



**BOARD OF DIRECTORS
DECEMBER 15, 2017**

ACTION REQUESTED: APPROVE

**PROPOSED NEW BOARD POLICY NO. 039: AUDIT POLICY
ADVISORY COMMITTEE AND AUDIT ACTIVITIES**

File Number 8000102

Introduction

As discussed at the November 3, 2017, Board of Directors meeting, Assembly Bill 805 (AB 805) (Gonzalez Fletcher) goes into effect on January 1, 2018, and there are many steps to carry out over the following months to implement its provisions. This report concerns the new provisions that AB 805 adds to Public Utilities Code Sections 132351.4 and 132354.1, which require the creation of a new Policy Advisory Committee, known as the Audit Committee, and independent performance auditor position.

Recommendation

The Executive Committee recommends that the Board of Directors approve the proposed new Board Policy No 039: SANDAG Audit Policy Advisory Committee and Audit Activities (Attachment 1). The Board also is asked to direct that SANDAG's existing Principal Management Internal Auditor report on audit matters to the Audit Committee once established.

Discussion

The proposed new Board Policy No. 39: Audit Policy Advisory Committee and Audit Activities, is provided as Attachment 1. The discussion below summarizes each section of the policy.

Audit Committee Provisions

Section 1

This section states that the purpose of the policy is to specify the functions of the Audit Committee and the agency's independent performance auditor.

Section 2

Pursuant to AB 805, this section provides that the Audit Committee is to consist of five voting members, with two Board members and three members of the public, all of which are to be appointed by the Board of Directors. AB 805 does not discuss how officer positions of the Committee will be filled, or whether there will be alternates. The language in the proposed policy is consistent with the process used for other SANDAG Policy Advisory Committees, under which the Chair of the Board would select who will serve as the Chair and Vice Chair of the Committee. Unlike the other Policy Advisory Committees, the term of office for the Chair and Vice Chair is proposed to be two years instead of one, and primary members would not be able to select their own alternates. This

approach is recommended because of the unique learning curve associated with serving on the Audit Committee as compared to other Policy Advisory Committees, and the goal of ensuring that the voting members, whether they be primary or alternate members, have the desired qualifications.

Section 3

Section 3 focuses on the responsibilities of the Audit Committee. Most of the responsibilities listed are specified in AB 805; these include making recommendations to the Board of Directors regarding the selection of the audit firm to be hired to conduct the annual SANDAG independent financial audit and hiring of the independent performance auditor, and approval of the annual audit plan. In addition, Sections 3.1.3, 3.1.6, 3.1.8, and 3.1.9 authorize the Committee to oversee the implementation of corrective actions as necessary.

AB 805 specifies that the independent performance auditor can only be removed for cause by a two-thirds vote of the Board and the Audit Committee; however, it does not state what constitutes cause. In Section 3.1.11, the draft policy proposes that sufficient cause include, but not be limited to, incompetence, dishonesty, unethical behavior, violation of state or federal laws, or failure to maintain required professional certifications.

Section 4

Section 4 is broken out into two parts. Section 4.1 describes the criteria for selection of the Board members, and Section 4.2 describes the criteria for selection of the public members on the Audit Committee. The draft policy requires that Board members who serve on the Committee have served on the Board of Directors for at least three years, have a basic understanding of the role of the Committee, and are willing to work through the Committee to pursue opportunities for improvements identified through the agency's audit products.

On the other SANDAG Policy Advisory Committees, each subregion (North County Coastal, North County Inland, East County, South County), the City of San Diego, and County of San Diego have a representative; however, per AB 805, only two Board members may serve on the Audit Committee. For this reason, the policy proposes that the SANDAG Chair recommend the Board members and alternates who will serve on the Committee, subject to approval by a majority vote of the Board.

Section 4.2 of the proposed new policy would require that the three public members who serve on the Committee have accounting, financial or auditing experience, including at least ten years of experience as a certified public accountant or as a certified internal auditor, or ten years of other professional accounting, financial, or legal experience in audit management.

The proposed public member criteria and selection process in Section 4.2 are a hybrid of the process used by the City of San Diego to select its audit committee members and the process SANDAG currently uses to select members of the *TransNet* Independent Taxpayer Oversight Committee. The selection process for public members allows for a screening committee to recommend applicants for both the primary and alternate seats if enough qualified candidates submit applications. Public members on the Audit Committee would be subject to approval by a majority vote of the Board, following an application and screening process.

Independent Performance Auditor Provisions

Section 5

This section of the draft policy contains the process for selecting the independent performance auditor. Rather than focusing on financial matters, performance auditing generally refers to the independent examination of a program, function, operation, or management systems and procedures to assess whether the entity is achieving economy, efficiency, and effectiveness in the employment of available resources. AB 805 requires that SANDAG “hire” an independent performance auditor. It does not dictate whether the independent performance auditor be a consultant firm or a contract employee of the agency. Staff is in the process of gathering information on the pros and cons of the two options and plans to bring the information to the Board at a future meeting for direction. The section delineates a two-year term and significant qualifications and experience criteria that would be used by the Committee to select the independent performance auditor.

Section 6

The purpose of Section 6 is to list the scope of authority and responsibilities of the independent performance auditor. Most of the responsibilities are specified in AB 805, such as the requirement that the independent performance auditor annually prepare an audit plan and perform planned audits in accordance with Government Auditing Standards, and that the independent performance auditor has unrestricted access to employees, information, and records for both audits and investigations into material claims of financial fraud, waste, or impropriety. In addition, this section requires that the independent performance auditor follow procedures recommended by the Association of Certified Fraud Examiners’ manual for investigations into allegations of financial fraud, waste, or impropriety.

AB 805 also provides that the independent performance auditor may examine any agency officer, agent, or employee; any claimant; or other person under oath. The proposed policy includes steps the independent performance auditor must take in coordination with the Committee and legal counsel to invoke this provision in order to mitigate risk exposure to the agency. Additionally, this section would require that the independent performance auditor coordinate audit functions with audits performed by the Independent Taxpayer Oversight Committee to avoid duplication and requires the independent auditor to employ existing SANDAG procedures for hiring, firing, and procurements when acting within the auditor’s area of purview.

Next Steps

An initial timeline for the creation of the Audit Committee and hiring of the independent performance auditor was presented to the Board of Directors at its meeting on November 3, 2017. This initial timeline concluded implementation in December 2018. At that meeting, the Board expressed a desire to significantly reduce the time necessary for implementation. In response to that direction, staff proposes a revised timeline.

Upon Board approval of the proposed Board Policy No. 039, it is likely that the creation of the Audit Committee could be completed by the Board in spring 2018. This could make it possible for the independent performance auditor to be hired by late summer/early fall 2018, reducing the original timeline by up to six months. Additionally, upon convening the Audit Committee in the spring, the

existing SANDAG Principal Management Internal Auditor could begin reporting on all matters, except administrative matters, to the Audit Committee. Such a move would allow the Committee to oversee the existing internal audit effort on an expedited basis.

Additional information on the costs associated with the creation of the Audit Committee and independent performance auditor position will be provided at a future meeting.

KIM KAWADA
Chief Deputy Executive Director

Attachment: 1. Draft Board Policy No. 039: Audit Policy Advisory Committee and Audit Activities

Key Staff Contact: Julie Wiley, (619) 699-6966, julie.wiley@sandag.org
Diane Eidam, (916) 300-2267, diane.eidam@sandag.org



BOARD POLICY No. **039**

AUDIT POLICY ADVISORY COMMITTEE AND AUDIT ACTIVITIES

1. Purpose

The purpose of this policy is to specify the functions of the Audit Committee and the SANDAG independent performance auditor.

2. Governance and Role of the Audit Committee

- 2.1. The Audit Committee shall be overseen by the SANDAG Board of Directors and shall govern itself in accordance with Public Utilities Code Sections 132351.4 and 132354.1, and the policies and procedures applicable to all SANDAG Policy Advisory Committees.
- 2.2. Membership of the Audit Committee shall be as set forth in Board Policy No. 002: Policy Advisory Committee Membership. The Audit Committee shall consist of five voting members with two members of the Board of Directors and three members of the public, all of which shall be appointed by the Board of Directors. Due to the qualification requirements and selection process described in this policy, Audit Committee members and alternates shall be selected according to the processes below.
- 2.3. The Chair of the Board will select which members of the Audit Committee will hold the Chair and Vice Chair positions on the Audit Committee every two years or whenever a position is vacant.
- 2.4. The role of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities and provide a forum for pursuing the opportunities for improvements in operations, financial reporting and internal controls identified through the agency's audit products.

3. Authority of the Audit Committee

- 3.1 The Audit Committee may hear items within the subject areas of audits, internal controls and investigations into fraud, waste, or impropriety, and may be asked to provide actions or recommendations on other matters within the Audit Committee's purview. The responsibilities of the Audit Committee include:
 - 3.1.1 Recommend to the Board which firm to contract with to conduct the annual financial statement audits.
 - 3.1.2 Meet with management and the independent performance auditor to review and discuss SANDAG's annual financial statement audits, internal control reports and other audits performed by external auditors.
 - 3.1.3 Review and oversee the implementation of corrective action to address noted audit deficiencies.

- 3.1.4 Based on the Board's direction regarding whether to hire an individual or firm, recommend to the Board which individual or firm to hire to carry out independent performance auditor responsibilities.
- 3.1.5 Recommend to the Board the annual compensation of the independent performance auditor.
- 3.1.6 Oversee the work of the independent performance auditor in preparing and issuing audit and investigative reports and other audit, review or attest activities.
- 3.1.7 Approve the annual audit plan after discussion with the independent performance auditor pursuant to Public Utilities Code Section 132354.1(b), and make recommendations to the Board regarding the budget needed to carry out the annual audit plan of the independent performance auditor.
- 3.1.8 Monitor the implementation of the annual audit plan and provide an annual report the Board.
- 3.1.9 Monitor the implementation of corrective action identified in audit and investigative reports and inform the Board when corrective action is insufficient or untimely.
- 3.1.10 Conduct the independent performance auditor's annual performance evaluation against performance measures established and adopted by the Audit Committee.
- 3.1.11 Vote on whether to remove the independent performance auditor for cause including, but not limited to incompetence, dishonesty, unethical behavior, violation of state or federal laws, or failure to maintain required professional certifications; such removal being subject to an approving vote by two-thirds of the Audit Committee and the Board.
- 3.1.12 Recommend internal control guidelines to be adopted by the Board to prevent and detect financial errors and fraud based on the internal control guidelines developed by the State Controller pursuant to Government Code Section 12422.5 and the standards adopted by the American Institute of Certified Public Accountants.

4. Selection of Audit Committee Members

- 4.1 The Board members serving on the Audit Committee shall be appointed by the Board using the procedures in this subsection 4.1.
 - 4.1.1 The two Board members and any Board member alternates serving on the Audit Committee shall be recommended for appointment by the Chair of the Board. The Chair of the Board shall select Board members to recommend to the Board based on the following criteria:
 - 4.1.1.1 The Board member shall have served on the Board for at least three years;
 - 4.1.1.2 The Board member shall have a basic understanding of the role of the Audit Committee; and

- 4.1.1.3 The Board member shall express a willingness to work through the Audit Committee to pursue opportunities for improvements in operations, financial reporting, and internal controls identified through the agency's audit products.
 - 4.1.2 The Board members recommended by the Chair of the Board shall be subject to approval by a majority vote of the Board.
 - 4.1.3 Audit Committee members shall serve until their successors are appointed. In the event that the Board member who has been appointed to serve on the Audit Committee is no longer a primary or alternate member of the Board of Directors, the position shall be considered vacant. If and when vacancies in the voting membership of the Audit Committee occur, the same selection process as outlined above shall be followed to select a replacement.
 - 4.1.4 Board members appointed to the Audit Committee shall serve a term of two years. At the completion of a term, eligible incumbent members will need to apply for reappointment for another term. In no case shall any member serve more than five years on the Audit Committee.
- 4.2 The public members serving on the Audit Committee shall be appointed by the Board using the procedures in this subsection 4.2.
 - 4.2.1 Whenever there is a vacancy for a public member seat on the Audit Committee, application forms will be made available on the SANDAG website for persons interested in applying for an Audit Committee position. Applications shall be due within 30 days after the application forms are posted. Only candidates who submit an application by the deadline will be considered.
 - 4.2.2 Applicants shall possess the independence, experience, and technical expertise necessary to carry out the duties of the Audit Committee. This expertise includes, but is not limited to, knowledge of accounting, auditing, and financial reporting. The minimum professional standards for public members shall include at least ten years of experience as a certified public accountant or as a certified internal auditor, or ten years of other professional accounting, financial, or legal experience in audit management.
 - 4.2.3 The candidates shall be recommended by a majority vote of a screening committee composed of a member of the Board selected by the Chair of the Board, the chief financial officer or finance director of a SANDAG member agency, and at least one outside financial expert appointed by the other two members of the screening committee and confirmed by the Board. Persons serving on the screening committee shall sign a declaration establishing that they do not have a conflict of interest.
 - 4.2.4 The screening committee may interview one or more of the candidates. The screening committee shall submit its recommended nominee(s) for the position(s). The screening committee also may nominate alternates from among the applicants.
 - 4.2.5 In the event that the screening committee is unable to recommend any of the applicants for any or all positions, or an insufficient number of applications have been received, the screening committee may recommend a supplemental process, subject

to Board approval. The constraints set forth in the normal nomination process shall not be mandated to apply to the supplemental process.

- 4.2.6 The public members nominated by the screening committee shall be subject to approval by a majority vote of the Board.
- 4.2.7 Audit Committee members shall serve until their successors are appointed. If and when vacancies in the voting membership of the Audit Committee occur, the same selection process as outlined above shall be followed to select a replacement to fill the remainder of the term.
- 4.2.8 Public members appointed to the Audit Committee shall serve a term of two years. At the completion of a term, eligible incumbent members will need to apply for reappointment for another term. In no case shall any member serve more than five years on the Audit Committee.

5. Selection of Independent Performance Auditor

- 5.1 The independent performance auditor shall serve a two-year term and shall be selected on the basis of qualifications and experience, which include, but are not limited to:
 - 5.1.1 At least ten years of experience performing audits under Government Audit Standards;
 - 5.1.2 At least five years of management experience;
 - 5.1.3 A Bachelors or higher degree in business, public administration, finance, accounting or a related field; and
 - 5.1.4 Possession of a Certified Public Accountant or Certified Internal Auditor license or certificate.

6. Scope of Authority and Responsibilities of Independent Performance Auditor

- 6.1 The independent performance auditor shall annually prepare an audit plan and conduct audits in accordance therewith and perform those other duties as may be required by the Board or as provided by the California Constitution and general laws of the state. The independent performance auditor shall follow Government Auditing Standards.
- 6.2 All officers and employees of SANDAG shall furnish to the independent performance auditor unrestricted access to employees, information, and records, including electronic data, within their custody regarding powers, duties, activities, organization, property, financial transactions, contracts, and methods of business required to conduct an audit or otherwise perform audit duties. It is also the duty of any consolidated agency officer, employee, or agent to fully cooperate with the auditor, and to make full disclosure of all pertinent information, with the exception of information that is protected by law from disclosure.
- 6.3 The independent performance auditor shall prepare a proposed budget and submit it to the Audit Committee for a recommendation to the Board of Directors for its approval 180

days prior to the beginning of each fiscal year or as otherwise requested by the Director of Finance.

- 6.4 The independent performance auditor shall have the power to appoint, employ, and remove assistants, employees, and personnel as deemed necessary for the efficient and effective administration of the affairs of the independent performance auditor. The independent performance auditor may prescribe the duties, scope of authority, and qualifications of employees and consultants overseen by the independent performance auditor. The independent performance auditor's authority shall be subject to the annual audit plan and the budget approved by the Board, SANDAG rules and policies related to the management and hiring of SANDAG employees and consultants, and the scope of the independent performance auditor's purview as determined by the Board.
- 6.5 The independent performance auditor may investigate any material claim of financial fraud, waste, or impropriety within SANDAG and for that purpose may summon any officer, agent, or employee of the consolidated agency, any claimant, or other person, and examine him or her upon oath or affirmation relative thereto. The independent performance auditor will conduct investigations generally following the procedures recommended by the Association of Certified Fraud Examiners' Fraud Examiners Manual for any allegations of financial fraud, waste or impropriety. Prior to questioning any person under oath, the independent performance auditor shall advise the members of the Audit Committee of that intention, seek legal counsel from the Office of General Counsel or outside counsel under contract to SANDAG regarding the relevant legal issues, and document the reasons why the questioning must be done under oath instead of by some other form of affirmation.
- 6.6 The independent performance auditor shall coordinate audit functions such that there is no duplication of effort between the audits undertaken by the independent performance auditor and audits undertaken by the Independent Taxpayer Oversight Committee.
- 6.7 All SANDAG contracts with consultants, vendors, or agencies will be prepared with an adequate audit provision to allow the independent performance auditor access to the entity's records needed to verify compliance with the terms specified in the contract.
- 6.8 Results of all audits and reports shall be made available to the public in accordance with the requirements of the California Public Records Act (Chapter 3.5 (commencing with Section 6250) of Division 7 of the Title 1 of the Government Code). Final versions of formal reports also shall be posted on the SANDAG website.
- 6.9 All materials or services needed by the independent performance auditor shall be procured using an open and competitive basis with solicitation of proposals from the widest possible number of qualified firms as prescribed by SANDAG's procedures for procurement. The scope of work of all such consultant work shall be subject to approval by the independent performance auditor prior to any such solicitation.

Adopted _____ 2018