

# EVALUATION OF AUDITOR-CONTROLLER CAFR FOOTNOTE DISCLOSURE PROCESS

For the Year Ending:  
June 30, 2007

We are pleased to report we noted (11) Industry Leading Best Practices in the Auditor-Controller CAFR Footnote Disclosure Process.

Additionally, we propose six (6) recommendations to further enhance existing controls and processes over the Auditor-Controller's CAFR Footnote Disclosure Process.

AUDIT NO: 2767  
REPORT DATE: MARCH 13, 2009

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RISK BASED AUDITING

Peer Review Compliant – 2001, 2004, 2007



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 ORANGE COUNTY BOARD OF SUPERVISORS'  
**Internal Audit Department**

*Peer Review Compliant - 2001, 2004, 2007*

*Providing Facts and Perspectives Countywide*

**RISK BASED AUDITING**

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**OC Fraud Hotline (714) 834-3608**

# Letter from Dr. Peter Hughes



## Transmittal Letter



**Audit No. 2767**    **March 13, 2009**

**TO:** David E. Sundstrom  
Auditor-Controller

**FROM:** Dr. Peter Hughes, CPA  
County Internal Auditor

**SUBJECT:** Evaluation of Auditor-Controller  
CAFR Footnote Disclosure Process

We have completed an evaluation of the Auditor-Controller's CAFR footnote disclosure process for the year ending June 30, 2007. The final **OC Internal Auditor's Executive Report** is attached along with your responses to our recommendations.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). As a matter of policy, our **first Follow-Up Audit** will begin at six months from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will begin at six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented. However, we will not perform our follow-up until after the next CAFR cycle.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

# Letter from Dr. Peter Hughes



Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendations.

Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

**Attachment A: Report Item Classifications**  
**Attachment B: Auditor-Controller Management Responses**

Other recipients of this report are listed on the OC Internal Auditor's Executive Report on page 5.

# Table of Contents



## Evaluation of Auditor-Controller CAFR Footnote Disclosure Process Audit No. 2767

For the Year Ending  
June 30, 2007

Transmittal Letter	i
OC Internal Auditor's Executive Report	1
OBJECTIVES	1
BACKGROUND	1
SCOPE	3
CONCLUSION	4
ACKNOWLEDGMENT	5
Detailed Findings, Recommendations and Management Responses	6
Audit Objective #1: Understand the Auditor-Controller's CAFR Footnote Disclosure Process	6
Audit Objective #2: Identify Process and Control Strengths	6
Audit Objective #3: Identify Any Areas that Could Benefit From Enhancements	7
Findings & Recommendations	
1. Detailed Analysis of the Respective Financial Reporting Standards is Not Documented (Control Finding)	7
2. CAFR Review Instructions Are Not Clearly Defined (Control Finding)	9
3. Newly Established CAFR Review Committee Enhancement (Control Findings)	9
Management Responses:	
ATTACHMENT A: Report Item Classifications	13
ATTACHMENT B: Auditor-Controller Management Responses	14



**Audit No. 2767**

**March 13, 2009**

TO: David E. Sundstrom  
Auditor-Controller

FROM: Dr. Peter Hughes, CPA  
County Internal Auditor

SUBJECT: Evaluation of Auditor-Controller  
CAFR Footnote Disclosure Process

## Audit Highlight

We completed an evaluation of the Auditor-Controller's CAFR Footnote Disclosure Process for the year ending June 30, 2007.

We are pleased to report we noted (11) **Industry Leading Best Practices** in the Auditor-Controller CAFR Footnote Disclosure Process.

Additionally, we propose six (6) recommendations to further enhance existing controls and processes over the Auditor-Controller's CAFR Footnote Disclosure Process.

## OBJECTIVES

The Internal Audit Department conducted an evaluation of the Auditor-Controller CAFR footnote disclosure process. Our evaluation objectives are:

- (1) Understand the Auditor-Controller's CAFR footnote disclosure process,
- (2) Identify process and control strengths, and
- (3) Identify any areas that could benefit from enhancements.

## BACKGROUND

The mission of the **Auditor-Controller** is to promote public oversight, provide accountability, and support financial decision-making for the County. The Auditor-Controller's annual budget is a net County cost of \$8.4 million and \$27.1 million of cost apply and revenue services provided mostly to other department/agencies. The total number of employees is 424. The Auditor-Controller is organized into three major divisions: (1) Central Operations; (2) Satellite Accounting; and (3) Information Technology. Three smaller sections that come under the executive management umbrella and report directly to the Auditor-Controller are CAPS+ System Implementation, CAPS Program Management Office, and an Internal Audit Unit.

The Auditor-Controller is responsible for the core County accounting activities, including payroll and claims processing; accounts receivable and collections functions; Countywide cost allocation plan; and the County's Comprehensive Annual Financial Report (CAFR). The Auditor-Controller supports seven County agencies/departments by providing outstationed agency/department accounting support sections entirely funded by their host agencies that have outside revenue sources. In addition, the Auditor-Controller is responsible for the implementation, maintenance and upgrade of the County's central accounting and financial systems, as well as the development of other accounting-related systems.



The Auditor-Controller's Financial Reporting Group prepares the County's CAFR, which is audited by an outside, independent accounting firm. The CAFR is an annual presentation of the County's financial information. It is used by the public, bond-rating agencies, governments, and internally to examine and understand the financial position of the County.

The Auditor-Controller received a Certificate of Achievement for Excellence in Financial Reporting for its CAFR for the year ended June 30, 2007. This is the County's thirteenth consecutive award. The Certificate of Achievement is the highest form recognition for excellence in state and local government financial reporting from the Government Finance Officers Association.

### **Relationship to the Sarbanes-Oxley Act**

With taxpayers, political watchdogs, and bond rating agencies closely monitoring how state and local governments are managing and protecting public resources, internal control and governance are on the minds of government officials. Stakeholders are expecting government officials to pay closer attention now than in the past to prudent fiscal management including financial reporting. Under the Sarbanes-Oxley Act of 2002, management of public companies is required to:

- Accept responsibility for the effectiveness of the entity's internal control over financial reporting.
- Evaluate the effectiveness of the entity's internal control over financial reporting using suitable control criteria, for example, those defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).
- Support the evaluation with sufficient evidence, including documentation.
- Present a written assessment about the effectiveness of the company's internal control over financial reporting as of the end of the entity's most recent fiscal year.

**The requirements under the Sarbanes-Oxley Act of 2002 do not apply to government municipalities.** However, in 2006 the American Institute of Certified Public Accountants' (AICPA) Auditing Standards Board issued nine Statements on Auditing Standards (SAS) relating to the assessment of risk in an audit of financial statements. These Standards apply to non-public organizations, including government municipalities, and have similar requirements as Sarbanes-Oxley.



## Relationship to the Risk Assessment Standards

The AICPA issued SAS No. 104 through No. 112 to establish standards and provide guidance concerning the auditor's assessment of risks of material misstatement, whether caused by error or fraud, in a financial statement audit, and the design and performance of audit procedures whose nature, timing, and extent are responsive to the assessed risks. Additionally, the Standards establish requirements related to communicating matters related to an entity's internal control over financial reporting identified in an audit of financial statements.

The primary objective of these Standards is to enhance auditor's application of the audit risk model in practice by specifying, among other topics:

- ▶ More in-depth understanding of the entity and its environment including its internal control, to identify the risks of material misstatement in the financial statements and what the entity is doing to mitigate them.
- ▶ More rigorous assessment of the risks of material misstatement of the financial statements based on that understanding.
- ▶ Improved linkage between the assessed risks and the nature, timing, and extent of audit procedures performed in response to those risks.
- ▶ Clarification of the internal control matters that auditors must communicate to their audit clients.

## SCOPE

Our evaluation was conducted to understand the processes, risks, and controls of selected aspects of the CAFR footnote disclosures in the Auditor-Controller's office for the year ending June 30, 2007. We gathered written documents and other relevant information on the CAFR footnote disclosure process as a starting point. The evaluation considered processes over the following selected CAFR footnote disclosures:

1. Deposits and Investments (Note No. 3)
2. Retirement Plans (Note No. 17)
3. Postemployment Health Care Benefits (Note No. 18)

We did not review the information system controls over the Auditor-Controller's financial reporting system. Our methodology included inquiry, auditor observation and inspection of relevant documents. However, we did not audit the documentation we obtained. Our evaluation was conducted in accordance with professional standards established by the Institute of Internal Auditors.



## CONCLUSION

Below are the results of our audit survey/evaluation:

**Audit Objective #1:** Understand the Auditor-Controller's CAFR Footnote Disclosure Process.

**Results:** We gathered information from the Auditor-Controller on the CAFR footnote disclosure process that enabled us to evaluate selected aspects and controls of this critical function.

**Audit Objective #2:** Identify Process and Control Strengths.

**Results:** The CAFR Footnote Disclosure Process includes several **Industry Leading Best Practices** including: the recent establishment of a formal CAFR Review Committee comprised of countywide "subject matter experts" with scheduled working sessions and status briefings; the provision of reference guides and graphic aids and other relevant support material to the CAFR review committee members; the long standing practice of having very well qualified "knowledge experts" to oversee the CAFR disclosure process; a dedicated central coordinator to manage and direct the CAFR disclosure process; the wide and timely distribution of materials and drafts to countywide "subject matter experts" for review and comments; written policies and procedures as well as the retention of relevant supporting documentation.

**Audit Objective #3:** Identify Any Areas that Could Benefit From Enhancements

**Results:** We noted two (2) **Control Findings** where an analysis of mandated requirements was not documented and CAFR review instructions were not clearly defined. We noted (1) **Control Finding** where we proposed four (4) possible enhancements for the newly established CAFR Review Committee itself. See Attachment A for a description of report item classifications.

## **Management's Responsibilities for Internal Controls**

In accordance with the Auditor-Controller's County Accounting Manual section S-2 - *Internal Control Systems*, "All County departments/ agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls. Control systems shall be continuously evaluated and weaknesses, when detected, must be promptly corrected."

The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Internal Audit's review enhances and complements, but does not substitute for the Auditor-Controller's continuing emphasis on control activities and self-assessment of control risks.



## **Inherent Limitations in Any System of Internal Control**

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, and circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our evaluation would not necessarily disclose all weaknesses in Auditor-Controller's operating procedures, accounting practices and compliance with County policy.

## **ACKNOWLEDGMENT**

We appreciate the courtesy extended to us by the Auditor-Controller's Office. If we can be of further assistance, please contact me directly; or Eli Littner, Deputy Director at 834-5899 or Alan Marcum, Senior Audit Manager at 834-4119.

**Attachment A: Report Item Classifications**

**Attachment B: Auditor-Controller Management Responses**

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors  
Members, Audit Oversight Committee  
Thomas G. Mauk, County Executive Officer  
Bob Franz, Deputy CEO, Chief Financial Officer  
Shaun Skelly, Senior Director, A-C Accounting/Technology  
Jan Grimes, Director, A-C Central Accounting Operations  
Claire Moynihan, Senior Manager, A-C Financial Reporting  
Nancy Ishida, Manager, A-C Internal Audit/Staff Services  
Foreperson, Grand Jury  
Darlene J. Bloom, Clerk of the Board of Supervisors

# Detailed Findings, Recommendations and Management Responses



## **Audit Objective #1: Understand the Auditor-Controller's CAFR Footnote Disclosure Process**

The Auditor-Controller's Financial Reporting Group prepares the County's Comprehensive Annual Financial Report (CAFR). The Financial Reporting Group consists of 10 accountants, and is headed by a Senior Manager. The Financial Reporting Group compiles the CAFR by taking raw financial data and transforming it into a coherent, accurate report that complies with Generally Accepted Accounting Principles (GAAP). To comply with GAAP, the Financial Reporting Group must implement Governmental Accounting Standards Board (GASB) pronouncements that affect CAFR reporting.

The Financial Reporting Group organizes the preparation of the CAFR disclosures by footnote number and projects within the footnote number. The projects are different tasks to be completed. For example: Note No. 3 for *Deposits and Investments* contains six projects, e.g., Project No. 71 is for the *Reconciliation of Deposits and Investments*. Each project contains a pro forma checklist, written procedures, and supporting documentation.

The Financial Reporting Group prepares and distributes instructions, schedule and timeline of responsibilities for the CAFR process to other Auditor-Controller (A-C) management and staff, County departments (e.g., County Executive Office, Treasurer-Tax Collector, and County Counsel), and the external auditors. As the Financial Reporting Group receives financial data, they compile the CAFR footnote disclosures. The CAFR footnote disclosure drafts are distributed for preliminary and final review and comment to the same contributing individuals along with the Chief Financial Officer and Director of the Internal Audit Department.

## **Audit Objective #2: Identify Process and Control Strengths**

We identified the following controls and processes as either industry leading or best practices for the preparation of the County CAFR footnote disclosures. These controls and processes were drawn from a 2006 report prepared by the Audit Committee of the City of San Diego. This exhaustive and comprehensive report was prepared with the assistance of Kroll consulting and Willkie Farr & Gallagher LLP. Specifically, the report evaluated the adequacy of the City's financial reporting process in light of legal challenges to the adequacy of its financial disclosures regarding the Employees' Retirement System and the Sewer Rate Structure.

1. The recent establishment by the A-C office of a formal CAFR Review Committee comprised of appropriate countywide subject matter experts.

# Detailed Findings, Recommendations and Management Responses



2. The long established practice of designating a knowledge expert as the central coordinator to manage and direct the CAFR footnote disclosure process.
3. The long established practice of a timely distribution of CAFR footnote disclosure drafts for review and comment to countywide subject matter experts.
4. The initiation of frequent and timely working sessions for the newly established CAFR Review Committee.
5. The long established practice of an “Open Issues Log” which tracks through resolution all concerns and issues brought to the Auditor-Controller’s office regarding footnote disclosures.
6. The long established practice of close and timely supervision and oversight of the CAFR footnote disclosure process through direct involvement and leadership of the Director of Central Accounting Operations, Senior Director of Accounting and Technology, and the Auditor-Controller himself.
7. The long established practice of oversight of the CAFR review footnote disclosure process by Certified Public Accountants. The Auditor-Controller, Senior Director of Accounting and Technology, and Director of Central Accounting Operations are all Certified Public Accountants.
8. The provision of written policies and procedures detailing key aspects of the CAFR footnote disclosure review process.
9. The long established practice of the retention of important documentation supporting the CAFR footnote disclosure by a dedicated central coordinator.
10. The initiation of a final review by the newly created CAFR Review Committee.
11. The long established practice of the formal review and authorization of all CAFR footnote disclosures prior to finalization by the Auditor-Controller and key staff.

## **Audit Objective #3: Identify Any Areas that Could Benefit From Enhancements**

We identified the following areas where processes and controls could be improved:

### **AUDIT FINDINGS & RECOMMENDATIONS**

#### **1. Detailed Analysis of the Respective Financial Reporting Standards is Not Documented (Control Finding – Recommendation No.1)**

A detailed analysis of the respective financial reporting standards is not documented in the specific project files (e.g., GASB No. 27 – *Accounting for Pensions by State and Local Governmental Employers*).

# Detailed Findings, Recommendations and Management Responses



The written procedures cite the applicable financial reporting standards and responsible preparers and reviewers have access to the accounting pronouncements. However, because of the criticality and complexity of financial reporting standards and Countywide impact, it is important to have well-documented analysis of accounting pronouncements.

A detailed analysis and documentation of specific financial reporting standards facilitates effective and efficient preparation and review of the CAFR footnote disclosures. The detailed analysis and documentation of financial reporting standards relative to the footnote disclosure should include general requirements as well as specific reporting requirements related to the respective area. Internal employee turnover for the Auditor-Controller's Financial Reporting Group is expected, 36% of the personnel changed (4 of 11 positions) between the CAFRs for the fiscal years ending June 30, 2007 and 2008. Detailed analysis and documentation would mitigate the effects of internal employee turnover, further assist in the development training of staff, increase standardization of the process, and clarify financial reporting responsibilities.

Statement on Auditing Standards (SAS) No. 109 states, in part, that internal control is a process designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control consists of interrelated components including information and communication systems that support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.

**Recommendation No. 1:** We recommend that the Auditor-Controller consider documenting the requirements mandated in the respective financial reporting standards for CAFR footnote disclosures. The documentation could be maintained within the existing project files supporting the specific CAFR footnote disclosures.

**Auditor-Controller Management Response:** Concur. We will include a more detailed analysis of the Generally Accepted Accounting Principles (GAAP) in the GAAP Guidance section of the Comprehensive Annual Financial Report (CAFR) footnote disclosure files. The guidance will be more specific in identifying all required elements in the footnote disclosures as well as supporting documentation for major decisions made in the application of the GAAP guidance.



## 2. CAFR Review Instructions Are Not Clearly Defined (Control Finding – Recommendation No. 2)

The CAFR review instructions distributed to the various County department managers, while general, are not specific or clearly defined as to the responsibilities and focus for their review. Levels of review are not specific for compliance with applicable accounting standards in respect to the following:

- A full cover-to-cover review in which the reviewers examine the financial statements and related disclosures.
- A targeted issue review in which the reviewers examine the CAFR for one or more specific items of disclosure.

SAS No. 109 states, in part, that communication involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting. It includes the extent to which personnel understand how their activities in the financial reporting information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity.

**Recommendation No. 2:** We recommend that the Auditor-Controller consider enhancing the instructions to more clearly define the criteria and level of the CAFR review by specific managers. A detailed matrix of expertise, expectations, and financial reporting standards by subject matter expert and statement component could be helpful.

**Auditor-Controller Management Response:** Concur. We will consider this recommendation as we continue to develop and define the structure of the CAFR Review Committee.

## 3. Newly Established CAFR Review Committee Enhancement (Control Findings – Recommendation Nos. 3, 4, 5, 6)

During our evaluation, the Auditor-Controller commenced formation of a CAFR Review Committee to enhance the existing controls over financial disclosure. The committee will be comprised of representatives from departments currently providing review and comment on the CAFR.

SAS No. 109 states, in part, that the control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for effective internal control, providing discipline and structure. The control environment includes the assignment of authority and responsibility. This factor includes how authority and responsibility for operating activities are assigned and how reporting relationships and authorization hierarchies are established.

# Detailed Findings, Recommendations and Management Responses



It also includes policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties. In addition, it includes policies and communications directed at ensuring that all personnel understand the entity's objectives, know how their individual actions interrelate and contribute to those objectives, and recognize how and for what they will be held accountable.

The Bylaws of the Orange County Audit Oversight Committee (AOC), Section VI.b. states that the AOC is "To oversee the quality of financial reporting activities which portray the County's financial condition, results of operations, and plans and long-term commitments, primarily through oversight of the public accounting firm providing the external audit coverage of the County's consolidated financial statements."

The roles and responsibilities of the committee are under development. We commend the Auditor-Controller for taking this action to improve the existing process. The proposed committee should consider including the following practices:

**Recommendation No. 3:** We recommend the proposed CAFR Review Committee consider establishing bylaws that specify rules, duties, order and scheduling of meetings, public participation (if any), authority, objectives, and reporting relationship to the Audit Oversight Committee.

**Auditor-Controller Management Response:** We have considered this recommendation, and we recognize the need to define the objectives of the committee as well as outline the roles, duties, and expectations of the members. However, the CAFR Review Committee's role is strictly advisory, and there is no reporting relationship to the Audit Oversight Committee. The Auditor-Controller is responsible for the preparation of the CAFR based upon the order of the Board of Supervisors Resolution No. 69-733, which enacted Government Code Sections 26880-26886 and designates the Auditor-Controller as the Chief Accounting Officer of the County.

The purpose of the CAFR Review Committee was to provide more structure to the CAFR final review and approval process and provide additional assistance to those making this review in order to enhance controls over our current County management review process. Our intent was to establish a workgroup comprised of managers involved with the CAFR development process. The workgroup includes key managers from some of the County's largest operational areas. The objective is to facilitate the final review process through some guided discussions of the development and revision of important CAFR topics and new standards; and to provide a forum for open discussion on our interpretation and application of the standards and pronouncements. The expectation is that a member would only review and approve those areas of the document that pertain to their areas of operations.

# Detailed Findings, Recommendations and Management Responses



In addition, it is not our intent or desire that the CAFR Review Committee be subject to the Brown Act requirements because then all materials, including CAFR drafts, would be available to the public throughout the deliberative process. Government Code 26908.5 prohibits the auditor or his or her employees from releasing “papers, correspondence, memoranda, or any substantive information pertaining to any audit not completed.” We would not want to expose the County to unnecessary risk by distributing CAFR drafts to members of a Brown Act Committee because the drafts would become public documents. Without the deliberative process, we undercut the ability for reviewers to provide meaningful comments for drafts. The deliberative process argument is not a valid defense if a record is made available to all or a majority of a Brown Act public body.

The AOC continues to provide oversight of the public accounting firm engaged for the external audit coverage of the County’s consolidated financial statements. The external audit firm is obligated to perform the engagement in accordance with professional standards established by the American Institute of Certified Public Accountants (AICPA). These professional standards specify the required communications they must make to the Audit Oversight Committee before, during, and at the conclusion of the audit. The AICPA Statement on Auditing Standards (SAS) No. 114, “The Auditor’s Communication With Those Charged With Governance,” distinguishes between those responsible for overseeing the strategic direction of the organization (i.e. the AOC) and those who are responsible for making decisions about how to execute the strategic directives (County management, including the CAFR Review Committee management). SAS No. 114 expanded communications and stressed the importance of effective two-way communication between those governing organizations and auditors. Management is responsible for the organization’s financial statements. The types of issues the auditor is required to communicate provide a type of “report card” related to the audit, including the following:

- The auditor’s responsibility under Generally Accepted Auditing Standards
- Significant accounting policies
- Significant accounting estimates
- Significant audit adjustments
- Disagreements with management
- Consultation with other independent accountants (“opinion shopping”)
- Issues discussed prior to retention of independent accountants
- Difficulties encountered in performing the audit
- Overview of the planned scope of the audit
- Representations the auditor is requesting from management

# Detailed Findings, Recommendations and Management Responses



**Audit Rejoinder:** In the Auditor-Controller's response they recognize the need to define the objectives of the committee as well as outline the roles, duties, and expectations of the members. In addition, they have addressed the reporting relationship with the Audit Oversight Committee. We conclude that the Auditor-Controller's response addresses the intent of our recommendation.

**Recommendation No. 4:** We recommend the proposed CAFR Review Committee maintain on file meeting agendas and minutes.

**Auditor-Controller Management Response:** Concur. The Auditor-Controller Financial Reporting & Mandated Costs unit will continue to prepare, distribute, and file the CAFR Review Committee meeting agendas and minutes.

**Recommendation No. 5:** We recommend the newly established CAFR Review Committee consider the benefits and appropriateness of providing a briefing of the committee's results to the Audit Oversight Committee.

**Auditor-Controller Management Response:** We have considered this recommendation and determined that the CAFR Review Committee is an advisory committee whose role is to review and comment on the CAFR prior to issuance. As discussed in Recommendation No. 3, it is appropriate to continue to rely on the external audit firm's reporting to the AOC.

**Audit Rejoinder:** See Audit Rejoinder to Recommendation No. 3.

**Recommendation No. 6:** We recommend the CAFR Review Committee Coordinator facilitate training, on a regular basis, for the review committee members and Auditor-Controller staff, regarding their obligations relating to disclosure matters and regulations and new technical pronouncements and developments.

**Auditor-Controller Management Response:** Concur. As training opportunities arise, we will continue to inform committee members. In addition, the contract with our external auditors, Vavrenik, Trine & Day (VTD), requires them to provide 8 hours of continuing education training. We will invite committee members to any training provided by VTD.

**Audit Rejoinder:** We believe that as training opportunities arise, that Auditor-Controller Financial Reporting Group staff should also be invited to participate in the training.



## ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

▶ **Material Weaknesses:**

Audit findings or a combination of Significant Issues that can result in financial liability and exposure to a department/agency and to the County as a whole. Management is expected to address “Material Weaknesses” brought to their attention immediately.

▶ **Significant Issues:**

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of processes or internal controls. Significant Issues do not present a material exposure throughout the County. They generally will require prompt corrective actions.

▶ **Control Findings and/or Efficiency/Effectiveness Issues:**

Audit findings that require management’s corrective action to implement or enhance processes and internal controls. Control Findings and Efficiency/Effectiveness issues are expected to be addressed within our follow-up process of six months, but no later than twelve months.

# Detailed Findings, Recommendations and Management Responses



## ATTACHMENT B: Auditor-Controller Management Responses

	<b>AUDITOR-CONTROLLER COUNTY OF ORANGE</b>	<b>SHAUN M. SKELLY</b> SENIOR DIRECTOR ACCOUNTING & TECHNOLOGY
	HALL OF FINANCE AND RECORDS 12 CIVIC CENTER PLAZA, ROOM 200 POST OFFICE BOX 567 SANTA ANA, CALIFORNIA 92702-0567 (714) 834-2450 FAX: (714) 834-2569 www.ac.ocgov.com	<b>RECEIVED</b> <b>INTERNAL AUDIT DEPARTMENT</b> 2009 MAR 11 AM 5:25 <b>JAN E. GRIMES</b> DIRECTOR CENTRAL ACCOUNTING OPERATIONS <b>WILLIAM A. CASTRO</b> DIRECTOR SATELLITE ACCOUNTING OPERATIONS <b>PHILLIP T. DAIGNEAU</b> DIRECTOR INFORMATION TECHNOLOGY

DAVID E. SUNDSTROM, CPA  
AUDITOR-CONTROLLER

March 10, 2009

TO: Peter Hughes, Director  
Internal Audit Department

SUBJECT: Revised Draft Report of the Evaluation of Auditor-Controller CAFR Footnote Disclosure Process for the Year Ending June 30, 2007, Audit No: 2767

Following is our response to the recommendations contained in the Revised Draft Report of the Evaluation of Auditor-Controller CAFR Footnote Disclosure Process for the Year Ending June 30, 2007.

**Recommendation No. 1:** We recommend that the Auditor-Controller consider documenting the requirements mandated in the respective financial reporting standards for CAFR footnote disclosures. The documentation could be maintained within the existing project files supporting specific CAFR footnote disclosures.

**Auditor-Controller Response:** Concur. We will include a more detailed analysis of the Generally Accepted Accounting Principles (GAAP) in the GAAP Guidance section of the Comprehensive Annual Financial Report (CAFR) footnote disclosure files. The guidance will be more specific in identifying all required elements in the footnote disclosures as well as supporting documentation for major decisions made in the application of the GAAP guidance.

**Recommendation No. 2:** We recommend that the Auditor-Controller consider enhancing the instructions to more clearly define the criteria and level of the CAFR review by specific managers. A detailed matrix of expertise, expectations, and financial reporting standards by subject matter expert and statement component could be helpful.

**Auditor-Controller Response:** Concur. We will consider this recommendation as we continue to develop and define the structure of the CAFR Review Committee.

# Detailed Findings, Recommendations and Management Responses



## ATTACHMENT B: Auditor-Controller Management Responses

Peter Hughes, Director, Internal Audit Department  
March 10, 2009  
Page 2

**Recommendation No. 3:** We recommend the proposed CAFR Review Committee consider establishing bylaws that specify rules, duties, order and scheduling of meetings, public participation (if any), authority, objectives, and reporting relationship to the Audit Oversight Committee (AOC).

**Auditor-Controller Response:** We have considered this recommendation, and we recognize the need to define the objectives of the committee as well as outline the roles, duties, and expectations of the members. However, the CAFR Review Committee's role is strictly advisory, and there is no reporting relationship to the Audit Oversight Committee. The Auditor-Controller is responsible for the preparation of the CAFR based upon the order of the Board of Supervisors Resolution No. 69-733, which enacted Government Code Sections 26880-26886 and designates the Auditor-Controller as the Chief Accounting Officer of the County.

The purpose of the CAFR Review Committee was to provide more structure to the CAFR final review and approval process and provide additional assistance to those making this review in order to enhance controls over our current County management review process. Our intent was to establish a workgroup comprised of managers involved with the CAFR development process. The workgroup includes key managers from some of the County's largest operational areas. The objective is to facilitate the final review process through some guided discussions of the development and revision of important CAFR topics and new standards; and to provide a forum for open discussion on our interpretation and application of the standards and pronouncements. The expectation is that a member would only review and approve those areas of the document that pertain to their areas of operations.

In addition, it is not our intent or desire that the CAFR Review Committee be subject to the Brown Act requirements because then all materials, including CAFR drafts, would be available to the public throughout the deliberative process. Government Code 26908.5 prohibits the auditor or his or her employees from releasing "papers, correspondence, memoranda, or any substantive information pertaining to any audit not completed." We would not want to expose the County to unnecessary risk by distributing CAFR drafts to members of a Brown Act Committee because the drafts would become public documents. Without the deliberative process, we undercut the ability for reviewers to provide meaningful comments for drafts. The deliberative process argument is not a valid defense if a record is made available to all or a majority of a Brown Act public body.

The AOC continues to provide oversight of the public accounting firm engaged for the external audit coverage of the County's consolidated financial statements. The external audit firm is obligated to perform the engagement in accordance with professional standards established by the American Institute of Certified Public Accountants (AICPA). These professional standards specify the required communications they must make to the Audit Oversight Committee before, during, and at the conclusion of the audit. The AICPA Statement on Auditing Standards (SAS) No. 114, "The Auditor's Communication With Those Charged With Governance," distinguishes between those

# Detailed Findings, Recommendations and Management Responses



## ATTACHMENT B: Auditor-Controller Management Responses

Peter Hughes, Director, Internal Audit Department  
March 10, 2009  
Page 3

responsible for overseeing the strategic direction of the organization (i.e. the AOC) and those who are responsible for making decisions about how to execute the strategic directives (County management, including the CAFR Review Committee management). SAS No. 114 expanded communications and stressed the importance of effective two-way communication between those governing organizations and auditors. Management is responsible for the organization's financial statements. The types of issues the auditor is required to communicate provide a type of "report card" related to the audit, including the following:

- The auditor's responsibility under Generally Accepted Auditing Standards
- Significant accounting policies
- Significant accounting estimates
- Significant audit adjustments
- Disagreements with management
- Consultation with other independent accountants ("opinion shopping")
- Issues discussed prior to retention of independent accountants
- Difficulties encountered in performing the audit
- Overview of the planned scope of the audit
- Representations the auditor is requesting from management

**Recommendation No. 4:** We recommend the proposed CAFR Review Committee maintain on file meeting agendas and minutes.

**Auditor-Controller Response:** Concur. The Auditor-Controller Financial Reporting & Mandated Costs unit will continue to prepare, distribute, and file the CAFR Review Committee meeting agendas and minutes.

**Recommendation No. 5:** We recommend the newly established CAFR Review Committee consider the benefits and appropriateness of providing a briefing of the committee's results to the Audit Oversight Committee.

**Auditor-Controller Response:** We have considered this recommendation and determined that the CAFR Review Committee is an advisory committee whose role is to review and comment on the CAFR prior to issuance. As discussed in Recommendation No. 3, it is appropriate to continue to rely on the external audit firm's reporting to the AOC.

# Detailed Findings, Recommendations and Management Responses



## ATTACHMENT B: Auditor-Controller Management Responses

Peter Hughes, Director, Internal Audit Department  
March 10, 2009  
Page 4

**Recommendation No. 6:** We recommend the CAFR Review Committee Coordinator facilitate training, on a regular basis, for the review committee members and Auditor-Controller staff, regarding their obligations relating to disclosure matters and regulations and new technical pronouncements and developments.

**Auditor-Controller Response:** Concur. As training opportunities arise, we will continue to inform committee members. In addition, the contract with our external auditors, Vavrenik, Trine & Day (VTD), requires them to provide 8 hours of continuing education training. We will invite committee members to any training provided by VTD.



David E. Sundstrom  
Auditor-Controller

CM:lr (Resp— Revised Draft Report of CAFR Footnote Disclosure Process)

cc: Shaun Skelly, Senior Director, A-C Accounting & Technology  
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