

# 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, September 25, 2014, 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

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

**Supervisor Shawn Nelson**  
**Fourth District**  
Member

**Supervisor Pat Bates**  
**Fifth District**  
Member

**Jan Grimes, CPA**  
**Auditor-Controller**  
Member

**Philip Cheng**  
**Performance Audit Director**  
Member

**Michael Giancola**  
**County Executive Officer**  
Member

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

**Dr. Dave Carlson**  
Private Sector Member

**Gary Caporicci, CPA**  
Private Sector Member

ATTENDANCE: Jan Grimes, Michael Giancola, Mark Wille, Shari Freidenrich, Dave Carlson, Philip Cheng, Shawn Nelson, Sally Anderson, Pat Bates, Gary Caporicci

EXCUSED: None

ABSENT: None

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

**2:00 P.M.**

## 1. Roll Call

Attendance of AOC members is noted above.

Guests:

Supervisor John Moorlach, Second District; Policy Advisors Lindsay Brennan and James Townsend; Fifth District Chief of Staff: Brian Probolsky; County Executive Office – Frank Kim, Chief Financial Officer; Internal Audit staff – Mike Goodwin, Alan Marcum, Michael Dean, Dave Wiggins; Auditor-Controller Staff – Denise Steckler, Victoria Ross, Autumn McKinney, Toni Smart, Tonya Riley, Nancy Ishida, Richard Son; OC Public Works Shane Silsby; External Auditors Macias, Gini, O'Connell – Jim Godsey, Linda Hurley and Katherine Lai; OCTA Audit Director Janet Sutter, Auditor-Controller Elect Eric Woolery

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2. **Approve Audit Oversight Committee regular meeting minutes of June 3, 2014.**

Motion: Freidenrich, Second: Grimes, Anderson abstained, Giancola excused, Bates, excused. All others were in favor, none opposed. The item carried.

**Approved as Recommended.**

3. **Receive Open Item of Audit Recommendations not Implemented from Second Follow-Up Internal Control Audit of OC Public Works Fee Generated Revenue (Audit No. 1022-F2) and Recommend Memo to Audit File.**

Moved: Freidenrich, Seconded: Giancola. All were in favor, none opposed. The item carried.

**Received as Recommended.**

Mike Goodwin, Senior Audit Manager, Internal Audit Department, explained the open item was being presented in compliance with AOC policy that any open item remaining after the second follow-up audit would be brought to the attention of the AOC. He stated the County policy requires that fee studies were to be done at least once a year or every three years but only if approved by the CEO.

Mr. Shane Silsby OC Public Works Director addressed the Committee. He stated he examined staff resources on how basic services were being provided and also how to reduce their dependency on the general fund. At the time he was appointed as Director staffing was down with 150 vacancies and some adjustments were made. His response to the open item was posed to the AOC. He wondered if it was best for his staff to conduct fee studies if there were no adjustments made. Mr. Silsby stated he directed his department to focus on cost recovery because the department was under recovering programs when he started. He said he recognized fully the policy requirements; however, allocating resources to studies when no adjustments will be approved by the Board was not efficient.

Ms. Anderson asked why the fees must be examined annually. She suggested staggering the time requirement to ease pressure. If it would be practical or realistic to change the examination period, it should be considered. Mr. Silsby agreed and stated he just learned that an exemption clause was available. He stated market studies were important to consider each year.

Dr. Carlson asked how many fees existed. Mr. Silsby reported approximately 200 development fee categories, 10 parking fees, 200 agricultural fee category fees, and more. He stated approximately 600 to 1000. Dr. Carlson asked how much was under recovered in a recent fiscal year. Mr. Silsby reported \$4.5 million in development fees alone.

Dr. Carlson asked if the policy was a requirement by statute or practice. Mr. Goodwin responded it was an Auditor-Controller County revenue policy. He stated it was written a long time ago and there were allowances for extensions or exemptions.

Ms. Grimes stated the problem wasn't the frequency of how the rates were calculated or updated. Processes exist to adjust or work with the departments over frequency. She stated the policy was based on a Board directive for full cost recovery. She stated at the heart of the challenge was that the County is an extreme economic environment where fee increases must be seriously discussed and debated to create an environment where the constituency and business partner can operate together.

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She stated communication needed to be clearer between the departments requesting the fee adjustments and the Board that needs to approve the adjustments. She stated she is open to allowing the departments to comply with the accounting policy and allow the Board to end up with the result they feel appropriate.

Mr. Silsby agreed communication was important and wants to know how much the County wants to subsidize programs.

Guest Supervisor Moorlach stated the Committee should consider the history of the financial position of the County. After the bankruptcy certain fees were not adjusted by the Board. The Planning department was overcharging and reserves were building. There were changes made and then the recession hit and the fee adjustments no longer offset the expenses. He said the recent OC Animal Care situation is similar. How much should the County charge, how much does the owner pay and what should be subsidized? Supervisor Moorlach acknowledged that staff had conducted fee studies, but the Board voted down any adjustments. He expressed the need to find a balance. Supervisor Moorlach agreed with Ms. Anderson's suggestion to consider a triennial evaluation.

Ms. Grimes stated she didn't feel there was anything in the County policy was limiting and that the framework already existed. She stated certain departments hold different positions on the policy.

Ms. Freidenrich thanked Mr. Silsby for all his efforts in shaping and forming OC Public Works in the time he's been there. She suggested improved communication on the existing policy because departments have different issues. She also suggested a legal review of the policy to consider the three year evaluation be changed to up to five years.

Supervisor Bates expressed that the Board considers the service delivery level and communicating that to the residents. The services wanted would cost a certain amount. She suggested that departments be clearer in their presentations to the Board to address the cost for service levels in incremental components and why fees are increasing. The Board wants to find a balance in a political and policy arena concerning fee increases.

Mr. Giancola said the policy states that the CEO in consultation with the Auditor-Controller will establish the policy and frequency. He stated there were many methods to accomplish the needs of each department. When he was director of OC Waste & Recycling, they did ten year agreements with the base fee set on CPI. He suggested the departments consider the same approach to alleviate the need to return to the Board. Mr. Giancola stated they would discuss the issue with the new Board. He said his office would meet with departments and Auditor-Controller staff to evaluate and identify a process within the policy in approaching the Board.

Dr. Carlson asked if certain fees were at a material level of under recovering that correction should be considered. Mr. Silsby stated he examined the fees prior to the meeting and estimated approximately 75% or greater were 50% or below in under recovering cost. He stated the fees had not been adjusted for a length of time. He referenced the Planning Department and the Barrett lawsuit that it limited the County to two months of operating capital. Recessions or increases last longer than two months. Costs have gone up for the County and the market impacts add to that.

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Mr. Silsby also informed the AOC of a significant issue that is affecting OC Public Works related to unincorporated areas in the County. As unincorporated areas were reducing in square mile areas and cost to provide basic services for the remaining unincorporated areas increase. The smaller the unincorporated areas become the larger the costs to the County will rise.

Mr. Wille thanked Mr. Silsby for raising the issues to the AOC and suggested an update by the Auditor-Controller and CEO to the AOC in a future meeting.

4. **Receive the required communication from External Auditors including the Single Audit Report for year ended June 30, 2013.**

Moved: Carlson, Seconded: Anderson. All were in favor, none opposed. The item carried. **Received as Recommended.**

Ms. Anderson introduced the external auditors from Macias, Gini and O'Connell. Ms. Katherine Lai presented the Single Audit Report for year ended June 30, 2013.

The audit was of approximately \$600 million of federal expenditures in the County for the reporting period. A risk assessment was performed based upon the professional standards. As a result of the risk assessment, 13 individual grants were identified that required to be tested. She discussed the four federal findings that pertained to three different programs. The compliance finding noted was related to sub-recipient monitoring by HCA. MGO did not issue an internal control finding over the compliance matter because the State had not provided proper guidance. Two findings were related to the Asset Forfeiture Grant in the Sheriff's department. The last finding was related the Justice Assistance Grant in the Sheriff's department. MGO also provided a brief summary of Uniform Guidance as requested from the last meeting.

Mr. Wille asked Dr. Hughes to consider following-up on the four findings identified and get back to the AOC if needed.

5. **Receive and file the Reconciliation of FY12-13 Governmental Activities Unrestricted Net Position (AOC Meeting June 3, 2013, Item 3).**

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

Ms. Grimes provided the reconciliation as requested from the last meeting. Guest Supervisor Moorlach stated the prior external auditors missed the UNP by approximately \$160 million. He felt the clerical error was significant enough to restate the financials.

Ms. Hurley stated they were aware the GFOA found the error and there were discussions about what and how it happened. She stated MGO met with management and the reconciliation and analysis was added to the closing process for the future to ensure the error would not occur again. Supervisor Moorlach suggested that if an error occurs again it should be noted in the financial statements. Mr. Godsey stated when the error was discovered, they evaluated the standards and they were not "compelled"- by the standards to qualify their opinion. They agreed it was important and it was discussed. They concluded the standards did not compel them to qualify their opinion on the second year of the financial statements. Supervisor Moorlach asked if their work papers noted that they 1) spoke with management about the issue and 2) recommend to management the error

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should be noted and responded they did not want to make the disclosure. Ms. Hurley stated they did in fact have the discussion but that MGO did not recommend the error be disclosed.

Dr. Carlson requested further explanation of the error. Ms. Hurley explained that when the County examined their investment and capital assets, there was a capital asset balance. When the net investment and capital assets were reported in the equity section, the balance should be reduced by any related debt that was outstanding. She stated the error was that a particular capital lease should have reduced the balance but it was added to the balance twice.

**6. Receive and file Orange County Employee Retirement System Communication and discuss and consider early implementation of new accounting standards GASB 67 & 68 and direct staff)**

Motion: Anderson, Second: Grimes. All were in favor, none opposed. The item carried.  
**Received and filed oral status report as recommended.**

Mr. Wille stated the audit was already in process and it was reported there was no possibility for early implementation.

Mr. Eric Woolery, Auditor-Controller Elect, introduced himself to the Audit Oversight Committee. His current position was that of Deputy Director, Riverside County District Attorney's Office overseeing Accounting, Finance, HR, Facilities issues. He is the City of Orange Treasurer. Additionally, he served on the Orange County Board of Education at the time of the Orange County bankruptcy in 1995.

New AOC Member Gary Caporicci introduced himself. He serves as Chair of the California Committee of Municipal Accounting. He serves on the council of CalCPA and he has written the GASB 67, 68 and 71 auditing courses.

**7. Approve the Revised Fiscal Year 2014-2015 Annual Audit Plan and Risk Assessment.**

Moved: Giancola, Second: Grimes. All were in favor, none opposed. The item carried.  
**Approved as recommended.**

Supervisor Bates asked for clarification to the scope of the audit for the 700 hours allocated to OC Public Works/OC Flood. Dr. Peter Hughes explained he used professional judgment based on past audits and other variables to estimate the hours planned. If overruns occur or if the audits were completed ahead of schedule, the quarterly status report of audit activity would reflect any adjustments.

Dr. Hughes said a general description was provided related to the scope of the audit and objectives, under Internal Control Audits, on page 5. The intent was to validate, substantiate and confirm the adequacy of critical internal controls. Emphasis was focused on key controls to ensure the assets were safeguarded from loss, waste and abuse and to determine compliance with department and County policies. He stated efficiency and effectiveness was also evaluated throughout the process under the review.

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Dr. Hughes said six fiduciary and special revenue audits were also planned this year to ensure revenues and expenditures were proper and in compliance with County and departmental procedures and laws. Dr. Hughes explained that a prior audit in the Clerk-Recorders' office identified accounting issues in special revenue funds that were missed. He said the County had approximately \$1.2 billion dollars in special or restricted revenues and spends upwards of \$500 million through those accounts each year. The department itself plans to examine the terms of restrictions and audit the funds to determine if the accounting and spending of those funds are in accordance with those restrictions.

Supervisor Bates thanked Dr. Hughes for the information and said she could meet with him to discuss further. Supervisor Bates requested that Dr. Hughes prepare information to present to her predecessor to help her understand the Internal Audit function, how it allocates audit resources and how and why the audit reports to the Board. Dr. Hughes agreed.

Discussion was held by members of the AOC over the number of auditors funded for IAD. Dr. Hughes stated that when he was originally hired as the director 15 years ago he was budgeted for 22 positions but due to budget cuts made by the County, he was now down to 15 positions. He reported that fewer auditors conduct few audits. He noted he has kept the AOC and the Board informed of these reductions over the years and their response has been to have IAD focus on the high risk audits first prior to planning audits on medium or low risk areas. Given his limited staffing, this means the medium to low risk areas historically have not been subject to audit. He noted that while this reduced coverage does present risks of missing issues in the unaudited areas, the risk has been weighted by the AOC and Board as a lower priority than the high risk areas identified and audited by IAD. Dr. Hughes said that the decision is a defensible one given the resource limitations and the fact that IAD has a very successful Control Self Assessment program that over the years has involved over a thousand County employees and almost every County department. He said all 11 auditors in the department are CPAs and that each has over 15 years of experience. Dr. Hughes noted that this level of expertise makes each of the CPA's very productive. Dr. Hughes was encouraged by members of the AOC to work through the budget process if additional staff were needed. Dr. Hughes was asked how many additional auditors he needed and he stated two for now. Mr. Giancola said it was difficult for general fund departments to find resources and might be difficult to get new positions added.

Dr. Hughes was asked why he audits leases. He stated revenue generating leases produce approximately \$150 million per year for the County. The County enters into leases with vendors and receives a gross off the top of revenues. Internal Audit works with three larger departments that accounts for most of the leases and audits to identify ambiguities and omissions in the contracts that may disadvantage the County. He stated focus on contract language was important.

Mr. Wille received a motion to approve as recommended items 8, 9 and 10. Motion: Caporicci, Second: Nelson. All were in favor, none opposed. The items carried.

8. **Approve OC Internal Audit Department FY13-14 4<sup>th</sup> Quarter Status Report for the period July 1, 2013 through June 30, 2014 and approve 4<sup>th</sup> Quarter Executive Summary of Audit Finding Summaries for the period July 1, 2013 through June 30, 2014.**

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

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Ms. Anderson asked for an explanation of cancelled audits. Dr. Hughes stated there were various reasons for cancelling an audit. It could be at the request of the department for legitimate reasons such as system implementations. If the item was cancelled, it is noted and reevaluated in the risk assessment for the following year.

Dr. Hughes explained column 3A was included on page 1 of 3 because data was lost between quarters when the department server change was made. One auditor's time was lost during the migration. A total of 285 hours were added and allocated between four audits and were identified in column 3A.

**9. Approve 4<sup>th</sup> Quarter FY13-14 External Audit Activity Quarterly Status Report for the Quarter Ended June 30, 2014**

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

**10. Receive and file Summary Highlights of Audit Reports Issued by Month for FY13-14 July 1, 2013 to June 30, 2014 and FY14-15 July 1, 2014 to July 30, 2014**

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

PUBLIC COMMENTS: None.

AOC COMMENTS: Supervisor Nelson thanked Supervisor Bates for her years of service on the Audit Oversight Committee. Supervisor Nelson requested for County Counsel to work with Internal Audit to amend AOC Bylaws to stagger the terms of the Private Sector At-Large Members.

ADJOURNMENT: 3:15 p.m.

NEXT MEETING: December 11, 2014, 3:00 P.M.