

# REGULAR MEETING OF THE AUDIT OVERSIGHT COMMITTEE ORANGE COUNTY, CALIFORNIA

Wednesday, September 4, 2013, 1:30 p.m.

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

Supervisor Shawn Nelson Dr. David Carlson, Public Member

Chairman Vice-Chairman

Supervisor Pat Bates Jan Grimes, CPA
Member Auditor-Controller

Member

Michael Giancola

County Executive Officer Shari L. Freidenrich, CPA
Member Treasurer-Tax Collector

Member

**Philip Cheng** 

Performance Audit Director Sarah J. "Sally" Anderson, CPA

Ex-Officio Member (non-voting) Public Member

Bruce Hughes, CPA Mark Wille, CPA
Public Member Public Member

ATTENDANCE: Don Hughes as Proxy for Pat Bates, Jan Grimes, Shari

Freidenrich, Michael Giancola, Bruce Hughes, Philip Cheng

EXCUSED: David Carlson

ABSENT: Mark Wille, Sally Anderson, Shawn Nelson

PRESENT: Director of Internal Audit: Dr. Peter Hughes, CPA

County Counsel: Ann Fletcher Clerk: Renee Aragon

AOC Chairman Nelson was not present to convene the meeting. AOC Vice-Chair David Carlson was not able to Chair the meeting because of posting requirements. CEO Mike Giancola was designated as Chair the AOC meeting with instructions to conduct a roll-call vote for each item. CEO Mike Giancola called the meeting to order.

<u>1:30 P.M.</u>

#### 1. Roll Call

Attendance of AOC members is noted above.

Internal Audit staff – Mike Goodwin, Alan Marcum, Michael Dean, Dave Wiggins; Auditor-Controller Staff – Denise Steckler, Victoria Ross, Autumn McKinney, Toni Smart, Tonya Burnett, Nancy Ishida, Richard Son; Health Care Agency staff – Dr. Jeff Nagel and Kim Engelby; External Auditors Macias, Gini, O'Connell – Jim Godsey, Linda Hurley and Katherine Lai

## 2. Approve Audit Oversight Committee regular meeting minutes of May 22, 2013

Motion-Freidenrich, Second-Grimes

Roll-Call Vote: Giancola-Yes, Freidenrich-Yes, Grimes-Yes, 5<sup>th</sup> District Proxy-D Hughes-Yes, Wille-Yes, Anderson-Yes, Carlson-Excused, Nelson-Absent, B. Hughes-Absent

Approved as Recommended

## 3. Receive Required Communication from External Auditors Macias, Gini & O'Connell, LLP

Motion-Freidenrich, Second-Grimes

Roll-Call Vote: Giancola-Yes, Freidenrich-Yes, Grimes-Yes, 5<sup>th</sup> District Proxy- D. Hughes-Yes, Wille-Yes, Anderson-Yes, Carlson-Excused, Nelson-Absent, B. Hughes-Absent

#### Approved as Recommended

Mr. Jim Godsey, Partner, Macias, Gini & O'Connell (MGO) introduced Partners Linda Hurley and Katherine Lai. As the new external auditors for the County, Mr. Godsey explained the first part of the required communication in the agenda item letter and the planned audit coverage planned for year ended June 30, 2013. Mr. Godsey stated the second part of the required communications would follow the completion of the audit to discuss any questions, deviations of the audit or exceptions that may be noted during the course of the audit. He stated their responsibility to express an opinion on management's financial statements whether they are fairly presented in accordance with US Generally Accepted Accounting Principles. As part of the execution of the audit, they will look at internal controls but not express an opinion on internal controls. In addition to internal controls, they will test for compliance with laws, regulations, contracts and grants as items that can have a direct and material impact on the financial statements. The basic financial audit is driven by materiality. The professional audit standards provide guidance of materiality thresholds.

The Single Audit Report (SAR) is performed because the County is the recipient of federal financial systems. The audit will be done in accordance with OMB Circular A133. The SAR has a great deal of complexity and expectations. The Circular identifies specific compliance items for any given major federal program. The programs identified will be subject to testing for internal controls and overall compliance.

Mr. Godsey discussed a new standard for 2013 dealing with a group auditor. MGO will be the group auditor for Orange County. He stated there were two component units for Orange County. The separate organizations are Children and Families Commission and CalOptima. Reporting on this new standard will be included in the comprehensive financial statements of Orange County. The organizations would be included as discretely presented in a separate column. As group auditors, MGO will not audit those organizations. They will rely upon the work of other auditors and the report will clearly state that. The Group Audit standards were changing and there was uncertainty what the new expectations would be. Mr. Godsey stated MGO was more aggressive compared to other firms as far as what the expectations would be and their involvement. There would be enhanced communications and discussions about significant risk areas with the other auditors.

Mr. Godsey said they would discuss materiality levels the other auditors would be using to make sure they are within and conform to overall standards. A key item will be the "stub" period which is between the date of their report and the date of the County report. Hopefully the two standalone organizations will be audited and the auditors will have expressed their opinions in the late October early November time period. The County probably planned to issue their report hopefully in early December. That period of the other auditor report date issuance and the date of MGO report on County financial statements is that subsequent event period. Mr. Godsey stated MGO would have responsibility for subsequent timeframe. He said they don't have to audit during that period of time but must be aware of things that could happen that may impact the financial statements and they have a requirement and responsibility to have management disclose those. The actual specific items were still being worked out as to whether MGO should do some of that work. It would be done at a minimum under MGO quidance. There was consideration for the component auditors to perform the work because they were familiar with the organization. If it was decided they do it, it would be at MGO discretion and request and would be part of their responsibility. Mr. Godsey stated the new standard was part of the AICPA standards as opposed to the governmental standards so it applied to all audits including governmental audits.

Mr. Mark Wille asked Mr. Godsey if dual dating was considered to avoid the stub period and so avoid additional expense. Mr. Godsey stated their interpretation was there would not be dual dating. He stated if something specific came to their attention that required a significant level of work, we could have the component auditors perform that work and dual date their report especially if it could impact their opinion. Mr. Godsey stated the dual dating was not an option.

Mr. Wille asked under the new group auditor roles if there was a supervisory responsibility of MGO. Mr. Godsey stated there was a new level of responsibility, not yet supervisory. He believed the profession says that if they were not taking responsibility but relying upon the work of the other auditors there was no change. Mr. Godsey said the new standard suggested that there was a responsibility for materiality at the primary government level and responsibility for understanding the environment the component unit is operating in. Mr. Wille asked if there was a responsibility for work paper review. Mr. Godsey said if MGO were accepting responsibility and not going to refer to the other auditors, yes, they would perform work paper reviews.

Mr. Mike Giancola asked how Children and Families Commission (CFC) and CalOptima were selected. Mr. Godsey stated it was depending upon the relationship that drives whether the organization in the component unit was included or not under the new standard. Mr. Godsey said the CFC historically was included in the financial statements. This was the first year CalOptima was considered to be part of the component unit. Mr. Godsey stated the authority of the Board of Supervisors and their ability to appoint or control members of that Board was the driving factor.

Ms. Freidenrich asked if under the new standard to consider to solicit a bid together or separately. She stated her concern was an increased cost to the County. Mr. Godsey stated he was in the first year of the new contract as the external auditors and when they proposed on the contract, they were aware that CFC was a component unit. He stated because CalOptima was not a component unit in the past, they had not anticipated that was another component unit. Mr. Godsey stated they were internally working on the issue and would be presenting suggestions of level of work and associated cost to be performed to the Auditor-Controller.

Ms. Sally Anderson noted there were three partners on the engagement and asked what partner had what responsibility. Mr. Godsey stated he was the Client Partner and the Director from a prior team and a Manager from a prior team were also included. The execution side was handled by Linda Hurley, Partner in Newport Beach office. Katherine Lia will oversee the Single Audit. Because of the complexity of the audit, they decided to assign three Partners. (Orange County is the sixth largest County in the USA out of over 3000 and has a budget over \$6 billion with 24 departments.)

Dr. Dave Carlson asked when the audit started. Mr. Godsey stated they started right after contract was signed on June 10, 2013.

4. Approved amended Audit Oversight Committee Bylaws changing ex-officio membership of Performance Audit Director to become a voting member (prior AOC meeting dates: Nov 7, 2012 and May 22, 2013)

Moved-Wille, Second-Anderson

Roll Call Vote: Giancola-Yes, Freidenrich-Yes, Grimes-Yes, 5<sup>th</sup> District Proxy-D Hughes-Yes, Wille-Yes, Anderson-Yes, Carlson-Excused, Nelson-Absent, B. Hughes-Absent *Approved as Recommended* 

Dr. Hughes stated Supervisor John Moorlach requested the ex-officio membership of the Performance Audit Director be considered as a voting member of the AOC. Chairman Nelson requested the AOC Bylaws be amended to change the ex-officio membership of the Performance Audit Director to be a voting member of the AOC. The amended AOC Bylaws with the requested changes were presented for approval. Dr. Hughes stated if the AOC approved the changes the amended Bylaws would be presented to the Board of Supervisors for final approval at a future date.

Ms. Anderson asked about the balance of inside members versus outside independent members. Dr. Hughes stated no other County in California of the 58 counties had an established oversight committee composed of Board Members as well as other elected Department Heads. Dr. Hughes stated all other county audit oversight committees were appointed by the elected or appointed auditor-controller. He wasn't aware of any preferences of either independent or not. Dr. Dave Carlson said there had been no attempt to balance the internal or external membership. Ms. Freidenrich noted the nine member voting committee would increase to a 10 member voting board if the membership was changed. Mr. Wille supported the proposed.

5. Discuss changing the name of the OC Fraud Hotline.

Motion by Wille to establish members Mark Wille, Dave Carlson and Mike Giancola to a subcommittee not to exceed 6 months and include Dr. Hughes as ex-officio participant and support regarding the hotline and possible ethics name change and return with results at a future AOC Meeting.

Motion-Wille, Seconded-Anderson

Roll Call Vote: Giancola-Yes, Freidenrich-Yes, Grimes-Yes, 5<sup>th</sup> District Proxy-D Hughes-Yes, Wille-Yes, Anderson-Yes, Carlson-Excused, Nelson-Absent, B. Hughes-Absent AOC Subcommittee established to discuss Fraud and Ethics not to exceed six months and report back to the AOC at a future meeting. AOC Subcommittee Members: Dave Carlson, Mark Wille, Mike Giancola, Dr. Peter Hughes Ex-Officio participant.

Dr. Carlson stated there were two drivers that led him to request the item to be placed on the agenda. The first driver was the state of ethics. The second driver was from his experience in publicly held companies and the concept of the tone from the top. His observation was that Orange County has a very robust fraud hotline that was operating very well. He said expanding the hotline to include ethics was logistically a governance matter.

Dr. Carlson said he and Dr. Hughes could conduct a more studied analysis or establish a small subcommittee to do more research to follow with recommendations back to the AOC. Mr. Wille asked why there was interest in changing the name. Dr. Hughes said there is not an impetus to change the name, but it warranted periodic review to ensure that the title or reference invited participation. The current fraud title might be perceived as intimidating or discouraging people from calling in. The word fraud carried a stigma to it and some calls of improprieties may not be made because of it. Examining the title to be more welcoming was the intent. Dr. Hughes stated the titles of hotlines varied widely and there was no uniform title that everyone adopted that he was aware of. He said Orange County would not be the first to add ethics to the title. Dr. Hughes stated the hotline directs calls to appropriate agencies that we do not handle. He said that any EEO matters were referred to Central Human Resource Services.

Ms. Anderson said of the other boards or committees she was involved in that 90 percent of calls were HR related issues. Ms. Anderson asked if Dr. Hughes felt he received enough calls. Dr. Hughes stated he felt the hotline had lots of exposure and it was advertised throughout the County and posters were at employee meeting places within County building locations. In addition, he stated the Hotline and contact numbers were included on the electronic paystub portal for all County employees. This information is also on Internal Audit Department official letterhead.

Mr. Giancola said two Board Members were researching the potential for California Fair Political Practices Commission (FPPC) to be the ethics commission for the County as a result of a Grand Jury report. He recommended waiting upon the Board results and if the Board agreed and moved forward, the ethics issue would be addressed. He said the Grand Jury had recommended a full Ethics Commission and the Board was looking at its options. Mr. Wille said he was too undecided and suggested the appointment of a small subcommittee at that time the ethics issue was addressed and to revisit the issue then. Dr. Carlson said the item could be deferred until the next meeting or upon any board action. Ms. Freidenrich suggested adding FPPC to the referral list on the hotline posters and website and any additional information on whistleblower laws and where to include ethics in those areas. Mr. Wille felt a subcommittee could address the questions and do some research. Mr. Giancola said the County had a robust and long standing grievance process for employees and the Hotline seems to get both.

Mr. Wille moved a subcommittee be appointed not to exceed 6 months regarding the hotline and possible ethics name change and return with results at a future AOC meeting. Ms. Anderson seconded the motion.

Mr. Don Hughes (Proxy for Bates) said there were other areas in addition to the Internal Audit Fraud Hotline such as the District Attorney's office, Human Resources/EEO, Performance Audit, FPPC, Tin Cup, etc. with so many review levels. He suggested the discussion be open to all input to determine if enough review levels already exist or not.

Mr. Giancola requested volunteers for the subcommittee. Mr. Mark Wille, Dr. Dave Carlson and Mr. Mike Giancola volunteered and Dr. Peter Hughes was asked to serve as ex-officio participant to the Subcommittee.

6. Approve OC Internal Audit Department FY12-13 4th Quarter Status Report for the period July 1, 2012 through June 30, 2013 and approve 4th Quarter Executive Summary of Audit Finding Summaries for the period April 1, 2013 through June 30, 2013.

Motion-Freidenrich, Second-Grimes

Roll Call Vote: Giancola-Yes, Freidenrich-Yes, Grimes-Yes, 5<sup>th</sup> District Proxy-D Hughes-Yes, Wille-Yes, Anderson-Yes, Carlson-Excused, Nelson-Absent, B. Hughes-Absent *Approved as Recommended* 

Dr. Hughes explained the status report of the audit plan coverage for the completed FY12-13 audit plan and the executive summaries. Dr. Hughes stated any revisions or changes were noted milestones and comments column. Ms. Anderson stated the report was well done and it detailed everything happening in a couple of pages.

7. Approve 4th Quarter FY 12-13 External Audit Activity Quarterly Status Report for the quarter ended June 30, 2013

Motion-Freidenrich, Second-Wille

Roll Call Vote: Giancola-Yes, Freidenrich-Yes, Grimes-Yes, 5<sup>th</sup> District Proxy-D Hughes-Yes, Wille-Yes, Anderson-Yes, Carlson-Excused, Nelson-Absent, B. Hughes-Absent *Approved as Recommended with additional information to be added to the report for the next reporting quarter and going forward.* 

Directive: Add all audits that Internal Audit performs for any department as an external auditor to the report.

Dr. Hughes explained the External Audit Activity Quarterly Status Report. He stated there was one material issue from Health Care Agency (HCA) Behavioral Health. Representatives from HCA, Dr. Jeff Nagel, Deputy Agency Director of Finance and Administrative Services and Kim Engelby, Auditor-Controller/Health Care Agency Accounting were present to address any questions and address the issue. Dr. Nagel stated the State Department of Mental Health audited the HCA cost report. The claim was approximately \$208,000 which was less than four percent of the overall claim. The finding dealt with the County's Medical units report against the State's Medical units. The discrepancy was the variance with the State's report. The HCA had a liability account that covered the amount of the discrepancy and HCA would not require other funding.

Dr. Nagel stated the HCA had its own Compliance team. The Compliance office in coordination with programs did audit individual claims and individual services provided. The Compliance team did not audit the Cost Report but rather audited at the service level only.

Ms. Anderson referenced page 5 of 13 and requested how certain single audit procedures were being dropped from the report. Mr. Michael Dean, Audit Manager, Internal Audit Department explained the report. He stated the departments were asked to provide a list of anticipated audits. As the year passes, the audits not performed were dropped off. Ms. Anderson asked if the external auditor's decided the scope of the single audit. Mr. Dean answered yes. Internal Audit had no authority over the audits in the report. The report tracked the third party audits only. Mr. Wille suggested the report should detail what was required and what was not required. Dr. Hughes agreed.

Ms. Anderson referenced page 6 of 13 and requested a status on the HCA item. Dr. Nagel stated the estimated findings total \$742,852. HCA requested clarification of approximately \$41,000 and HCA did not concur with the remaining estimated findings of \$701,852. Because the draft report was in discussions with the State, HCA would not consider it a finding and would report the status of the item in each quarter until resolved.

Ms. Freidenrich referenced page 13 of 13. She stated Internal Audit won the bid and had been doing the audit for the Treasurer's office as an external auditor and felt the audit should be stated in the report. Mr. Wille requested that any other audits that Internal Audit performed as an external auditor should be included in the report where applicable. Dr. Hughes agreed to add any items to the report as requested. Ms. Freidenrich motioned to approve the report and add any Internal Audits performed for any department as an external auditor to be included going forward. Mr. Wille seconded the motion.

8. Receive and file Summary Highlights of Audit Reports Issued by Month for FY 12-13 July 1, 2012 to June 30, 2013 and beginning FY-13-14 July 1 to July 30, 2013 Motion-Freidenrich, Second-Grimes

Roll Call Vote: Giancola-Yes, Freidenrich-Yes, Grimes-Yes, 5<sup>th</sup> District Proxy-D Hughes-Yes, Wille-Yes, Anderson-Yes, Carlson-Excused, Nelson-Absent, B. Hughes-Absent *Approved as Recommended* 

Mr. Wille requested for any items in the report be marked that were closed or resolved or ongoing. Mr. Cheng suggested the CAAT routines be reconsidered to run quarterly instead of monthly. Dr. Hughes stated he would consider it.

PUBLIC COMMENTS: None

AOC COMMENTS: None

ADJOURNMENT: 2:40 P.M.

NEXT MEETING: December 4, 2013, 1:30 p.m. REGULAR MEETING