

S U M M A R Y M I N U T E S

REGULAR MEETING OF THE AUDIT OVERSIGHT COMMITTEE ORANGE COUNTY, CALIFORNIA



Wednesday, May 27, 2009, 1:00 p.m.

HALL OF ADMINISTRATION
333 Santa Ana Blvd., **3rd Floor**
CEO Main Conference Room
Santa Ana, California

TELECONFERENCE LOCATION: IHS, Inc.
15 Inverness Way E
Englewood, Colorado 80112

Supervisor Patricia Bates
Member

Supervisor Janet Nguyen
Member

David Sundstrom
Chairman

Thomas G. Mauk
Member

Dr. David Carlson
Vice Chairman
Public Member

Chriss Street
Ex-Officio Member (non-voting)

ATTENDANCE: David Sundstrom, Chriss Street, Tom Mauk, Bob Franz (Proxy), Dr. David Carlson

EXCUSED: Pat Bates, Janet Nguyen, Tom Mauk

PRESENT: County Internal Auditor, Internal Audit Department: Dr. Peter Hughes
County Counsel: Ann Fletcher
Substitute Clerk: Ken Wong

1:04 P.M.

1. Roll Call

Internal Audit Department: Peter Hughes, Eli Littner, Mike Goodwin, Autumn McKinney, Alan Marcum, Camille Gackstetter, Wilson Crider, Ken Wong; Auditor-Controller and staff: David Sundstrom, Shaun Skelly, Claire Moynihan, Colin Hoffmaster, Samantha Yung; Treasurer-Tax Collector and staff: Chriss Street, Paul Gorman; County Executive Office: Tom Mauk, Bob Franz (Proxy received for Tom Mauk); County Counsel Office: Ann Fletcher; Public Member: Dr. David Carlson (Teleconference participation); Vavrinek, Trine, Day & Co.: Roger Alfaro

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2. Approve Audit Oversight Committee Minutes of March 25, 2009

VOTE: Motion-Franz (proxy for Mauk), Second-Carlson, Sundstrom-Yes, Bates-Excused, Nguyen-Excused

Approved

NOTE: Subsequent to adjournment, Ann Fletcher stated to Eli Littner that she was not in attendance for the March 25, 2009 meeting and Ben DeMayo was in attendance for the County Counsel Office. This was corrected in the minutes of March 25, 2009.

3. Receive Status of the Structured Investment Vehicles (SIV) Held in the County's Investment Pool (continued from AOC 9/17/08, Item 6, 5/29/08, Item 5, 2/28/08, Items 6 and 8, 12/11/09, Item 3, 3/25/09, Item 4)

No reportable action taken.

Mr. Street and Mr. Gorman entered meeting at 1:32 p.m.

Mr. Paul Gorman provided a hand out and status of the SIVs. Dr. Carlson received a faxed copy of the hand out. Mr. Gorman summarized the narrative portion on the second page of the hand out. Mr. Gorman stated that the third page of the handout compared the recovery amounts reported by the receiver and the County. Mr. Gorman further stated that the recovery amounts from the receiver were reported through notices as opposed to financial statements.

Mr. Sundstrom inquired on setting a lower price and difference for basis points. Mr. Street stated that there were no immediate plans to liquidate the investment. Mr. Street further stated that it would be better to ride out the recovery. Mr. Sundstrom stated that as the Chair of the County Treasury Oversight Committee, he wants to validate this course of action. Mr. Sundstrom further stated that if the investment does not comply with the County's Investment Policy Statement then it was important for the Treasury Oversight Committee to approve the holding. Mr. Sundstrom also stated that the investment was composed of a lot of AAA and AA rated investments and a calculation of the investment's credit rating disclosed the rating slightly below AA.

Dr. Carlson inquired on the range of loss for the investment. Mr. Street stated that the plan was to hold the investment and anticipates the financial position over time would become more favorable with a higher recovery rate. Mr. Sundstrom stated that a recent open auction of the investment disclosed the carrying value for the investment was approximately close to the market value.

Mr. Franz inquired on the outcome of the expired one year notes. Mr. Gorman stated that the notes would roll over. Mr. Franz stated that one option was to sell the investments at market value.

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4. Oral status of Internal Audit Department response to Grand Jury Report, "Guardian of Last Resort"
No reportable action taken.

Dr. Hughes stated that the Grand Jury's report on the Public Administrator/Public Guardian's office included a series of recommendations pursuant to the Penal Code. Dr. Hughes further stated that responses to the recommendations were due to the presiding judge. Dr. Hughes stated that one recommendation stated the Internal Audit Department should conduct a review for the existence of pension spiking practices at PA/PG and other County departments. Dr. Hughes stated that he discussed the issue with members of the AOC and certain members of the Board and the audit was included within the proposed audit plan for the upcoming fiscal year.

Dr. Carlson inquired on the approval process for promotions. Mr. Sundstrom responded that the authority for promotion rested with the elected official for that department.

Dr. Carlson inquired on what the audit scope would cover. Dr. Hughes stated that a survey could be conducted on process for authorizing appointments, promotions, and setting salaries. Mr. Sundstrom stated that pension spiking exists and cited two instances at the Probation Department. Mr. Sundstrom suggested measuring the occurrences. Dr. Hughes stated it was important to understand the questionable practices, whether there was a large pension impact, and if promoted individuals met the qualifications. Dr. Hughes further stated that the audit may conclude remedial action would be required to enforce or set new policies.

Dr. Carlson inquired on whether the subject was part of the legitimate scope of the Internal Audit Department and Audit Oversight Committee. Mr. Sundstrom inquired on whether the subject should be pursued prior to responding to the Grand Jury recommendations.

Dr. Hughes stated that the issue was not identified in the risk assessment process but outside the process. Dr. Hughes stated that the topic was reported in the local newspapers and revealed an impact to the taxpayers of an unfunded lifetime pension increase of \$1,500,000 for just one employee. Dr. Hughes stated that the magnitude of this one management decision was such to warrant an audit. He believes the audit would be a quick engagement and not bump other audits.

Mr. Sundstrom stated that a survey could be completed quickly. Mr. Sundstrom further stated that the survey could examine retirements in the last three years and whether pension spikes occurred. Mr. Sundstrom suggested that Ray Stephens from his office could provide the information.

Mr. Franz stated the recommendation requests responses from multiple groups and the Internal Audit Department should coordinate their response with the CEO and Human Resources Department. Mr. Franz stated that the Human Resources Department has examined a couple of the items in the Grand Jury report regarding pension spiking.

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5. Approve Annual Audit Plan for Fiscal Year 2009/2010
VOTE: Motion-Franz (proxy for Mauk), Second-Sundstrom, Yes-Carlson, Bates-Excused, Nguyen-Excused
Approved with the removal of Audit of Treasurer-Tax Collector SIV Sales and Proceeds (Item No. 6 on page 6).

Dr. Hughes presented the draft annual audit plan and asked for comments.

Mr. Franz inquired on whether the amount noted in the Audit Plan for Countywide Wire Transfers of \$22 billion was correct. Mr. Goodwin stated yes it was and that there were a variety of County processes involving wire transfers and the dollar amount stated in the draft annual audit plan was greater than what was initially identified.

Mr. Franz requested clarification on the audit of the Treasurer-Tax Collector SIV Sales and Proceeds. Mr. Marcum stated that one of the offices for Board of Supervisors requested a review of how the transaction was handled. Mr. Franz inquired on the budgeted hours for the assignment. Mr. Marcum stated that the audit would include examining the documentation related to the sale. Mr. Franz stated that the Treasurer's Office was on top of things regarding the timing of the sale. Dr. Hughes stated that the topic was sensitive due to the media reports and the audit would consist of the fundamentals for booking the transaction and related support. Mr. Franz inquired on whether the audit would determine whether the transaction was recorded correctly. Mr. Sundstrom inquired on how the audit would specifically address the issue. Mr. Sundstrom stated that his office already looks at this. Dr. Hughes asked whether the Auditor-Controller's office performed the review on a sample basis or all sales. Dr. Hughes also asked whether the Auditor-Controller's office would agree to perform an agreed upon procedures assignment on the topic. Mr. Sundstrom agreed to conduct a specific review of this transaction and clearly report on it in his upcoming audit so as to address it in enough detail to accomplish what Dr. Hughes was intending to do. Dr. Hughes stated that the audit would be dropped from the Internal Audit Department's 09/10 audit plan with this commitment from Mr. Sundstrom.

Mr. Sundstrom expressed his appreciation for the proposed information technology audits and complimented the selection to audit the CAPS+ Implementation Controls over HR/Payroll Systems. Mr. Sundstrom stated the County should keep as much as possible in house for the audit. Ms. McKinney stated that she met with Larry McCabe to discuss the controls over the HR/Payroll Systems implementation. Ms. McKinney further stated that internal validation procedures were completed. Dr. Hughes stated that the Internal Audit Department planned to prepare a matrix showing the levels of internal and external review to determine whether any gaps existed requiring the Internal Audit Department to participate in the validation process.

Mr. Sundstrom stated that the HR/Payroll Systems would be implemented over 18 months by the same company that was implementing the financial system. Mr. Sundstrom cited that the go-live date for the financial system was close and did not expect any hiccups as experienced by other entities.

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Dr. Carlson asked whether the implementation process was operating as it should. Ms. McKinney responded that the review of the financial implementation process disclosed project management controls and a sufficient number of people to reduce the risk of misrepresenting the status of the project. Ms. McKinney added that the existing controls had two levels of defense against misrepresenting the project status and another review by the Internal Audit Department would be a third level of defense. Mr. Sundstrom stated that the implementation process for the financial system included a fit gap analysis and contained over 200 highly detailed deliverables for the contractor. Mr. Sundstrom further stated that the implementation contract was a fixed fee and the contractor would not get paid until deliverables were met. Mr. Sundstrom stated that the contractor stands to lose more money than the County and accountability existed at the task level. Dr. Hughes stated that the task list showed a name and title for easy review. Mr. Sundstrom stated that the same company developed and engaged to implement the new system.

6. Receive and file Fraud Hotline Summary Report for the period Calendar Year 2008

VOTE: Motion-Carlson, Second-Franz (proxy for Mauk), Sundstrom-Yes, Bates-Excused, Nguyen-Excused

Received and filed.

Dr. Hughes stated that analysis was prepared in response to questions from Supervisor Nguyen at the prior meeting. Dr. Hughes further stated that the analysis disclosed only 5% of the hotline calls were received during non-business hours and 95% contacts were received during business hours through e-mail, telephone calls and walk-in appointment with the Internal Audit Department and that virtually none of the hotline calls were received during the weekend.

Dr. Hughes stated that the volume of calls was increasing due to the consolidation of County business functions and layoffs. Dr. Hughes added that the Internal Audit Department was working with other departments to analyze internal controls during the layoff process. Dr. Hughes stated that departments don't want to remove key personnel without assessing the effect of layoffs. Dr. Hughes stated that three lines of defense exist in the county whenever an employee has a concern over the conduct of the county: first they can meet with the employee's immediate supervisor; next they can meet with the department head, and as a last resort they can meet with the Internal Audit Department if remedies were not adequate. Dr. Hughes stated that ethics training was provided at the larger county agencies as well as at the County Leadership Academy. Dr. Hughes stated he has and will also provide training on ethics when requested.

Mr. Sundstrom asked if there was a recommendation to discontinue use of the vendor to process hotline calls during non-business hours. Dr. Hughes responded that his recommendation was to continue using the external vendor to ensure coverage. Dr. Hughes added that the vendor fee is \$3,000 per year and the Internal Audit Department approved of the reporting format from the vendor. Dr. Hughes added that the vendor had delivered as contracted.

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7. Discuss Audit Oversight Committee Checklists for Self-Evaluation, Compliance and Review Calendar and direct staff

Directed staff to distribute to committee for comment

Dr. Hughes stated that the Checklists for Self-Evaluation, Compliance and Review Calendar were in response to questions raised during the orientation for Supervisors Bates and Nguyen. The checklists were "Cliff Notes" for quick reference on audits and managing risk for the Board and AOC. The checklists include research materials from an association of government audits and best practices for oversight committees based upon a survey of governmental entities. Dr. Hughes further stated that effective practices were not one size fits all and government agencies need to fit their specific particulars. Dr. Hughes asked for input from the AOC on the checklist in draft form.

Mr. Sundstrom stated that the content of the checklists is a healthy process. Mr. Sundstrom further stated that the association of governmental auditors was composed of largely federal auditors with a different viewpoint than local auditors. Mr. Sundstrom stated that best practices should not be majority rule. Mr. Sundstrom further stated that the AOC should prepare a self assessment. Mr. Sundstrom further stated that Dr. Hughes' checklists did a good job but the committee members should read the entire document for context and send the comments to Dr. Hughes. Mr. Sundstrom suggested that the comments should be captured and included in the report with a workshop arranged for discussion.

Dr. Hughes suggested conducting a formal assessment and the AOC has been regularly introspective. Dr. Hughes stated that the AOC was in full compliance of its own rules and regulations.

Mr. Street stated that he was impressed with the checklists and suggested publishing it in written form for the public. Mr. Street further stated that publishing the checklists gives creditability and adds value and discipline to the AOC.

Mr. Sundstrom stated that a couple more steps need to be taken for the checklists. Mr. Sundstrom further stated sending the AGA document to the committee members and incorporating comments from the AOC members to the checklists. Mr. Sundstrom suggested the AOC provide comments and recommendation, meet to discuss, and publish the checklists for the public.

Dr. Hughes stated checklists provide accountability to the AOC bylaws and administrative rules and enhance public transparency. Dr. Hughes thanked Mr. Sundstrom for his input and stated his input would improve the checklists.

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8. Approve OC Internal Audit Department Status Report for Period July 1, 2008 through March 31, 2009, Executive Summaries of Audit Finding Summaries for the Period January 1, 2009 through March 31, 2009
VOTE: Motion-Carlson, Second-Franz (proxy for Mauk), Sundstrom-Yes, Bates-Excused, Nguyen-Excused
Approved
9. Approve External Audit Coverage 3rd Quarter Status Report FY 08/09
VOTE: Motion-Franz (proxy for Mauk), Second-Carlson, Sundstrom-Yes, Bates-Excused, Nguyen-Excused
Received and filed

Mr. Street and Mr. Gorman left meeting at 2:28 p.m.

Dr. Hughes stated that the document reflects the status as of 3/31/09 and the department is on schedule with adjustments due to the many directives.

Mr. Sundstrom stated that the status report notes show three vacant positions with no plans to recruit. Mr. Sundstrom further stated that there is a need to understand the fiscal effect on reducing audit coverage and the AOC should discuss this at a future meeting.

Dr. Hughes stated that the department has a budget meeting with the EAs tomorrow. Dr. Hughes further stated that the department is going into 9% cost reduction due to frozen positions and other budget situations. Dr. Hughes stated that the department's cost reductions had three times the impact of other effected department. Dr. Hughes further stated that audit plan is narrowing the topics to high risk areas and leaving lesser risk areas not subject to review.

Ms. McKinney stated that the administrative manager vacancy cuts into the audit plan.

Mr. Sundstrom stated that the County is experiencing severe cuts across the board and tough times will get tougher.

Dr. Hughes stated that a long term remedy is needed to address the cuts in the future. Dr. Hughes further stated that the executive summary of findings was inspired by Dr. Carlson and helps out-lying departments as an early warning system. Dr. Hughes stated that the executive summary of findings provides a tool to other departments to be used proactively. Dr. Hughes further stated that the department is available to discuss the findings with other departments. Dr. Hughes stated that the external audit summary reported no significant issues and provides a good tracking mechanism for over 100 audits not including the CAFR and IAD assignments.

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Public Comments – *At this time members of the public may address the AOC on any matter not on the agenda but within the jurisdiction of the AOC. The AOC may limit the length of time each individual may have to address the Committee.*

No comments. Dr. Carlson stated that a notice of the meeting was posted at the building for the teleconference location. Dr. Carlson further stated that no public members were in attendance at the teleconference location.

AOC COMMENTS & ADJOURNMENT:

AOC COMMENTS: Mr. Sundstrom announced effective July 1, 2009 that he will become a member of the Government Accounting Standards Board. Mr. Sundstrom thanked Dr. Carlson for the positive professional reference.

ADJOURNED: The meeting adjourned at 2:42 p.m.

NEXT MEETING:

September 2, 2009, 2:00 p.m., Regular Meeting