

COUNTY OF ORANGE
AUDIT OVERSIGHT COMMITTEE

DRAFT MEETING MINUTES
Thursday, August 17, 2006, 3:30 p.m.

The Audit Oversight Committee of the County of Orange met on August 17, 2006 at 3:30 p.m., at the Hall of Administration, Building 10, Fifth Floor, Conference Room B, Santa Ana, California.

Members Present/Absence Noted:

Present: Supervisor Bill Campbell, Chairman, Board of Supervisors
Mr. David Sundstrom, Auditor-Controller
Dr. Dave Carlson, Public Member, Chair, Audit Oversight
Absent: Supervisor Chris Norby, Vice-Chair, Board of Supervisors
Mr. John Moorlach, Treasurer-Tax Collector, Ex-Officio Member
Tom Mauk, County Executive Office

1. **Call to Order: (Dave Carlson, Ph.D., Chair, Audit Oversight Committee)**

Dr. Carlson, Chair, called to order the meeting on August 17, 2006 at 3:30 p.m. Dr. Carlson asked for roll call before proceeding with the agenda.

Committee Members: Mr. Sundstrom, Dr. Carlson, Supervisor Campbell

Guests:

Internal Audit Staff: Dr. Peter Hughes, Eli Littner, Alan Marcum, Autumn McKinney, Michael Goodwin, Camille Gackstetter; Auditor-Controller Staff: Denise Steckler; Claire Moynahan, Shaun Skelly; Macias, Gini and Company, James Godsey, Jane ; District Three staff: Bryan Rayburn; Treasurer Tax Collector's Office: Chriss Street Treasurer Tax-Collector-Elect

2. **Approval of Minutes from May 4, 2006, (Dave Carlson, Ph.D., Chair, Audit Oversight Committee)**

Recommended Action: Approved

Approved as recommended.

3. **Required Communications (Macias, Gini and O'Connell, Mr. Godsey)**

Recommended Action: Discussion

Mr. Godsey informed the AOC members of its new partner Mr. Kevin O'Connell effective July 1, 2006. The firm name has changed to Macias, Gini and O'Connell.

Mr. Godsey reconfirmed their understanding of service provided to the County. Mr. Godsey briefly reviewed the coverage and stated audit objectives. Management Responsibilities were also discussed.

4. 2006/07 Audit Plan and Risk Assessment Schedules (Continued from 5/4/06, Item 7)

Recommended Action: Approve

Dr. Hughes announced as an FYI that the AOC's minutes indicated that both Dr. Carlson and the Hon. Sundstrom have attended every AOC quarterly meeting since inception over nine years ago. He mentioned that he was sharing this information because he felt such dedication deserved recognition.

Summary

There was much discussion regarding the content of the Annual Audit Plan, the frequency of audit coverage, the rotation cycle, the types of audits conducted as well as the adequacy of the Internal Audit Department's staffing level. Specifically, the following issues and positions were addressed and presented:

1) The Audit Plan and Risk Analysis was approved by the AOC with the following conditions:

a) The higher risk areas are audited prior to lower risk areas and that Dr. Hughes provide more detail of IT and "Core" Business System audit coverage.

b) Supervisor Bill Campbell expressed a concern about the Audit Plan and asked Dr. Hughes to consider including in the Plan an audit of JWA Cash Disbursements and Accounts Payable and the Sheriff's Office Contract Administration. He gave several sound reasons and the AOC supported his observations and recommended audits. Dr. Hughes concurred.

c) The Auditor/Controller David Sundstrom voiced interest in ensuring that there was coverage of the Core or Centralized Business processing operations. He asked if IAD could breakout this type of coverage separately from the Departmental Internal Control Review Matrix and if IAD could meet with him to discuss this issue further. Dr. Hughes replied to his points and agreed to do so.

Dr. Hughes noted that they are on a three to five year rotational cycle regarding Internal Control Reviews of the Departmental Business Processes and that IAD was close to completing their first full cycle.

He stated that he had identified 187 auditable business activities for the County's 23 departments. He explained these activities included Cash Receipts, Accounts Receivable, Disbursements, Revolving Funds, Procurement and Contract Management, Payroll, Trust Funds, Budgeting and Revenue Generating Leases.

Dr. Hughes noted that over the past several years they had either conducted or would do so by the end of the New Year 110 audits of the 187 auditable business activities for 59% coverage. But more importantly, he noted they have audited or will audit by the end of this upcoming summer all of the High Risk Activities noted on the 2006/2007 Matrix.

Dr. Hughes noted that their audits test transactions from the point of origin in the Department up through posting into the Auditor/Controller's General Ledger. They audit the specific internal controls in the Departments and trace selected transactions through the Departments' records all the way into the Auditor/Controllers books and records. They also audit on a periodic basis the specific controls in select Auditor/Controllers' County's Central or Core Processing units. Dr. Hughes also mentioned that they do audit for the Effectiveness and Efficiency of the business processes as a sub part of their Internal Control Reviews. Specifically the auditors have audit steps were they look for examples of unnecessary process steps or tasks as well as for the achievement of their set objectives of obtaining proper authorizations and segregation of duties. In the future, audit reports will explicitly state this in the scope and objectives.

In addition, Dr. Hughes stated that his staff is verifying the accuracy and reasonableness of the Departments reported Performance Measures and have finished 6 of them to date and plan on finishing the entire County by the end of 2008. Dr. Hughes reminded the AOC that these “validation” audits were in response to requests from members of the AOC that felt IAD’s Validations to be critical to the integrity of the County’s Performance Measurement requirement. Dr. Hughes mentioned that few counties have Performance Measures as well developed and time tested as the County’s. He also stated that even for those counties with performance measures, it was his understanding that few counties conducted performance validation reviews. He stated it was very impressed that Orange County had both Performance Measures and now an independent Validation of the accuracy of such reported results.

He noted that they had reduced the level of risk in a number of audited activities as a result of the sound control environment noted during the audits over the past few years. He cited the small number of material (less than 2%) or significant audit findings (less than 4%) as part of the basis for their upgrading the soundness of the internal controls for departments’ business systems.

Dr. Hughes noted that the Peer Reviewers hired by the AOC examined IAD’s Risk Assessment process and found it to be among the best they have seen. The fact that IAD meets regularly with senior management and brainstorms with them regarding their specific Departmental or Agency accounting and business process vulnerabilities and exposures is a very important step in developing a cost effective, current and defensible audit plan. Coupling this input with the review by the AOC and the opportunity for public comment gives impressive assurance regarding the integrity of the Audit Plan (Typically these meetings result in 100 years of management experience and 100 years of executive audit experience sitting at the same table exploring and examining the business processes’ internal control risks for each Department and Agency.)

Years ago IAD initially rated the level of risk at the inherent level based upon size, volume, complexity, past audit history, if any, and vulnerabilities. After examining the controls in place, observing management’s attitude, competence, continuity of staff, presence of operating manuals and other critical control factors each activity is re-evaluated and assigned a new Risk Factor based upon their findings. The Risk Factor can go up or down depending upon the auditors observations.

Dr, Hughes stated that in several cases, the new Risk for audited activities has been **lowered** due to a strong control environment noted in the course of the Internal Audit.

In response to AOC member questions, Dr. Hughes stated that he and his Executive Audit Committee (his Deputy and three Audit Managers) believed they had enough auditors to address the internal control audit risks regarding the AOC focus on business systems and processes of the County on a three to five year rotational cycle. He reminded them that the AOC’s focus for the past seven years has been on financial and accounting controls and not on program or network security audits. Given this focus, and one well documented in the AOC Annual Plan, he believed he was adequately staffed. However, Dr. Hughes stated that it is the AOC’s role to ultimately determine the range of the audits that IAD conducts as well as to establish the rotation schedule.

Dr. Hughes mentioned that if the AOC wants him to increase the frequency of Internal Control Reviews, Core Business Systems or add new types of audits without cutting back in other areas, then he would need to expand his staff. If given more auditors, Dr. Hughes said he could shorten the cycle or do different types of audits, but he felt comfortable that the current cycle was reasonable given the current focus. He reminded the AOC that less than 6 out of 100 audit findings have been serious control weaknesses and as such, he did not see at this time weaknesses that would obligate the AOC to accelerate the cycle, but that was their decision. He said he wouldn’t turn down more auditors if offered.

Dr. Hughes stated he had three audit position openings and was looking to hire this Spring and would keep the AOC posted on his progress. He mentioned that the demand for auditors due to the Federally mandated SOX Act for Public Corporations had driven up the salaries of auditors and that he was not competitive on salary. He mentioned that he has been told by candidates that they are making \$90,000 for performing the same job his CPAs get paid \$75,000. In fact, he said he was about 20% below the market in Orange County. (The salary he pays his CPA's are at the level that auditors are paid in such low cost of living places like San Antonio, Texas and Corvallis, Oregon.) However, Dr. Hughes said he was having some success with bringing in great auditors who were attracted to the 4x10 and 9/80 and flex hours and defined benefits retirement plan (the County's retirement plan is viewed rightly by the staff as deferred compensation that over the long run brings IAD salaries closer to the private sector salaries).

He noted that his plan for IT audit coverage was going to be a combination of in-house audits of selected and limited IT system issues and outsourced audits of the more technical IT areas. The CEO has offered to fund such expenditures within reason as augmentation to IAD's budget as needed. Dr. Hughes stated that he is adopting this approach upon discussion with several of his colleagues and in particular the County of Maricopa in Arizona. Dr. Hughes mentioned that a recent survey of sister counties revealed that most counties do not have dedicated IT auditors.

The County of Maricopa has agreed to share with IAD their expensive outsourced risk assessment and IT audits and audit programs as a way of enabling IAD to compare its' assessment with an outside vendors' assessment to see if IAD can improve or enhance its process. Dr. Hughes stated that his most recent survey of sister counties revealed that the majority of County Internal Audit Departments don't conduct any IT audits whatsoever with or without outsourced IT support and that the last Peer Reviewers were very impressed with Orange County's IT assessment and coverage.

Dr. Hughes also stated that his auditors will be trained on the upgraded business systems as they are unfolded over the next five years so as to be able to take advantage of Self Query features available to auditors with special access privileges. He said this will enable his auditors to be even more productive. The new upgrades should allow IAD to replace their ACL Audit Computer Language programs with the vendors own audit programs. Dr. Hughes stated they will report back to the AOC regarding their progress in this approach. Dr. Hughes stated he intended to have his auditors to audit for the adequacy of "audit trails" in the new business system upgrades as their main focus and contribution to the CAP's upgrade.

In conclusion, Dr. Hughes expressed appreciation for the questions and insights provided by the AOC. He mentioned that the benefit of having the AOC hire its own outside and independent Peer Review was to give the AOC assurance that both the AOC and the Internal Audit Department was doing the "right thing the right way." The fact that the last Peer Review done by the Washington DC., CPA firm (Thompson, Cobb & Bazilio), praised their audit risk assessment, the scope of their audit coverage and the quality of their work reflected very well on both the AOC's and IAD's dedication to delivering quality internal audit services to the County. Given that they are the firm hired by the US government to audit the Office of Inspector Generals' audit department worldwide makes their praise of IAD that much more impressive.

The consensus of the AOC appeared to support the current level and nature of audit coverage and cycle and no challenges were made or alternatives offered by the AOC to the present course of action other than the three items noted earlier.

Approved with two changes as requested by Supervisor Bill Campbell.

5. Internal Audit Department 2007 Peer Review (Continued to August 17, 2006)

Recommended Action: Establish Timeline

This item was continued to the next meeting.

Dr. Hughes stated he was bring up this issue one year in advance of the required finish date for the Peer Review so as to ensure the AOC had plenty of time to appoint a Chair and Vice Chair of the Peer Review selection committee and start the vendor selection process. The AOC moved to table this item until the next AOC meeting. Dr. Hughes noted that the finished Peer Review Report is due August 1, 2007 and that the RFP process for the hiring of the last Peer Reviewers took about four months.

6. Outsourcing Options of OC Fraud Hotline (Continued from 5/4/06, Item 4 and 2/23/06, Item 4) (Dr. Peter Hughes, Director, Internal Audit Dept.)

Recommended Action: Discussion

Dr. Hughes reported that they now have 24 times 7 live person coverage of their Hot Line and would report quarterly the results. All members of the AOC were complementary regarding the management of the Hot Line by IAD.

7. Status Report #7, Period 1/1/05 to 3/31/06 (Dr. Peter Hughes, Director, Internal Audit Dept.)

Recommended Action: Receive and File

The AOC received and filed the report unanimously. Members commented on the thoroughness of the report and were pleased that IAD was so well managed and successful at completing its Annual Plan.

Approved as recommended.

8. External Audit Coverage, First Quarter, FY 05/06 Status Report (Dr. Peter Hughes, Director, Internal Audit Dept.)

Recommended Action: Receive and File

As the Lead on all such activity, IAD's report is critical to keeping the AOC and BOS informed of all other audit activity and results in the County. The AOC was complementary regarding the Executive Summary and contents of the report.

Approved as recommended.

9. Executive Summaries of Audit Assignments, Period 4-1-06 to 6-30-06 (Dr. Peter Hughes, Director, Internal Audit Dept.)

Recommended Action: Receive and File

AOC members were complementary regarding the utility and advantage of these summaries and were pleased to be told by Dr. Hughes that the whole AOC packet is posted on IAD's web page for the County and community to review. Dr. Hughes underscored his commitment to the BOS's desire to have the IAD reports and results transparent.

In addition, Alan Marcum, the Audit Manager on the Treasurer Fund Audit brought to the AOC attention that we had completed the management letter noting our audit findings regarding our Annual TFA audit of the assets held as of 12/31/05 and issued it on May 8, 2006, in draft form, but

had not received an official reply to our audit findings as of August 17, 2006. Mr. Marcum noted that per the AOC Administrative Rule, the auditee is to reply within 60 days and that it had been 90 days since the release of the draft.

Chriss Street, the Deputy Treasurer/Tax Collector was in attendance and stated their reply would be forthcoming soon. Supervisor Bill Campbell thanked IAD for the update and accepted Mr. Street's explanation.

Approved as recommended.

10. Next Meeting: Set AOC Meeting Date (November)

- Agenda Item Suggestions/Action:
Peer Review

11. Public Comments

None.

12. Adjournment

The meeting was adjourned at 4:00 p.m.