

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, June 1, 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:
Director of Performance Audit:

Shari Freidenrich, CPA
Eric Woolery, CPA
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; Peter Agarwal, Private Sector Member; Frank Kim, County Executive Officer; Robert Brown, Private Sector Member; Chris Gaarder, Proxy for Supervisor Andrew Do; Natalie Medvedev, Proxy for Supervisor Michelle Steel; Drew Atwater, 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.

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2. Approve Audit Oversight Committee regular meeting minutes of March 30, 2017

Dr. Carlson asked for a motion to approve the minutes of the March 30, 2017 meeting. Mr. Wille made a motion, Mr. Atwater seconded.

All in favor, none opposed. The item carried.

Approved as recommended.

3. Receive Single Audit Report, Communication with Those Charged with Governance at the Conclusion of the Audit FY 2016, Management Letter FY 2016, Communication with Those Charged with Governance during Planning and Audit Engagement Letter FY 2017

Dr. Carlson opened the floor for Ms. Hurley from MGO (Macias Gini & O'Connell). Ms. Hurley stated she provided a PowerPoint presentation summary regarding her discussion items, along with copies of the reports referenced.

Ms. Hurley stated that for the Single Audit, the County had approximately \$667 million in expenditures. On the MGO Risk Assessment under Uniform Guidance, eight major programs were selected for testing. Ms. Hurley stated that MGO's "in relation to" opinion on the Schedule of Expenditures of Federal Awards was unmodified, and the opinion on the Financial Statements was also unmodified. Ms. Hurley stated that MGO found no material weaknesses as part of the Federal Compliance Audit, but did identify a significant deficiency in relation to subrecipient monitoring, affecting three programs: state administrated matching grants for Supplemental Nutrition Assistance Program (SNAP), HIV emergency relief project grants, and the block grants for Community and Mental Health Services. The findings were related to DUNS numbers not issued with subawards. Ms. Hurley stated that this was a repeat finding and had been identified in other programs in previous years and the finding is a significant deficiency because it is a compliance requirement. From an administrative standpoint, the contracts had been in place prior to identifying these issues. Ms. Hurley stated that MGO is aware various County departments have made changes in their policies to ensure this is addressed moving forward.

Mr. Wille asked if these findings had been reported to all the departments so they were aware these are potential issues. Mr. Woolery stated that the Auditor-Controller's (A-C) office reaches out to departments when there are findings. Ms. Hurley stated that at the direction of the A-C's office, MGO provides a training to County departments and part of that training will address Uniform Guidance and the results of the audit.

Mr. Agarwal asked Ms. Hurley to expand on why the lack of a DUNS number is a significant finding. Ms. Hurley stated that in the Federal Compliance Guidance, under Uniform Guidance, there is a specific requirement indicating that DUNS numbers are to be provided to all subawards.

Ms. Hurley stated that the change to Communication with Those Charged with Governance at the Conclusion of the Audit FY 2016 was the implementation of GASB Statement 72, which relates to disclosures regarding Fair Value.

Ms. Hurley stated that the Management Letter identified one control deficiency as part of the Financial Statement Audit related to duplicate bank files in the Treasurer-Tax Collector (T-TC) system that needed to be corrected. Ms. Hurley stated that MGO did not feel it rose to a level of significant deficiency or material weakness because of the compensating controls within T-TC. Mr. Brown asked Ms. Hurley if she was referring to the \$110 million issue and why it does not rise to a higher level in terms of a material deficiency. Ms. Hurley stated that MGO looked at various

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factors and determined that if the error had been found before T-TC identified it, then it would have risen to a higher level of reporting. However, because T-TC had compensating controls that identified the discrepancy, MGO looked at it from an overall internal control process. Additionally, T-TC identified some improvements within their Policies and Procedures.

Ms. Freidenrich stated that processing money through the bank account for the County is an automated process. One of the staff members thought that the process had not been completed, so they went into the system and manually created the files, resulting in a duplicate entry for \$110 million. T-TC isolated the problem and created a checklist so that staff cannot go in and manually update information. Ms. Freidenrich stated that reconciliations are done daily and the process is to have a sign off within 10 days. However, T-TC had to work with their IT department to have all the manual entries removed from the reconciliation. Ms. Freidenrich stated that T-TC felt there was no impact to the County because the error was identified the next day.

Ms. Hurley stated that when looking at a control structure, MGO considers preventative and detective controls. In this instance, there was a detective control in place but a preventative control should have been in place.

Mr. Wille stated that it seems there should be an ability to manually override entries in special circumstances. Ms. Freidenrich stated that T-TC has implemented a process where management approval is required to download a file. Mr. Wille asked Ms. Freidenrich if a software change would need to be made. Ms. Freidenrich stated that T-TC went to the Board of Supervisors to get on the current version of Quantum software and T-TC is in the process of implementing it with the help of Auditor-Controller Information Technology (A-C/IT).

Dr. Carlson asked Ms. Freidenrich if the size of the issue made any difference in the ability to detect it. Ms. Freidenrich stated that the account is reconciled daily, down to the penny, and that she did not believe the amount made a difference.

Ms. Hurley stated that the other comments MGO had were informational regarding new GASBs. The biggest one is the implementation of GASB 74, which is Financial Reporting for Other Postemployment Benefits (OPEB). GASB 74 will be implemented in fiscal year 2018 because the County's OPEB plan is on a calendar year, and the plan year drives the implementation.

Dr. Carlson asked Ms. Hurley if she foresaw any risks in the County's ability to implement the new standards. Ms. Hurley stated that a couple of meetings have taken place between A-C and Employee Benefits, as well as OCERS, to discuss preliminary questions.

Ms. Hurley stated that there are three Status of Prior Year Recommendations. The recommendation regarding Investments has been implemented and the two recommendations regarding IT General Controls are still in process. MGO identified the IT General Controls findings during general controls procedures. Ms. Hurley stated that the Internal Audit Division (IAD) is going through a full IT risk assessment, which will capture MGO's recommendations, but will also go deeper in scope than a financial audit would. No new findings have been identified in relation to IT General Controls.

Ms. Hurley stated that the Engagement Letter for Communication with Those Charged with Governance during Planning for 2017 has been drafted and was submitted to the A-C office for review and signature. The AOC packet includes Required Communications for Planning for 2017, which recaps MGO's responsibilities under Generally Accepted Auditing Standards and Government Auditing Standards in the Uniform Guidance, scope, deliverables, and timing. Ms. Hurley stated that the IAD has engaged MGO to assist with the IT Risk Assessment. MGO has

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evaluated independence threats and does not feel that these services will conflict with their responsibilities as external auditors.

4. Receive Oral Report on County Cyber Security Program and Audit Coordination

Ms. Smart thanked Mr. Margolis, Chief Information Security Officer (CISO), for collaborating with Ms. Stallworth on the presentation. Ms. Smart stated that the IAD would be participating in quarterly meetings with OCIT.

Mr. Margolis stated that working with IAD was a natural fit because it allows OCIT to establish a baseline risk assessment and drive risk assessments. Mr. Margolis stated that one of the challenges in risk assessment is that the threat is largely unknowable but there can be a plan on how to respond and how to protect what we currently have by emphasizing continuity of operations, disaster recovery, and cyber incident response management.

Mr. Margolis stated that from January 13, 2017 to now, the County has achieved 89% completion of basic cybersecurity online awareness training. The program will continue to expand training objectives for IT professionals so that there are basic benchmarks that those charged with managing the systems have to meet. This ensures the individuals are qualified, that their skill sets are up to date, and they are doing what they need to do for their job.

Mr. Margolis stated that segregation of duties is also a preventative control, and this aspect will be a part of awareness training. Additionally, with the help of IAD, OCIT will be looking at what controls are, if they can be improved, modernized, or streamlined because sometimes there is a lot of redundancy, which can also create more risk.

Mr. Margolis stated that the Cyber Resilience Program is based on a 3-year cycle assessment that departments would go through. In the first year, IT staff would collaborate with department heads and administrative services for a self-assessment. In year two, if departments are posting the information on governance risk and compliance platforms, OCIT and IAD will work with the departments to validate the self-assessment completed in the first year. This phase will prepare departments for the third party review by Tevora Business Solutions. Mr. Margolis stated that the information IAD provides would drive the things to look at in the third year, such as a penetration test or a social engineering test.

Ms. Stallworth stated that IAD will “dovetail” the documentation that Tevora requests, and will capture that in a central repository. Mr. Margolis stated that it is the County’s Governance and Compliance platform. Ms. Stallworth stated that on the self-assessment process, IAD will work in an advisory capacity with departments by ensuring departments are on the right track.

Mr. Wille asked Mr. Margolis if cybersecurity SOC (System and Organization Controls) reports should be obtained for County vendors on a yearly basis. Dr. Carlson asked Mr. Wille to discuss what SOC reports are. Mr. Wille stated that the reports were called SSAE 16 but are now SOC 1, 2, and 3. These reports audit certain systems of a company and are used by smaller auditors when they need to review the same system. Mr. Wille stated that this report is to get good controls in place and a continual SOC report is issued later, which reviews if systems are in place and continue to work. Mr. Wille asked if the County has considered going down this road in the County for the cybersecurity area.

Mr. Margolis stated that the County is taking steps in that direction. OCIT works with vendors to have them provide a SOC-type report when dealing with County information systems or data.

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However, when companies are small, it is hard to get a SOC report, so OCIT conducts a risk assessment. If there is a high risk, OCIT would not compromise and would require a SOC report.

Mr. Wille asked Mr. Margolis how often he could report to the AOC. Mr. Margolis asked how often the committee would like him to report. Dr. Carlson stated that Mr. Margolis should report at every meeting, at least for the next year. Mr. Margolis agreed.

Mr. Margolis stated that a Maturity Index Level will be established using the Cyber Resilience Review from the Department of Homeland Security. Mr. Wille stated that at the next AOC meeting, he would like to know the status of selecting a vendor for the SOC report.

Mr. Margolis stated that OCIT has feeds with the California Cybersecurity Information Center that provide updated threat analysis. Mr. Wille stated that he thinks the Sheriff's Department would have some overlap with OCIT. Mr. Margolis stated that he is establishing a relationship with an investigator at the District Attorney's office, which is the next step in cybersecurity response. OCIT capabilities are not set up to isolate a system for law enforcement.

Mr. Agarwal asked Mr. Margolis if the initial assessment for the County would be conducted in 2018. Mr. Margolis responded that the assessment was due from all departments in June 2018. A big portion of IAD's Risk Assessment would be completed by November 2017.

5. Receive Oral Report on Auditor-Controller Internal Audit Division's Independence

Ms. Smart stated that Auditing Standards, Standard 110, require the audit function report its independence. Ms. Smart stated that she was reporting on the independence of the auditing function from June 2, 2016 through the current period (June 1, 2017). The audit function has had no interference with the scope, procedures, timing, or reporting of an audit.

6. Receive Oral Report on External Quality Assessment Performed by the Institute of Internal Auditors (IIA)

Ms. Smart stated that the External Quality Assessment was performed by the IIA. The formal report would be available at the next meeting. IAD was found to "generally conform", which is the highest rating. IAD had two areas of "partial conformance," which Ms. Smart will discuss at the next meeting. The IIA also identified 12 Areas of Best Practice and IAD was found to be well structured and progressive.

Mr. Smart stated that based on the Internal Quality Assessment, the IIA knew IAD would be a well-run function because of the transparency. The IIA also provided Best Practices that can be implemented, and IAD plans to implement them.

7. Approve the Auditor-Controller Internal Audit Division's FY 2017-18 Annual Audit Plan and Risk Assessment

Dr. Carlson asked for a motion to approve the Annual Audit Plan. Motion by Mr. Wille, second by Mr. Brown.

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Ms. Smart stated that there were many audits carried forward, leaving the amount of hours for new audits very limited. Ms. Smart stated that Mr. Woolery met with some Board members and she met with MGO to receive input on what risk areas could be incorporated in the Audit Plan.

Dr. Carlson asked Ms. Smart the number of vacancies in the department. Ms. Smart stated that there is one vacancy and that the position is frozen. Mr. Wille asked why the position was frozen. Mr. Kim stated that the County has a hiring freeze that is expected to lift at the end of June, with the passage of the State budget. Mr. Kim stated that certain State legislation would have dramatic impacts on the General Fund. As a precaution, most General Fund positions have been frozen but departments can make requests to unfreeze positions.

Ms. Smart stated that there are also government mandated audits, which include the Biennial Audit of the Juvenile Records and Accounts in the Probation Department, and a Tax Redemption Officer Audit, done every three years. Ms. Smart stated that the biggest audit area was A-C/IT and that IAD was going to do a comprehensive General Controls review of the A-C/IT function. The other audits were requested by departments or came up during the last Audit Plan. Ms. Smart stated that as the IT Comprehensive Risk Assessment is completed, if other areas are deemed high-risk, she would return to the AOC to revise the Audit Plan.

Mr. Agarwal asked if the Board had approved the 29,000 hours. Ms. Smart stated the amount was based on the amount of staff in the department and backing out any mandatory training and administrative hours. Mr. Agarwal stated that he believed 700 hours was not enough for IT audits. Ms. Smart stated that this number was only for the Comprehensive Risk Assessment, not all resources available to complete audits. Mr. Agarwal asked if this was similar for the 50 hours allocated to Cybersecurity. Ms. Smart stated the 50 hours was only to participate on the Cybersecurity Task Force and that there is room to re-allocate hours.

Mr. Kim stated that the plan has a lot of auditing of the IT and contract management process, and requested coordination between IAD and the County Procurement Office (CPO). Mr. Kim stated that he does not want CPO to complete an assessment of a department, and immediately follow it with an audit from IAD. Ms. Smart stated that she agreed with Mr. Kim.

Mr. Wille stated that coordination between departments has gotten much better over the years.

Dr. Carlson asked Ms. Smart to discuss the Schedule of 10-Year Prior Audit Coverage. Ms. Smart stated that a lot of the departments or business processes do not have a lot of activity, so they come in at a low risk area. Mr. Wille asked why IAD does not get into Child Support Services, County Counsel, and the Public Defender. Ms. Smart stated that it depends on the risk and availability of resources, and some of the areas do not have an element of risk that would require IAD to go in. Mr. Wille asked Ms. Hurley if MGO uses the IAD Schedule to create their risk assessment. Ms. Hurley stated that it is taken into consideration but MGO has different levels of materiality.

Mr. Gaarder asked Mr. Kim if, as a form of cost recovery, there were any areas that are audited with regularity, that IAD does not have to focus on. Mr. Kim stated that the cost of IAD is in the General Fund and recovered through administrative overhead billings. Mr. Kim stated that being responsible for a majority of County departments, it is not appropriate for him to tell IAD what they should or should not audit. Mr. Kim stated that he would identify areas of risk during the interview process but he keeps a level of independence from IAD.

Ms. Freidenrich stated that CPO has a review program that complements IAD, which provides comfort that some of the areas not being audited are also not being ignored. Mr. Kim stated that

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the review is part of their compliance, and is an opportunity to see that there is standardization in purchasing.

Dr. Carlson asked Mr. Kim if he would be willing to provide a brief overview at the next AOC meeting. Mr. Kim agreed.

All in favor, none opposed. The item carried.

Approved as recommended.

8. Receive Oral Report on Status of Hiring Director of Performance Audit

Mr. Kim stated that the Board approved the executive search firm and the recruitment would be opening this week, with a three-month window.

Mr. Wille asked Mr. Kim if an independent contractor firm should begin to provide this function until the system is in place, and if the AOC should begin the process of defining what the system would look like. Mr. Kim stated that the function of Performance Audit is under the direct supervision of the Board. Mr. Kim stated that one of the challenges in the last recruitment was that the applicant pool was comprised of financial auditors, which the Board was not looking for.

Mr. Kim stated that in 45-60 days he would see the recruitment list. If he felt that there were enough candidates with the right background, it would make sense to finish the recruitment. If potential candidates are financial auditors, then he may have a conversation with the Board about retaining a consultant to do that function. However, he would be faced with the same challenges of finding a consultant that has the experience in the field.

Mr. Wille asked Mr. Kim if it would be easier to hire a consultant instead of an individual inside the County. Mr. Kim stated that it was the purview of the Board. Mr. Wille stated that after two years, perhaps it is time to consider other alternatives.

9. Receive Oral Report on Status of the Request for Proposals (RFP) for Consultant Services for Independent Auditing and Related Services

Ms. Sinclair stated that the scope of work has been received and a draft is in progress. Panel members will be contacted once the RFP closes. Ms. Sinclair stated that a pre-proposal vendor conference would be scheduled mid-July. Vendors will be able to come in and ask questions, with a deadline for proposals of August 17.

Ms. Sinclair stated that proposals and review instructions would be provided to Panel members the last week of August. Panel members will have two months to review the proposals, and another meeting will be held to have Panel members come to a consensus on which firm will be recommended to the AOC. A draft contract will be presented to the AOC at the December or January AOC meeting. Ms. Sinclair stated that with the AOC's recommendation, the contract would be taken to the Board in March, with a contract start date of May 1.

Mr. Agarwal asked Ms. Sinclair if there was a clause in the RFP indicating that a minimum number of bids had to be received. Ms. Sinclair stated that the County generally does not include such information, however, if one bid was received, the County can reject the bid and go back out to bid. Mr. Agarwal stated that he thinks the County would want at least three bids. Dr. Carlson stated that many firms choose not to bid. Additionally, due to the County's financial issues 23

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years ago, there are some firms that are precluded from bidding, and the panel looks at firms with County experience with counties similar in size. Dr. Carlson asked Ms. Sinclair what the rule was for changing auditors. Ms. Sinclair stated that the Board indicated there could be a three-year contract with two one-year extensions, for a total of five years.

10. Approve Auditor-Controller Internal Audit Division's FY 2016-17 3rd Quarter Status Report for the period January 1, 2017 through March 31, 2017 and approve 3rd Quarter Executive Summary of Findings for the period January 1, 2017 through March 31, 2017

Dr. Carlson asked for a motion to approve the 3rd Quarter Status Report. Mr. Wille made a motion, Mr. Brown seconded.

Dr. Carlson asked Ms. Smart if there were any material issues. Ms. Smart stated that there were none but there were eight draft reports in Internal Controls. The next Status Report would have those reports completed.

All in favor, none opposed.

Approved as recommended.

11. Approve 3rd Quarter FY 2016-17 External Audit Activity Quarterly Status Report for the Quarter Ended March 31, 2017

Dr. Carlson asked for a motion to approve the External Audit Activity. Mr. Wille made a motion, Mr. Atwater seconded.

Ms. Smart stated that there were no material issues to report.

All in favor, none opposed.

Approved as recommended.

12. Receive Oral Report on COSO Usage in the County, Green Book or COSO County Acceptance, Internal Audit and the Systemic Cause of a Finding, and Performance Auditor and COSO Audit at the Department

Mr. Wille stated that he was very appreciative of the COSO presentation by MGO because this was a way to educate the County on how COSO works. Mr. Wille stated that the AOC Bylaws Article 7, Section 7 indicate that the AOC, along with the Auditor-Controller and CEO, will review the adequacy of the County's internal control structure. Mr. Wille stated that, in general, COSO is a recommended system but the County has to use it because it receives federal money. Mr. Wille stated that he wanted to know if there was anything that should be done with the Auditor-Controller and CEO to address this Article.

Mr. Woolery stated that the assessments that occur on internal controls satisfy this area.

Dr. Carlson asked Mr. Woolery and Mr. Kim to prepare comments regarding the adequacy of the current operations, as outlined in Article 7, Section 7.

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Mr. Kim stated that the review of adequacy occurs as a normal course of work because IAD conducts internal assessments and he is included in the distribution of drafts. When there are disagreements, Mr. Kim discusses them with Mr. Woolery and IAD staff.

Dr. Carlson stated that he agreed with Mr. Kim but would like explicit consideration at the next AOC meeting.

Mr. Wille asked Ms. Freidenrich if she had any thoughts about the COSO training. Ms. Freidenrich stated that she thought getting the training periodically was important because people forget. Ms. Smart stated that the video and PowerPoint are available online for those that did not attend.

Mr. Wille stated that an evaluation form could be sent to attendees to ask what changed within the department because of the training.

Mr. Gaarder stated that he was impressed by the quantity of high-level individuals that attended.

Public Comments – None

AOC COMMENTS & ADJOURNMENT

AOC COMMENTS: None

*AOC Chairman,
Dr. Dave Carlson*

ADJOURNMENT: 11:47 A.M.

NEXT MEETING: Regular Meeting, September 28, 2017