

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

SPECIAL MEETING OF THE AUDIT OVERSIGHT COMMITTEE ORANGE COUNTY, CALIFORNIA



Wednesday, October 14, 2009, 10:00 a.m.

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

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, Bob Franz (Proxy for Tom Mauk),
Janet Nguyen

EXCUSED: Pat Bates, David Carlson

PRESENT: Director, Internal Audit Department
County Counsel:
Clerk:

Dr. Peter Hughes
Ann Fletcher
Renee Aragon

10:00 A.M.

1. Roll Call

Internal Audit Department: Peter Hughes, Eli Littner, Ken Wong; Auditor-Controller and staff: David Sundstrom, Shaun Skelly, Treasurer-Tax Collector: Chriss Street; County Executive Office: Bob Franz (Proxy received for Tom Mauk); County Counsel Office: Ann Fletcher; Vavrinek, Trine, Day & Co.: Kevin Pulliam; Second District staff: Lindsay Brennan; First District staff: Ryan Trabuco

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2. Discuss, consider and direct staff on AOC Charter Review
NOTE: Mr. Sundstrom would endeavor to present a draft Charter at the next AOC Regular Meeting on November 12, 2009 based upon the feedback of the Committee.

Discussion:

Mr. Sundstrom stated the purpose of the Special Meeting. He felt it was important for the committee to develop a good charter. He said his matrix was a result of Dr. Hughes' compliance audit report. He added that while in compliance with our own practices, he felt it fell short for what the industry held. Therefore he took two documents, the GFOA best practices document as well as a document called audit committees and he combined them with an AICPA document which were recommendations for audit committees in government (located on the AICPA website).

Mr. Sundstrom stated he felt the AOC had never really sat down to evaluate where the committee really was and it was a recommendation of both the GFOA and AICPA. He noted there were modifications of the Bylaws and the Internal Audit Department (IAD) charter in the past but not a full review of what was in those documents. The AICPA recommended an annual review.

Mr. Sundstrom said he used the GFOA recommendations and compared them against current practice with cited sources. He said he used the Internal Audit Department's document extensively for those cited references. The highlighted sections in yellow were where he felt the current practices and documents were not fully addressed. He stated he would only discuss the yellow highlighted sections and after the meeting he would draft a document and bring it back to the AOC for review before forwarding it on to the Board of Supervisors approval.

Mr. Franz stated he observed that the structure, based on best practices, the Internal Audit Department (IAD) was created to report directly to the Board. The AOC was created at the same time with some overlap in terms of best practices. As an example, he said related to budget his reaction was that IAD had its own budget. Although it was not the AOC's budget, the IAD had facilitated the AOC's intent. Another example was the IAD charter was established and it seemed the AOC should not start from ground zero.

Mr. Sundstrom stated he wasn't starting from ground zero at all. He would take two documents, the AOC Bylaws and IAD Charter, and specifically he would lift items from the IAD charter and he would also add elements from the AOC Bylaws into the new AOC Charter. He felt the Bylaws were still needed as a standard for any committee in the County of Orange.

Mr. Sundstrom stated he would work with County Counsel so that the document satisfied the requirements.

Mr. Sundstrom stated he felt the vision of the audit committee originally, going back 12-13 years, was to primarily deal with IAD. He felt audit committees evolved radically over those 13 years where now the audit committee's primary purpose was oversight of the financial report process. He believed it a total shift according to the best practices document. He stated that of 90,000 governments just a sliver actually had internal audit practices at all with an audit committee.

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Mr. Franz said our structure was that we currently had an Internal Audit Department operation with an AOC. Mr. Sundstrom agreed.

Supervisor Nguyen asked if the AOC was a legal requirement and if it was time to evaluate whether or not to continue the AOC. Mr. Sundstrom stated it was not a legal requirement but a practice acknowledged in the industry for controls where the external auditors evaluate in the County's control structure when auditing the financial statements and could ultimately jeopardize the audit by removing an AOC. Supervisor Nguyen stated there were other committees that had been collapsed in the past. She was not suggesting removing the AOC but he was moving into creating its own charter and it seemed it was moving away from the Board of Supervisors. She felt the Board still needed to keep the AOC and IAD together not separated and did not want it to move into that direction.

Mr. Sundstrom stated he would work in that direction to clearly delineate the roles for a reasonable overlap and not force more responsibility onto the Board of Supervisors members. He stated he had no intention of separate the two and there were considerable best practices for oversight of the Internal Audit Department.

Supervisor Nguyen noted that of the Committees she held position she had not seen charters created. She reviewed mission statements but not charter. She said that she was also considering the common practice of other committees.

Dr. Hughes said he observed a best practice that a separate charter should be considered for the AOC however, no one was saying there wasn't a charter empowering the AOC because in the original creation of the IAD function and charter, the Board had authorized the AOC back then to oversee the external audit, internal controls, and act as a liaison with operating management. He said initially the Board recognized there was wider responsibility than just overseeing Internal Audit but there was not articulation about what it means to oversee the external auditor and internal control or risk management system. Dr. Hughes said he noted in his audit that the language in the Charter was not explicit although practices had evolved that adequately addressed the issues. The language in the charter and the resolution was, however, explicit about what the AOC did with the Internal Audit department and not explicit about the other aspects.

Supervisor Nguyen stated she understood however asking for a budget and charter that it seemed it would become another new organization. She felt that was not where the Board wanted to go. Mr. Franz said new language would clarify some issues. Supervisor Nguyen suggested if a budget would be considered an augmentation to IAD budget for strict AOC purposes. She's concerned other committees would want their own budget. Mr. Sundstrom stated the purpose of money for the AOC was to commission an expert for a specific area that may be beyond the purview of IAD. If it was agreed, the budget would be retained in Internal Audit. Supervisor Nguyen asked if it happened in the past. Dr. Hughes explained that when a Peer Review was done of the department an augmentation was done at that time. The AOC selected a peer reviewer and IAD paid for it. The AOC discussed the augmentation at that time and was reimbursed. The process was through the normal budget process for \$66,000. Dr. Hughes stated one other item was for a payroll audit and his budget was augmented for that as well. There was never a lack of cooperation or impediments for funding any special request.

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Supervisor Nguyen felt that either of the two Supervisors sitting on the AOC could ensure any urgent requests for consideration on at Board meeting.

Mr. Sundstrom stated he wanted to make sure and discuss the Board membership on the AOC as it was a highlighted item. He added he felt there was not an absolute need and that writing into the charter that based on the vote of the committee items of urgency be immediately placed on Board agenda.

Mr. Sundstrom then began to address the highlighted areas:

Item 2, page 2, Scope of the AOC: Mr. Sundstrom stated it was not prescriptive beyond general needs. He would attempt to make the item more prescriptive when he drafted the new charter and hopefully solve the scope.

Item 2, page 3, Audit Committee Budget: he felt he understood the consensus of no separate budget. Mr. Sundstrom asked if the preference was to augment a small amount of cash into the IAD budget and if not used by the AOC the money reverts back. Supervisor Nguyen stated the normal practice was fine and did not have a preference. Mr. Franz clarified the language that any added amount should be in the IAD budget as a fund for contingency of the AOC. Supervisor Nguyen wanted to ensure the IAD budget would not be reduced.

Mr. Sundstrom clarified the money would not be reducing the budget of IAD but augmented in by the general fund and returned to the general fund if not used by the AOC. Mr. Sundstrom stated he would write it that the Committee would make a recommendation to the Board for the budget year. Supervisor Nguyen agreed.

Item 3, page 3, External Auditor selection: Mr. Sundstrom stated he would like to formalize the appointment processes of where the AOC was currently. A subcommittee is appointed and evaluations and recommendations return back to the AOC for approval before submission to the Board of Supervisors. The renewal terms would also be detailed. At the end of the contract (three year contract with two one-year renewals) the AOC would decide to whether to renew under the same terms and conditions. Mr. Franz clarified the AOC approval was for a recommendation to the Board to hire the external auditor. Mr. Sundstrom and asked if the RFP should be brought to the AOC before opening the item up. Supervisor Nguyen stated she didn't mind. Mr. Sundstrom stated when the subcommittee was established the subcommittee would develop the RFP and would solicit responses. Timing and process was discussed. Dr. Hughes asked for clarification as to whether or not the AOC subcommittee would report back to the full AOC regarding its recommendation.

Mr. Sundstrom stated the subcommittee would provide the evaluation. Mr. Sundstrom stated programmatically the A-C administered the contract and requested it be directly stated in the charter.

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Item 5, membership: Supervisor Nguyen the issue was discussed earlier. She asked why the change in membership. Mr. Sundstrom stated the Chair and Vice-Chair were always permanent members. Mr. Sundstrom asked Ann Fletcher if membership could be stated in the charter and not in the Bylaws. Ms. Fletcher stated membership was currently in the Bylaws. Mr. Sundstrom asked if membership could be removed from the bylaws and placed in the Charter. Ms. Fletcher stated it probably didn't matter where it was as long as the approval process was sought.

Mr. Sundstrom stated he would examine the Bylaws and lift appropriate information into the charter and visa versa and present both to the AOC and the Board.

Item 6, page 4, reviewing the AOC themselves. Mr. Sundstrom stated the GFOA recommendation was every 5 years and the AICPA was every year.

Mr. Sundstrom recommended every 3 years. Supervisor Nguyen and Mr. Franz agreed.

Item 7, page 5, possessing or obtaining sufficient understanding of governmental financial reporting: Mr. Sundstrom stated both item 7 and **item 8** were tied together as it concerned membership. He stated item 7 would require all the members of the audit committee to have a certain degree of financial expertise and fund accounting expertise in a way. Mr. Sundstrom stated he spoke to the man who wrote the standards in the GFOA. He stated the best practices were written for governing bodies that had more than 5 members. He noted that it also said the elected auditor or controller could be considered a member of the governing body. Mr. Sundstrom stated that if only the Board of Supervisors were to be considered for the full membership then it would be a Board Member meeting. Supervisor Nguyen stated no committee of the county could have a majority. She noted that members of the Board were not selected based on their financial expertise or background or that they have certain degrees. Mr. Sundstrom asked the members to consider the automatic appointment of the Chair and Vice Chair. The discretion should be that they might want to appoint someone with substantial financial acumen. Supervisor Nguyen noted that only one current Board Member was a CPA. When that member terms out or was replaced by the voters there was no guarantee any Board Member would retain any financial expertise and didn't feel it was the correct approach. She preferred the Chair and Vice Chair retain membership. Dr. Hughes stated financial expertise was important but that governance expertise was also important. Dr. Hughes interpreted the recommendations to say that the individual audit committee members did not have to be experts in accounting and auditing financial reports and internal controls but had to be sufficiently informed about the topics so as to make an informed decision with the assistance of the financial experts. Dr. Hughes stated that reference was from the GFOA's book. He noted the permanent member was the Auditor-Controller and by definition was the financial expert. Therefore, there would always be a financial expert in the audit committee in whoever holds that position. Dr. Hughes stated in the past 10 years he had seen the benefit of having a variety of opinions and not a bias toward any one perspective. He added that the Auditor-Controller had been sufficient as the resident financial expert and as a voting member of the Committee.

Supervisor Nguyen felt the Chair and Vice-Chair should remain and the Chair could make the decision to replace himself or herself by appointing another Supervisor but that the Vice Chair should remain a member always. Mr. Sundstrom supported the suggestion of Supervisor Nguyen.

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Item 8, pages 5 and 6, non-governing membership: Mr. Sundstrom stated he would be blunt and asked if the CEO should be on the audit committee. He stated the audit process was devoted to auditing the CEO and the CEO's responsibilities. Mr. Franz stated yes. Supervisor Nguyen asked who would replace the CEO. Mr. Sundstrom stated it would be another department. Mr. Franz stated the CEO reports to the full Board and there was a benefit in the CEO bringing to the AOC the "County" perspective. Mr. Franz said he believed the CEO had a perspective that none of the other members hold. Supervisor Nguyen stated she felt she represented the Board. Mr. Franz noted the CEO reports to all five districts rather than one individual office. Mr. Sundstrom stated he would like to have an additional public member with staggering terms. Supervisor Nguyen asked why the Treasurer requested to be removed from the AOC. Mr. Sundstrom stated it was the request of the TTC back then. Supervisor Nguyen asked if Mr. Street would want to become a voting member. Mr. Sundstrom responded yes. Supervisor Nguyen suggested adding the TTC and a public member back in and leave the CEO in. Mr. Sundstrom stated a quorum issue was raised. Supervisor Nguyen suggested contacting Mr. Street if he would like to be added back in.

Supervisor Nguyen stated the AOC should leave the membership as is and ask the CEO if he would like to be on the Committee and if he did not, seek an alternative. Mr. Sundstrom stated okay.

Item 10, page 6, orientation of new members: Mr. Sundstrom felt there should be some orientation of new members and he would write in what he felt appropriate or generally refer to it in the charter organization.

Supervisor Nguyen suggested that the Internal Audit Director and the Chair of the AOC meet with any new member and explain the committee. Mr. Sundstrom agreed.

Item 11, page 6 and 7, selection and reporting process of external auditor: Mr. Sundstrom stated there was already discussion over this item and he would formalize the selection process and the reporting process in the new charter.

Mr. Sundstrom noted he would look through the GFOA and AICPA recommendations to add detail in the language.

Item 13, page 9, adding a statement in the charter: Mr. Sundstrom stated he would add language in the new charter that any non-audit services taken on by the current financial auditor must be approved by the committee. Mr. Franz agreed there should be clarification that any augmentation or funding for these services should be reviewed by the AOC. Mr. Sundstrom stated we don't want the external auditors doing a lot of consulting work. Mr. Pulliam stated additional services were extremely limited by governmental standards.

Mr. Sundstrom stated he would add language in the new charter that any non-audit services taken on by the current financial auditor must be approved by the committee.

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Item 15, page 10, internal control structure: Mr. Sundstrom stated the AOC should become more consistent with the entire risk sweep to review the control structure. He stated he would add explicit language from the GFOA on Q28 on the first page and would add that language. Mr. Franz felt that the IAD have a primary responsibility. Mr. Sundstrom stated management responsibility was to conduct a formal risk assessment. He added that Macias was working with him to develop a template. Mr. Sundstrom felt the committee should be responsible for more along with him. He stated the law pointed directly to him, but wanted the committee to be involved in or at least a review of the final product.

Mr. Sundstrom stated he would add explicit language from the GFOA on Q28 on the first page and would add that language.

Item 16, page 10, evaluation of independent auditors: Mr. Sundstrom stated he would add a sentence that the AOC evaluate the independent auditors. He was sure about the process or detail, but would present language. He stated the committee should assess the quality of the auditors work.

Mr. Sundstrom stated he would add a sentence that the AOC evaluate the independent auditors.

Item 18, page 12, annual report of the AOC: Mr. Sundstrom stated although the Internal Audit Department prepared an annual report to the Board of Supervisors, there was no detailed report of the AOC and formalizing the details of the year. Mr. Franz felt the Internal Audit Department could combine the results and make the annual presentation to the Board because there was detail of what was presented to the AOC quarterly already. Mr. Sundstrom objective to combine the two reports and wanted a separate AOC report. He stated he envisioned a three page letter. Dr. Hughes stated the Annual Internal Auditors Report was not a report from the AOC to the Board and supported a three page letter to the Board directly from the AOC. Mr. Sundstrom stated it would not conjugate the two.

Mr. Sundstrom stated a he would prepare a three page letter annual report to the Board from the AOC.

Item 19, page 12, hotline activity: Mr. Sundstrom stated there were no specific procedures for handling complaints about accounting or internal controls or auditing matters for a review through the Committee for such complaints. Dr. Hughes stated the Charter delegates to the Internal Auditor responsibility for running the hotline and we have our own procedures and report twice a year to the Board. Mr. Sundstrom felt something in the charter should say any complaints regarding the county internal controls or auditing matters would be forwarded and reviewed by the Committee. He stated that if he received a cost accounting concern that says we were illegitimately charging grants and contracts for something he felt he should being it to the Committee.

Mr. Sundstrom stated he would add in the charter that any complaints regarding the county internal controls or auditing matters would be forwarded and reviewed by the Committee.

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Item 20, page 13, monitoring senior management: Supervisor Nguyen asked for an example related to the item. Mr. Sundstrom stated he could not provide an example from his perspective. He stated it would depend on how senior management was defined. Mr. Franz asked if it was different from internal controls. Mr. Sundstrom stated it was actually monitoring senior management in the application of controls. The things they authorize. Mr. Sundstrom stated he didn't authorize a whole lot. Supervisor Nguyen did not understand the intent. Dr. Hughes stated it may have been addressed by the external auditors. He noted that the external auditors must comply with certain auditing standards. One strict standard requires them to design and test for potential fraud and misappropriation and management override issues. Mr. Pulliam stated that when they review the internal control structure they look for where management could over ride controls and select samples for tests, they looks to see if those controls were in fact overridden by management. The tests were not designed to look for fraud, but look for an override of controls or for someone that might circumvent the system of controls.

Mr. Sundstrom stated he was confused as well and that refer back to the COSO document for more descriptive language to understand what was needed and add that language to the charter.

Item 22, page 14, annual report to the Board: Supervisor Nguyen asked if this was the same item as above for the annual report to the Board if it was one in the same.

Mr. Sundstrom stated yes and it was part of the auditing standards for required communication.

Mr. Sundstrom stated he would try to present a draft AOC charter that incorporated the discussed changes for review by the next AOC regular meeting on November 12, 2009.

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 were made by the public.

AOC COMMENTS & ADJOURNMENT:

AOC COMMENTS:

ADJOURNED: The meeting adjourned at 11:28 a.m.

NEXT MEETING:

November 12, 2009, 2:00 p.m., Regular Meeting