:00 A.M.**

**1. Roll Call**

Audit Oversight Committee (AOC) Vice Chairman Drew Atwater called the meeting to order at 10:00 A.M. Attendance of AOC members noted above.

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## 2. Approve Audit Oversight Committee Regular Meeting Minutes of September 28, 2017

Mr. Atwater asked for a motion to approve the minutes of the September 28, 2017 meeting. Motion by Mr. Brown, seconded by Mr. Murphy.

All in favor, none opposed.

**Approved as recommended.**

## 3. Receive Oral Report on Required Communication from External Auditors

Mr. Atwater opened the floor to Ms. Linda Hurley from Macias Gini & O'Connell (MGO). Ms. Hurley stated the Comprehensive Annual Financial Report (CAFR) was out in December. Additionally, six deliverables from the MGO contact have been issued: the CAFR, which includes MGO's opinion on the Basic Financial Statements, John Wayne Airport Financial Statements and Schedule of Passenger Facility Charge Revenues and Expenditures, Orange County Waste and Recycling Financial Statements, Orange County Redevelopment Successor Agency Financial Statements, County of Orange Appropriations Limit Agreed-Upon Procedures (AUP), and Orange County Flood Control District Appropriations Limit AUP.

Ms. Hurley stated there was an ancillary contract with the Orange County District Attorney's Office, and the three reports under their Insurance Fraud Programs were issued. These reports include Worker's Compensation Insurance Fraud Program, Automobile Insurance Fraud Program, and Disability Healthcare Insurance Fund Program. Ms. Hurley stated that for all financial statements that required an Independent Auditor's Opinion, all were Unmodified, which is the highest level of assurance MGO can provide that the financial statements are presented in accordance with Generally Accepted Accounting Principles.

Ms. Hurley stated that regarding the County's overall financial statements, there were no significant changes. Ms. Hurley stated that for the AUP for the Appropriation Limits there were no findings. Ms. Hurley stated deliverables to be completed are the Single Audit, Tobacco Settlement Revenue AUP, Treasury Statement of Assets, Treasury Compliance AUP, and Client Training. Client training is scheduled for April and will be customized for County staff.

Ms. Hurley stated once the Single Audit is issued, required communications would be provided in writing. Ms. Hurley stated that regarding Qualitative Aspects of Accounting Practices, the Significant Accounting Policies are noted in the Notes to the Financial Statements. Ms. Hurley stated there are several estimates in the financial statements and no new estimates needed highlighting.

Mr. Wille asked Ms. Hurley about the estimate regarding the pension plan liability. Ms. Hurley stated the audit for that estimate starts in April. Ms. Hurley stated that for the sensitivity analysis, the Government Accounting Standards Board requires disclosure of liability if the discount rate drops or increases by a percentage point, which shows how investments can be affected if there is volatility in the market. Ms. Freidenrich stated the discount rate was decreased from 7.25% to 7%, which will increase the pension liability. Ms. Hurley stated the actuary considers projected investment earnings as well as the actual, and differences are amortized into the pension expense over 5 years.

Ms. Hurley stated there were no difficulties in completing audits and MGO was pleased with Mr. Woolery, and Ms. Moynihan and her team.

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Ms. Hurley stated that regarding Corrected/Uncorrected Misstatements, there were no material audit adjustments. Uncorrected misstatements were evaluated and, to the consideration of audit thresholds, would be reported to the AOC. Ms. Hurley stated there were no uncorrected misstatements this year and no disagreements with management during the audit process.

Ms. Hurley stated that management signs a representation letter at the end of an engagement, indicating they take full responsibility of the financial statements and have provided all information requested, which was delivered to MGO prior to the issuance of the report. Ms. Hurley stated MGO was unaware of any consultations with other independent accountants.

Ms. Hurley stated the financial statements include required supplementary information; that information is considered unaudited. MGO applies limited procedures to make sure that the information presented is consistent with the financial statements. Ms. Hurley stated MGO does not opine on the Introduction and Statistics sections of the CAFR but reviews the information to ensure consistency.

Ms. Hurley stated MGO had several observations on the IT General Controls Audit that were discussed with the department, and a draft report was provided to the Auditor-Controller's office. Ms. Hurley stated the IT department agreed with all of MGO's observations and they are being incorporated into the Cybersecurity Risk Assessment. Ms. Hurley stated she would have more information at the next meeting, when she presents the Single Audit Report.

#### **4. Receive Results of Review by AOC Vendor Evaluation Subcommittee Regarding Independent Auditing Firms for All Funds Audit Solicitation**

Mr. Atwater opened the floor for Ms. Sinclair. Ms. Sinclair stated four firms replied to the solicitation by the August 17, 2017 deadline. Ms. Sinclair stated that at the first meeting, panel members received all proposal information, which they reviewed individually. At a subsequent meeting, vendors gave a presentation to the panel members. One panel member volunteered to check all references and all references were satisfactory. Another meeting was held to compare scores and arrive at a consensus as to which vendor to recommend.

Ms. Sinclair stated the four vendors that replied were Vavrinek, Trine, Day & Co. (VTD), Macias Gini & O'Connell (MGO), CliftonLarsonAllen, and Brown Armstrong. Ms. Sinclair stated it was the committee's recommendation to refer VTD as the primary vendor, with MGO as an alternate.

Ms. Sinclair stated the AOC's recommendation would be taken to the Board of Supervisors (BOS) on February 27, 2018 for approval to negotiate a contract. Once a Notice of Intent to Award is released, all solicitation materials would be public record and the 5-day protest period would commence.

Mr. Kim asked Ms. Sinclair what the length of the contract with the current auditor was. Ms. Sinclair stated it was a 3-year contract, with two 1-year renewals. Mr. Kim asked if there were any internal processes to ensure that at the end of 5 years, the County would not consider the current firm or that the County does not end up with the same auditors 10-15 years in a row. Mr. Wille stated the areas that had the most changes in this solicitation were in cost and technical experience.

Mr. Atwater stated the firm may remain the same but the lead partner would change. Mr. Gaarder asked if this was a formalized process. Mr. Atwater stated there is some guidance from accounting standards. Ms. Freidenrich stated there is required rotation and noticed the rating

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was lower in the technical experience too. Ms. Freidenrich stated the Treasury Oversight Committee required annual audits were added to the RFP for the County, which eliminates the Treasurer-Tax Collector from having to recommend a firm.

Mr. Woolery stated that no matter which audit firm is selected, the firm still has to live up to the same standards and procedures. Mr. Woolery stated the idea behind the 5 years is to get away from complacency. Even if MGO had been at the top again, they would have had to change the top people doing the audit. Ms. Freidenrich stated the way the County scores cost is set and she was not sure if the cost difference was large. Mr. Atwater stated the cost difference was approximately \$150k per year.

Mr. Brown stated the AOC provides a recommendation to the BOS but that is not a firm requirement for the BOS to follow. The BOS may look at how close the ratings are and use discretion to make a different decision.

**5. Approve Recommendations Regarding Selection of Primary and Alternate Independent Auditing Firms to Be Presented to Board of Supervisors for Approval to Negotiate a Contract**

Mr. Atwater asked for a motion to approve the recommendation made by the Vendor Evaluation Subcommittee. Motion by Mr. Kim, seconded by Mr. Murphy.

All in favor, none opposed.

**Approved as recommended.**

**6. Discussion on Status of Director of Performance Audit Vacancy and Role of the Function**

Mr. Atwater stated he understood there was a long-standing vacancy in Performance Audit (PA) due to the nature of the position and wanted to open up a discussion to offer potential suggestions on the function. Mr. Atwater stated there have also been many technological changes looking at how to integrate data from different departments across a complex entity such as the County, and there was an opportunity for the County to be innovative.

Ms. Freidenrich stated Mr. Atwater's suggestion had a lot of value. As an example, the Public Administrator/Public Guardian was having a hard time getting medallion signatures by the banks because things are done by court, and there are elected and appointed responsibilities. With BOS approval, the Treasurer-Tax Collector (T-TC) was able to become a Medallion Signature Guarantee Program only for County agencies, which will save time and money. Ms. Freidenrich stated this occurred because T-TC understood what other departments were doing and talked to each other, and recognized an innovative technique.

Mr. Kim stated that regarding the vacant Director of Performance Audit position, there is a BOS subcommittee comprised of Supervisor Steel and Supervisor Bartlett. Mr. Kim stated that a folder with the candidates was distributed to the subcommittee and interviews need to be scheduled.

Mr. Wille asked Mr. Kim what the level of confidence was regarding these candidates. Mr. Kim stated that there was a failed recruitment in the past. The BOS identified a candidate and the candidate took a different position before the process was concluded. Mr. Kim stated that the recruitment process is still moving along and he cannot say if this recruitment will be successful until it is completed.

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Mr. Wille asked Mr. Servino what the AOC Bylaws say regarding Performance Audit. Mr. Servino stated that the Bylaws outlined the AOC's oversight and responsibilities over Internal Audit and Performance Audit.

Mr. Kim stated that the authority and responsibility of the AOC was to coordinate and ensure audits are not overlapping. Mr. Kim stated that the responsibilities of the PA and whether that function will use data analytics falls on the BOS because that is the supervisory structure. Mr. Kim stated the AOC can make recommendations to the BOS but the BOS controls that function. Mr. Atwater stated that he agreed with Mr. Kim.

Mr. Gaarder stated that his district is very interested in what a PA would achieve, whether or not there is such an office. Mr. Gaarder stated that if the AOC had ideas of areas that should be looked at, his district is open to hearing these.

Mr. Atwater appointed Mr. Frank Kim, Mr. Mark Wille, Mr. Robert Brown, and himself to the subcommittee.

## **7. Receive Oral Report on Countywide Cybersecurity Assessment and Audit Coordination; Provide Direction to Internal Audit Division**

Mr. Atwater opened the floor to Mr. Golub, Chief Information Officer, for an update on the Cybersecurity Assessment. Mr. Golub stated the audit started in 2016, in collaboration with the Internal Audit Division (IAD). The audit was a broad audit of IT General Controls, which included passwords, logical access, access to facilities, and IT policy.

Mr. Golub stated the audit resulted in 31 findings and 40 recommendations. All recommendations have been accepted and OCIT is working on implementing them. Out of the 31 findings, six were critical control weaknesses. Mr. Golub stated that three findings have been completed and the rest will be completed by June. Additionally, OCIT has a group that will focus on ensuring the findings are completed and on incorporating the findings into OCIT standards.

Mr. Golub stated the audit included County managed services vendors SAIC, which runs the data center, and ATOS, which handles the network. As a result of the audit, service-level agreements with the vendor were modified to hold the vendor accountable. As an example, one of the vendors did not report that some of their staff was changing, so access to the data center was not eliminated.

Mr. Wille asked Mr. Golub if IT is in a constant audit because changes in technology are so rapid. Mr. Golub stated the process OCIT follows is standard, which is to develop procedures and policy, and ensure staff is trained in those. Mr. Golub stated the security awareness program was established because of discussions with IAD, and hiring a Chief Information Security Officer. Mr. Golub stated over 90% of County employees took the training to reduce risk of a security breach. Technology does change and OCIT is vigilant in their security program and will continue to be. Mr. Golub stated he was in the early stages of setting up an advisory committee to share policy and procedures from the private sector with the public sector. Additionally, there are employee focus groups, which encourage employees to identify issues and speak up.

Mr. Wille stated it would be beneficial for OCIT to report to the AOC once or twice a year because they are critical to the County. Mr. Kim stated the AOC meetings are public and specifics regarding the audit cannot be discussed. Mr. Atwater stated he wanted to make sure that IT and IAD continue to coordinate and OCIT should report to the AOC if there is a need.

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Mr. Kim stated the BOS approved the Tevora contract for testing of County security systems to ensure they are in place and adequate. Mr. Kim stated that as the IT Risk Assessment moves to Phase 2, it is important to ensure that all County departments are participating in the contract.

Mr. Atwater asked if this required shifting staffing hours or extra work. Mr. Kim stated it would not require extra work but it is important for the BOS to know that, as part of a security assessment, there was an understanding that all departments would comply with Tevora. Mr. Gaarder stated that any department not complying would be made clear to the BOS.

Mr. Woolery stated it would not be extra work and, under State law, the BOS can direct the A-C's office to do a specific audit of any department that has their funds within the County Treasury. The BOS's direction gives the A-C's office authority to go into any departments not complying.

Mr. Margolis stated there has to be consistency of results in order to understand what the findings are saying. Having multiple vendors provide different input on such a critical process makes it complicated to remediate the findings and budget to remediate those findings.

Mr. Atwater directed IAD to incorporate the results of the Cybersecurity Assessment with Phase 2 of the IT Risk Assessment.

**8. Approve Auditor-Controller/Internal Audit Division's FY 2017-18 1st Quarter Status Report for the Period July 1, 2017 through September 30, 2017 and Approve 1st Quarter Executive Summary of Findings for the Period July 1, 2017 through September 30, 2017**

Mr. Atwater opened the floor for Mr. Woolery. Mr. Woolery stated that Mr. Scott Suzuki has stepped into the role of Director of Internal Audit.

Mr. Suzuki stated that an IT Audit Manager III was hired in November but he is out on medical leave and is expected to return in February. Mr. Jimmy Nguyen and Mr. Scott Kim have been managing Phase 2 of the IT Risk Assessment. Ms. Carol Swe retired after 27 years with the County and her duties have been reassigned, with Ms. Lily Chin taking over T-TC financial audits. There are also two new staff auditors in IAD. One staff member recently obtained his Certified Public Accountant license and another earned his Certified Information System Auditor.

Mr. Suzuki stated that due to some vacancies and staffing changes, there are fewer audit hours available. As a result, OC Waste & Recycling Paradigm, OCIT General Controls Follow-Up, OCIT Capital Assets, and OC Community Resources Billing of Animal Care Services to Contract Cities will be postponed to the next fiscal year. OCSO Billing of Law Enforcement Services to Contract Cities will be cancelled because the cities have hired their own independent auditors, and Probation IT General Controls will be cancelled because it overlaps with OCIT General Controls.

Mr. Suzuki stated that of the audits completed this quarter, there was one critical control weakness and one significant control weakness stemming from a revenue generating lease audit at Mile Square Golf Course. Specifically, the minimum annual rent was calculated incorrectly, resulting in nearly \$3 million underpayment to the County. The significant control weakness was regarding a security deposit not updated as required.

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Mr. Brown asked Mr. Suzuki if the critical control finding regarding the Health Care Agency (HCA) occurred during a different period. Mr. Suzuki stated that the HCA audit was a follow-up audit and the finding was probably discussed in a prior AOC meeting. During the current period, IAD ensured that HCA had taken corrective action on the finding.

Mr. Atwater asked for a motion to approve the item. Mr. Brown made a motion, Mr. Murphy seconded.

All in favor, none opposed.

**Approved as recommended.**

## 9. **Approve 1st Quarter FY 2017-18 External Audit Activity Quarterly Status Report for the Quarter Ended September 30, 2017**

Mr. Atwater opened the floor to Mr. Suzuki. Mr. Suzuki stated that in accordance with Administrative Procedure 2, departments self-report audit activity in their departments to IAD. Mr. Suzuki stated that for the quarter ended September 30, 2017, there were no material issues reported.

Ms. Freidenrich stated at the January 23, 2018 BOS meeting, the BOS approved MGO to complete the T-TC Treasury and Investments audits, which is not reflected in the External Audit Activity report because it was a last minute change.

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

All in favor, none opposed.

**Approved as recommended.**

## 10. **Election of AOC Officers**

Mr. Atwater stated the AOC Bylaws outline when elections occur, and it was time for elections.

Mr. Wille made a motion to nominate Mr. Atwater for Chairman. Seconded by Mr. Brown. All in favor, none opposed.

Mr. Wille made a motion to nominate Mr. Brown for Vice Chairman. Seconded by Mr. Atwater. All in favor, none opposed.

**Public Comments** – Mr. Jim Godsey, Partner at MGO, thanked the County for the last four years. Mr. Godsey stated he was concerned there is not a lot of competition for public sector audits. Mr. Godsey stated that for the prior three evaluations, there was a downward trend in auditees, an unintended consequence of always wanting to get the best price. Mr. Godsey stated, after the Sarbanes-Oxley Act, Congress requested the Government Accountability Office (GAO) look at auditor rotation. GAO found the benefits of any increased independence from mandatory firm rotation are offset by the cost. Mr. Godsey stated four years ago, the price differential between firms was 1% but this time it was between 25%-33% and that has to have a negative impact on the work. Mr. Godsey stated MGO would not consciously reduce their scope of work or do less than what is required; MGO would not be able to come through in 4 years and be competitive.

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## AOC COMMENTS & ADJOURNMENT

**AOC COMMENTS** – Ms. Freidenrich stated the year-end process with the new federal tax changes affected the County in a positive way. Ms. Freidenrich stated when the new federal tax law was proposed in mid-December, T-TC and CEO worked together to post information on social media if people wanted to prepay their property taxes. When direction was received from the IRS, the guidelines mirrored what T-TC and CEO had put forth to the public. Ms. Freidenrich stated 80,000 more people paid the second installment, resulting in a total of 206,000 people who paid early. Ms. Freidenrich stated T-TC brought in over \$400 million from those 80,000 taxpayers. Additionally, a majority of payments were done online. Between Friday, December 29, 2017 at 5 PM, and Sunday, December 31, 2017 at midnight, the system processed over \$88 million with over 17,000 taxpayers on the website. Ms. Freidenrich stated T-TC also received 150 payments from taxpayers trying to prepay 2018; those checks were locked in a vault and when federal guidance was received indicating prepayment was not allowed, those payments were sent back to the taxpayers.

Mr. Woolery stated the Citizen's Report is available and he had extra copies for those interested in receiving one. Mr. Woolery stated colleagues at Sutter County noted Auditor-Controller operations; a delegation visited Orange County to observe A-C functions because they are thinking of replicating them in Sutter County.

**ADJOURNMENT:** 11:13 A.M.

## NEXT MEETING

Regular Meeting, March 29, 2018, 10:00 AM