

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 28, 2017, 10:00 a.m.

HALL OF ADMINISTRATION

333 W. Santa Ana Blvd., 2nd Floor

Conference Room 206

Santa Ana, California 92701

Dr. David Carlson (District 3)

AOC Chairman, Private Sector Member

VACANT

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

Richard Murphy, CPA (District 2)
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:
Director of Performance Audit:

Mark Malbon for 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; Chris Gaarder, Proxy for Supervisor Andrew Do; Arie Dana, Proxy for Supervisor Michelle Steel; Michelle Aguirre, Chief Financial Officer, Proxy for Frank Kim, County Executive Officer; Robert Brown, Private Sector Member; Drew Atwater, Private Sector Member; Richard Murphy, 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 noted above.

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2. **Approve Audit Oversight Committee Regular Meeting Minutes of June 1, 2017**

Dr. Carlson asked for a motion to approve the minutes of the June 1, 2017 meeting. Mr. Brown made a motion, Mr. Atwater seconded.

Seven in favor, none opposed, one abstained. The item carried.

Approved as recommended.

3. **Receive Oral Report on Required Communication from External Auditors and Signed Engagement Letter**

Dr. Carlson opened the floor to Ms. Hurley from Macias Gini & O'Connell. Ms. Hurley stated that the engagement letter signed by Mr. Woolery was included in the AOC handouts. Ms. Hurley stated that the first draft of the Comprehensive Annual Financial Report has been distributed and the expected issuance date is December 14th. Ms. Hurley stated that for the Single Audit, four major programs have been completed and the audit is going well.

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

Dr. Carlson opened the floor to Mr. Margolis from Orange County Information Technology (OCIT). Mr. Margolis stated that the County Cyber Security Framework has been approved for the Cyber Security Manual. The Framework will be submitted to the IT Executive Council in April 2018. Mr. Margolis stated that the Framework establishes the foundation for how to do cyber security in the County, and was approved by all County departments.

Mr. Margolis stated that all departments have encumbered funds or are in the process of doing their audits. The Cyber Security Assessment is being done against the Department of Homeland Security's Cyber Resilience Review and of all County facilities that were looked at initially, there were only six findings.

Dr. Carlson asked Mr. Margolis what it means to have encumbered funds and why that is good news. Mr. Margolis stated that it is good news because when the Board set out the directive to do the Countywide cyber security audits and assessments, County Finance did an evaluation on which departments had a revenue offset and which did not. The General Fund was used to shore up the need for departments that did not have a revenue offset.

Dr. Carlson asked Mr. Margolis what percentage of an organization the 24 reviews constitute. Mr. Margolis stated that the policy review is 100% and physical security is close to 100% because doors and windows are checked. A representative sample of workstations is scanned because there are over 25,000 end points. Mr. Margolis stated that a 10-20% cross-section of a population is selected, which is adequate because computers are grabbed from different buildings. If one computer is bad, usually all of the computers on that network segment are bad.

Mr. Atwater asked Mr. Margolis if, when developing a representative sample, stratification across departments was conducted, such as age of computer. Mr. Margolis stated that IT wants to know that the owner is locking everything that they have and that it is incumbent on the owner of the old system to provide a response or plan of action for a system that cannot be patched.

Ms. Smart added that the IT Audit Manager is no longer with the County. Ms. Smart stated that a new Senior Audit Manager has been identified and is expected to start November 13th. Additionally, the vacant Audit Manager position will be filled with another IT Auditor. Ms. Smart stated that Jimmy Nguyen is continuing efforts with Mr. Margolis on the Cyber Security Task Force and work on the IT Risk Assessment with the external auditors.

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5. **Receive Oral Report on County's Comprehensive Framework of Internal Control**

Mr. Woolery stated that under state statute, the Auditor-Controller (A-C) is tasked with creating the internal control framework. A-C has a working group within the Controller's office that meets on an as-needed basis to review internal control issues that occur during the normal processing of transactions. A-C ensures internal controls match the Single Audit for federal grants and state grants, and uses the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Standards.

Ms. Aguirre stated that Mr. Kim has indicated he is in concurrence with Mr. Woolery. Mr. Woolery stated that Policies and Procedures are methodically being updated where needed.

6. **Receive External Quality Assessment Report from Institute of Internal Auditors (IIA)**

Ms. Smart stated that the final report was available in the AOC package. Ms. Smart stated that she asked the IIA to provide Best Practices the Auditor-Controller/Internal Audit Division (A-C/IAD) could consider implementing. Ms. Smart stated that all recommendations would be looked at and a strategy would be developed to implement those suggestions.

Ms. Smart stated that 12 positive attributes were listed and the key statement made by the IIA is that A-C/IAD is "well-structured and progressive." Ms. Smart stated that there were two areas of "partial conformance." The first area was regarding Standard 2240 on Engagement Programs; the IIA found A-C/IAD engagement programs were well documented and objectives were properly stated, but there is a requirement to have supervisory review. Although the workpapers were reviewed, the reviewer failed to initial where needed. Ms. Smart stated that this was a minor oversight and that due to the implementation of auditing software, this would not happen in the future. The second item was Standard 2110 regarding Governance. Ms. Smart stated that the IIA determined the audit planning process "provides an appropriate basis to conduct audits of controls but does not adequately include an overall evaluation of County governance as part of the general control system. Their recommendation stated that we should consider periodically assessing and making recommendations to improve the County's governance process. This can be achieved by placing governance processes in the audit universe and including engagements in the annual audit plan or to include steps in our audit engagements that covers the elements of governance, whenever the opportunity exists." Ms. Smart stated that changes to the audit plan, activities, and approach should be discussed with the Board of Supervisors (BOS) and senior management – in this case, the Audit Oversight Committee.

Ms. Smart stated that there is a perception that the Governance Standard is Performance Audit because it is not a typical area in internal control. Ms. Smart stated that A-C/IAD could accept "partial conformance" and have Performance Audit handle those things when the County gets a Performance Auditor, or incorporate the elements of Governance into A-C/IAD audits.

Dr. Carlson asked Ms. Smart what steps were appropriate to implement our way out of partial compliance. Ms. Smart stated that could be achieved by taking the existing audit program and identifying opportunities to cover elements of Governance. Dr. Carlson asked Ms. Smart if she expected any difficulties in doing that because there seems to be an encroachment in other parts of the County. Ms. Smart stated that with the current environment of the County, it will be a challenge because of the perception that this is a Performance Audit function, not traditionally part of A-C/IAD. Ms. Smart stated that the CEO and Board offices will have to buy into the message as far as what A-C/IAD is doing and why.

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Mr. Woolery stated that when the audit plan was being developed, he met one on one with all the Supervisors and each Supervisor was asking A-C/IAD to look into areas that are Performance Audit. Mr. Woolery stated that internal audit and performance audit are most efficient when they take place at the same time. There is a void and, as a department, A-C does not know if it should step in and fill that void because it is getting those requests or if it should wait because in a month there will be a Performance Auditor.

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

Ms. Aguirre stated that the recruitment is still open. The executive search firm came with a first round of resumes and submitted them to the Board subcommittee. The subcommittee rejected all of the applicants because applicants continue to be more on the financial side than the performance audit function. Ms. Aguirre stated that Mr. Kim has asked the County Chief Human Resources Officer to work with the executive firm to attract the person that the County wants. The intent is to fill all the positions. Ms. Aguirre stated that departments were concerned regarding the work done by A-C/IAD but after the COSO training, departments are come comfortable in their understanding of findings and recommendations that were maybe believed to be outside of A-C/IAD's role.

Dr. Carlson asked Ms. Aguirre if she had any insight as to why it has been so difficult to fill the PA position. Ms. Aguirre stated that it was due to the applicants having more financial audit experience, not performance audit experience.

Mr. Brown asked if the AOC should operate on the assumption that it will be some time before the position is filled, and if it would be appropriate for A-C to step in. Ms. Smart stated that IAD is willing to take that on in the interim, as she has been a performance auditor. Mr. Woolery stated that it would have to be a Board item and there would need to be a budget earmarked for performance audit. Ms. Aguirre stated that the recruitment is still ongoing and an update would be provided at the next meeting.

Mr. Atwater asked Ms. Aguirre if there was an option to contract out the work until the position is filled. Ms. Aguirre stated that it is something that can be looked at. Ms. Aguirre stated that at the next meeting there would be a report on the status of the executive recruitment and research on options of a possible contract versus combining it with A-C/IAD.

Dr. Carlson stated that he was not comfortable with receiving updates one quarter at a time. Dr. Carlson stated that if no definitive candidate is likely to start in the January timeframe, there should be a recommendation as to how to proceed. Dr. Carlson asked Ms. Smart if there was anyone in A-C/IAD, other than herself, that has a background in performance audit and can be temporarily diverted. Ms. Smart stated there is no one and the staff available would be entry level.

Mr. Gaarder stated that there are two items being discussed: governance issues that relate to internal control and Performance Audit, which is set up separately by the Board for a reason. Mr. Dana stated that the Board subcommittee is actively engaged in the recruitment process.

Dr. Carlson requested a proposal between A-C/IAD and CEO on the next steps. Ms. Aguirre stated that ultimately it was up to the Board as the performance audit function is separate and they are the only ones with the authority to modify it. Dr. Carlson stated that he agreed and that the Board operates on proposals, so he would like a proposal at the next meeting.

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8. Receive Oral Report on County Procurement Office's Compliance Review Process

Dr. Carlson opened the floor for Mr. Richardson, County Procurement Officer. Mr. Richardson introduced Melva Gibson and Jan Eickholt as Certified Public Procurement Buyers, the highest designation in that professional area.

Ms. Eickholt provided an overview of CPO's Compliance Review Program through a detailed PowerPoint presentation. The presentation covered the Compliance Review Program from start to finish. Ms. Eickholt stated that the County Procurement Office (CPO) reviews all departments annually and each review results in a Final Discovery Report which is provided to the department. A notification memo is sent 30 days in advance to the Department Head, review participants and the Procurement Council Representative of the review department. The notification to the Procurement Council Representative, which is also a Deputy Purchasing Agent, contains a File Folder list and instructions to prepare for review team when they arrive on site. If there are instances of noncompliance, CPO does a mini training covering discoveries that are in question. If there is push back from the department, CPO will escalate to the department head.

Mr. Atwater stated that with local government, one of the biggest challenges is procuring and adapting to changes in technology, Mr. Atwater asked if practices were being evaluated to tap into micro services and the gig economy that creates a more competitive atmosphere. Mr. Richardson stated that CPO works with IT on issues that address these matters; one example is the implementation of an online universal requisition tool for the County called OC Expediter. Mr. Richardson stated that an electronic insurance monitoring tool is also being developed to ensure compliance with contract requirements.

Mr. Gaarder asked Mr. Richardson if departments are giving recommendations related to County Procurement Manual (CPM) revisions. Mr. Richardson stated that prior to the most recent CPM updates, CPO reached out to departments for their input and worked closely with Supervisor Steel and Supervisor Bartlett's respective offices on the subcommittee. Ms. Aguirre stated that the CPO does an annual survey requesting feedback and there are meetings with Deputy Purchasing Agents, so there is no lack of feedback.

Dr. Carlson asked Mr. Richardson if there are any areas within the County that do not go through this rigorous review process but should. Mr. Richardson stated that he is not aware of anything unattended and that the compliance review process is a good tool to ensure Policies and Procedures are being followed. Dr. Carlson asked Ms. Smart the same question. Ms. Smart stated that CPO has a very robust compliance program and a key part of the control system is having compliance. A-C/IAD reviews what happens to the results and goes out to departments to ensure they are following what they should be. Procurement is a high-risk area because of the amount of money going out.

Dr. Carlson asked how much money goes through the procurement process each year. Mr. Richardson stated it is probably between 2.5 and 3 billion dollars. Mr. Richardson stated that people need to know what the rules are and that there are consequences when those rules and procedures are not followed. Mr. Richardson stated that CPO has trainings and sets up meetings with specific departments when CPO recognizes the need. These meetings are an opportunity to let departments know CPO is closely reviewing what they submit and approval is not guaranteed Mr. Richardson stated that, as a result of the Board subcommittee, starting in January, all Procurement Managers and Procurement Staff will be required to attend an ethics course in addition to all the other mandatory training.

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9. Discussion of When to Consider an Audit Completed When One of the Findings Is a Critical Control Weakness and Audit Report Confidentiality

Dr. Carlson stated that he wanted to discuss Critical Control Weaknesses and when to consider them resolved. Dr. Carlson asked Ms. Smart to provide an overview of why the topic was brought up. Ms. Smart stated that the discussion had to do with a Critical Control Weakness pertaining to the ePages system. This system supports the Public Administrator and the Public Guardian tracking of assets of third parties.

Dr. Carlson asked Ms. Smart to define a Critical Control Weakness. Ms. Smart stated that a Critical Control Weakness is of such significance that the department is expected to take action to resolve it immediately. In this instance, the system lacks controls to ensure the accuracy of reporting, tracking assets, or protecting information. A-C/IAD's recommendation was to make it a priority to go out to bid and get Board approval to obtain a new system. Ms. Smart stated that during their conversation, Dr. Carlson asked why the finding was closed out as "implemented" after the department got approval to buy a system. Ms. Smart stated that the recommendation was satisfied. In addition, the Audit Plan has IT Auditors working in an advisory capacity, as part of the implementation process. As the system is implemented, IT Auditors ensure that the weaknesses A-C/IAD identified are addressed. Ms. Smart stated that A-C/IAD adds value in overseeing the implementation process because auditors can spot issues beforehand, rather than after the fact.

Dr. Carlson stated that the direction at which he approaches this issue is regarding the AOC and visibility the AOC has to these issues. Dr. Carlson stated that a declaration of intent and acquisition of funding does not constitute immediate action required by a Critical Control Weakness. Dr. Carlson asked if, from an AOC standpoint, it is reasonable to close a Critical Control Weakness when there is declaration of intent and acquisition of funding, rather than confirmation that the issue actually got fixed. Dr. Carlson requested that at the next AOC meeting there be a discussion on whether the AOC needs continued visibility of Critical Control Weaknesses even after a declaration of intent and the acquisition of funding.

Ms. Smart stated that regarding report confidentiality, as A-C/IAD starts looking at IT controls, a full disclosure report will not be provided to the public because of the risk associated with making vulnerabilities known. For the general audience, the report includes the number of weaknesses and the scope of the audit. A full Confidential report is provided to the BOS, AOC Chairman, and CEO.

Dr. Carlson asked Mr. Servino if he had any comments on the burden of redacting reports. Mr. Servino stated that by balancing security and transparency, there are two ways to approach redactions. Mr. Servino stated that one approach is to have the backup segregated from the report but still be able to describe the issue so that the report provides utility to the decision makers. The other approach is to redact the report but this also minimizes the utility of the report.

Dr. Carlson stated that the burden of the Public Information Act is to comply or justify noncompliance. Mr. Servino stated that every record is presumably a public record and is subject to disclosure unless there is an exemption. Mr. Servino stated that County Counsel is available to assist for the release of particularly sensitive reports where describing the issue simultaneously increases vulnerability. Dr. Carlson stated that, when in doubt, talk to Mr. Servino who will assist with balancing the public information with vulnerability.

10. Approve Auditor-Controller Internal Audit Division's FY 2016-17 4th Quarter Status Report for the period April 1, 2017 through June 30, 2017 and Approve 4th Quarter Executive Summary of Findings for the Period April 1, 2017 Through June 30, 2017

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Ms. Smart stated that all treasury audits were completed, there are many carryover audits in IT, and there are many internal control audits in process that will be carried over into the next fiscal year. Ms. Smart stated that she is recommending the SAIC and Xerox/Atos contract audit be postponed to discuss it with the future Performance Auditor. Ms. Smart stated that the Xerox/Atos contract is ending in approximately one year, so there will be a bid, and the SAIC contract will be extended. Ms. Smart stated that looking into the contracts should be a partnership between A-C/IAD and Performance Audit to look into the performance of the contractors.

Dr. Carlson asked for a motion to approve the Auditor-Controller Internal Audit Division's FY 2016-17 4th Quarter Status Report for the period April 1, 2017 through June 30, 2017. Mr. Atwater made a motion, second by Mr. Murphy.

All in favor, none opposed. The item carried.

Approved as recommended.

11. Approve 4th Quarter FY 2016-17 External Audit Activity Quarterly Status Report for the Quarter Ended June 30, 2017

Ms. Smart stated that each quarter an External Audit Activity Report is provided to the AOC, which contains input from all of the departments on audits that are planned and the status of the audits. Ms. Smart stated that the AOC has asked A-C/IAD to bring to their attention any material issues that arise through that inquiry process. For the quarter, there was one material issue pertaining to the Orange County Child Support Services.

Mr. Gorzo from Orange County Child Support Services (CSS) stated that a Corrective Action Plan has been implemented and the questioned cost is no longer on the 2016-17 Claim. Mr. Gorzo stated the demand letter from California Department of Child Support Services (DCSS) reduced the finding from \$625,000 to roughly \$345,000. Mr. Gorzo stated that CSS is seeking clarification from DCSS on whether some of the costs will be allowable going forward.

Dr. Carlson asked Mr. Gorzo if that makes the County vulnerable for the year subsequent to the findings. Mr. Gorzo stated it does but only for 2015-16 as the costs will no longer be claimed.

Ms. Smart asked Mr. Gorzo if there was a misinterpretation of Uniform Guidance pertaining the management fees. Mr. Gorzo stated that, in his opinion, there was a misinterpretation.

Dr. Carlson asked for a motion to approve the 4th Quarter FY 2016-17 External Audit Activity Quarterly Status Report for the Quarter Ended June 30, 2017. Mr. Brown made a motion, seconded by Mr. Murphy.

All in favor, none opposed. The item carried.

Approved as recommended.

12. Election of New Vice Chair

Dr. Carlson stated that he would like to nominate Mr. Atwater as Vice Chair and asked if there were any other nominations. There were none.

All in favor, none opposed.

Approved as recommended.

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Public Comments – Dr. Peter Hughes, Los Angeles County Assistant Auditor-Controller, stated that he had the privilege of working with Dr. Carlson for over 17 years. Dr. Hughes stated that Dr. Carlson volunteered to be appointed to the Audit Oversight Committee at a time when Orange County was considered the poster child of poor governance. Dr. Hughes stated that agreeing to serve 3 million citizens of Orange County was a daunting task and demotivated most executives from the private sector from agreeing to serve on the Committee. Dr. Hughes stated that during his time, Dr. Carlson was the constant in the AOC and saw 22 elected Supervisors, 8 CEOs, and 5 County Counsels working toward the goal of making Orange County the poster child of good governance.

Mr. Woolery stated that he would like to bestow Dr. Carlson with a Taxpayer Watchdog Award, which was created to acknowledge those within and outside the County that do good things for the taxpayer. Mr. Woolery stated that Dr. Carlson embodies a Taxpayer Watchdog in his service and thanked Dr. Carlson for his service.

AOC COMMENTS & ADJOURNMENT

AOC COMMENTS: None

*AOC Chairman,
Dr. Dave Carlson*

ADJOURNMENT: 11:29 A.M.

NEXT MEETING: Regular Meeting, January 25, 2018, 10:00 AM