

**External Quality Assessment of
the Internal Audit Activity at**

County of Orange

April 2017

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EXECUTIVE SUMMARY

The Orange County Auditor-Controller (A-C), who is an independently elected official, is the chief audit executive (CAE) of the County. He provides audit oversight, through his Internal Audit Division (IAD), of all county operations, including those under the County Board of Supervisors and those directed by other independently elected County officials, as well as his Accounting Division.

As requested by the CAE, IIA Quality Services, LLC (Quality) conducted an external quality assessment (QA) of the A-C's IAD. The principal objective of the QA was to assess IAD's conformance to The IIA's *International Standards for the Professional Practice of Internal Auditing (Standards)*, evaluate the IAD's effectiveness in carrying out its mission, and identify opportunities to enhance its management and work processes, as well as its value to the County.

OPINION AS TO CONFORMANCE

It is our overall opinion that the IAD “Generally Conforms” to the IIA’s Standards. For a detailed list of the *Standards’* ratings, please see Attachment A of this report. Additionally, the QA team identified opportunities for further enhancing IAD operations, details of which are provided in this report.

The IIA *Quality Assessment Manual* suggests a scale of three ratings, “*Generally Conforms*,” “*Partially Conforms*,” and “*Does Not Conform*.” “*Generally Conforms*” is the top rating and means that an internal audit activity has a charter, policies, and processes that are judged to be in harmony with the intent of the mandatory element(s) of the IPPF. “*Partially Conforms*” means practice(s) are noted that are judged to diverge from the intent of the mandatory element(s) of the IPPF, but the practice(s) does/do not preclude the internal audit activity from performing its responsibilities in an acceptable manner. “*Does Not Conform*” means there are deficiencies in practice that are judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

SCOPE AND METHODOLOGY

As part of the preparation for the QA, the IA activity provided advanced document guides with detailed information and sent out surveys to its staff and a representative sample of County of Orange executives and managers. Summaries of the survey results (without identifying the individual survey respondents) have been furnished to the IAD. Prior to commencement of the onsite work by the assessment team, the team leader conducted a preliminary conference, by telephone, with the Director of the Internal Audit Division (DIAD) to gather additional background information, select executives and managers for onsite interviews, and finalize planning and administrative arrangements for the QA. As a part of the review, extensive interviews were held with County of Orange's Chair of the Board of Supervisors, Chair of the Audit Oversight Committee, executives and operating managers, external auditors, and IA activity staff. Also reviewed were the IAD risk assessment and audit planning processes, audit tools and methodologies, engagement and staff management processes, and a representative sample of IAD working papers and reports.

OBSERVATIONS AND POSITIVE ATTRIBUTES

The IAD environment is well-structured and progressive, the *Standards* are understood and IAD management is endeavoring to provide useful audit tools and implement appropriate practices. Some successful practices observed were:

- IA activity staff is well credentialed
- Engagement work papers are complete and well prepared
- Developed an excellent audit policies and procedures manual
- Implemented “Annual Reporting” on IAD activities to Orange County citizens
- Developed a highly effective and informative Annual Plan process
- Developed a leading class quality self-assessment report providing excellent observations of best practices and process improvement opportunities
- Assembled a highly-qualified information technology (IT) audit team
- Developed a cooperative relationship with the County Chief Information Security Officer to raise awareness of cyber security risks
- Outsourced a project to conduct a comprehensive, County-wide IT risk assessment and build an appropriate IT audit universe
- Developed COSO training classes for County managers and staff
- Implemented the use of a software package for preparing engagement work papers
- Implemented the use of a software package for data mining and continuous auditing; the package is used by the entire audit staff

Consequently, observations and recommendations are intended to build on this foundation already in place within the IAD.

RECOMMENDATIONS

Recommendations are divided into three groups:

- First are those that relate to the County Auditor-Controller and suggest matters for his consideration that have the potential to enhance the effectiveness of the IAD.
- Second are those that relate to IAD’s conformance with individual *Standards* regarding the County governance structure, and approval of audit engagement work programs.
- Third are those that relate to potential opportunities for the IAD to enhance its efficiency and effectiveness.

Highlights of the recommendations are set forth below, with details in the main body of the report.

PART I – MATTERS FOR CONSIDERATION OF THE AUDITOR-CONTROLLER

1. **Clarify the mission of the IAD and the nature of their audit services** by holding discussions with County management to explain the purpose, focus, and impact of government over-sight auditing. (Successful Practice)
2. **Enhance the appearance of the IAD independence in the A-C’s Office.** Consider engaging a third-party contractor to assess the independence and objectivity of the IAD’s annual plan and audit engagements relative to the A-C’s Accounting Division during years when an external quality assessment is not performed. (Implementation Guidance 1112)

PART II – CONFORMANCE ISSUES FOR THE INTERNAL AUDIT DIVISION

1. **Supplement IAD efforts to improve County governance processes** by including them within the annual planning process and conducting audit engagements with scopes that are focused on governance. (Standard 2110)
2. **Strengthen procedures for approving engagement work programs** by ensuring the review and approval process is properly and timely documented within the engagement work papers. (Standard 2240)

PART III – OPPORTUNITIES TO ENHANCE THE INTERNAL AUDIT DIVISION

1. **Consider activities to enhance staff proficiency** such as assigning staff as client liaisons to County operating management, and increasing participation in professional organizations. (Successful Practice)
2. **Consider actions to enhance IAD efficiency and effectiveness** such as expanding the performance measures used in status reporting and leveraging audit work performed by external auditors. (Successful Practices)

Thank you for the opportunity to be of service to County of Orange. The QA team will be pleased to respond to further questions concerning this report and to furnish any desired information.



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OBSERVATIONS AND RECOMMENDATIONS

PART I – MATTERS FOR CONSIDERATION OF THE AUDITOR-CONTROLLER

These observations and recommendations originated principally from comments received from the management surveys, the interviews conducted with selected County executives and managers, and follow-up on the issues by the QA Team. They are provided as potential opportunities to enhance the effectiveness of the IAD and the value it adds to the County.

1. Clarify the Mission of the IAD and the Nature of Audit Services

The Auditor-Controller (A-C) of Orange County is an independently elected county-wide official. He is the CAE of the County, and has responsibility to conduct audits of all County operations. The audits are conducted by his Internal Audit Division (IAD), under the direction of the Director of the Internal Audit Division (DIAD). Additionally, the A-C is responsible for the accounting operations of the County.

The County Board of Supervisors (BOS), comprised of five independently elected officials representing all districts within the County, is responsible for most County operations and services. In addition to the A-C, services are also provided by five other independently elected officials. They are the Assessor, Clerk-Recorder, District Attorney, Sheriff-Coroner, and the Treasurer-Tax Collector. The A-C is responsible for auditing all these operations and services, including those within his own accounting operations.

As an independently elected official, the A-C does not have functional or administrative reporting relationships within Orange County government; he is solely accountable to the citizens of the County. He does have quasi-functional interaction with the BOS through its Audit Oversight Committee (AOC). The AOC reviews and provides recommendations regarding the “approval” of the IAD annual plan and IAD Charter to the BOS. The A-C maintains that this functional interaction is advisory in nature, and is not binding on his preparation of the annual plan or on conducting County audits. By law, the BOS can require the A-C to conduct an audit of specific County operations, if the BOS deems it necessary.

The IAD was originally part of the A-C’s Office, and was eventually moved to the BOS for a period. IAD was moved back to the A-C in August 2015. Since then, the A-C has reestablished the mission of the IAD as an advocate for the citizens of Orange County, to promote public oversight, provide accountability, and support financial decision-making for the County. Implementing this mission marks a change from the audit approach IAD had adapted while under the BOS. The nature of IAD audit services has shifted from a focus of aligning with the strategies, objectives of County managers to accountability, oversight, and transparency in County government financial operations.

Interviews with County managers indicated a clear and significant difference in the current approach to IAD auditing, from assistance to oversight. While the IAD meets the requirements of the *Standards*, the mission is more compatible with the nature and intent of government auditing standards.

Recommendations

To address concerns of County management regarding the nature of audit services, the A-C should consider initiating discussions with senior County management, the Board of Supervisors, the Audit Oversight Committee, and other independently elected County officials to articulate the vision of providing the County with the types of effective government audits performed at the Federal, State, and local levels, and have been proven to provide essential oversight, accountability and transparency over government programs. The A-C could use this opportunity to demonstrate that even with a shift in focus and nature of auditing, the output of the work performed should still provide IAD the ability to assist in identifying risk and achieving the organization's objectives.

Auditor-Controller Response

Concur. The Auditor-Controller will meet with senior County management, the Board of Supervisors, the Audit Oversight Committee, and other independently elected County officials to articulate how, as noted by the Institute of Internal Auditors, the audit function “has shifted from a focus of aligning with the strategies, objectives of County managers to accountability, oversight, and transparency in County government financial operations.”

The Institute of Internal Auditors also noted that while the audit division “meets the requirements of the [Red Book] *Standards*, the mission is more compatible with the nature and intent of [Yellow Book] government auditing standards.” The Auditor-Controller will explain the audit division’s obligations under the Government Auditing Standards (the “Yellow Book”) issued by the Comptroller General of the United States, who heads the Government Accountability Office.

As described by the Institute of Internal Auditors, the Auditor-Controller has reestablished the audit mission “as an advocate for the citizens of Orange County, to promote public oversight, provide accountability, and support financial decision-making for the County.” The Auditor-Controller will discuss how this mission of oversight and accountability is still compatible with assisting in identifying risk and achieving the County’s objectives.

2. Enhance the Appearance of Independence

Under the County’s legal structure, the independently elected A-C has responsibilities for auditing the County, and maintaining the County’s accounting system. He is accountable directly to the citizens of the County, and has no formal administrative and functional reporting relationships elsewhere within the County government structure. The A-C’s IAD provides audit coverage of all County operations, including the accounting function for which the A-C has responsibility.

The assessment concluded that IAD is appropriately independent and objective, in fact, regarding all County operations, including the A-C’s accounting function. The IAD annual planning and risk assessment process properly determines audit coverage of the A-C’s accounting function, and their audit engagement/reporting process results in complete, accurate and objective oversight of

that function. However, given the legal reporting structure, maintaining the appearance of independence is an inherent challenge for the IAD.

Recommendations

Currently IAD audit reports are available for review on the A-C Office public website, including any reports on the accounting function. Continuation of this practice and consideration of further steps toward enhancement of the appearance of IAD independence is encouraged. Since external assessments are required once every five years, consider engaging with an independent third party to review and attest to the independence of the IAD's audit planning and engagement processes, specifically relative to the accounting function, in those years when a routine external assessment is not required.

Auditor-Controller Response

Concur. Subject to budget constraints, the Auditor-Controller will consider engaging with an independent third party to review and attest to the independence of the audit division's audit planning and engagement processes, specifically relative to the accounting function, in those years when a routine external assessment is not required. The Institute of Internal Auditors concluded that the audit division "is appropriately independent and objective, in fact, regarding all County operations, including the A-C's accounting function." As such, the Auditor-Controller welcomes periodic re-confirmation of this independence and objectivity by an independent third party, subject to budget constraints.

PART II – CONFORMANCE ISSUES FOR THE INTERNAL AUDIT DIVISION

1. Enhance Efforts to Improve County Governance Processes

The focus of IAD audits is to provide oversight, accountability, and transparency of County financial operations and reporting, with emphasis on reviewing the control structure County management employs. While the IAD annual planning process provides an appropriate basis to conduct audits of controls at the detailed operating level, the planning process does not adequately include an overall evaluation of County governance as part of the general control system.

Recommendation

The DIAD should consider periodically assessing and making recommendations to improve the County's governance processes. This can be achieved by placing governance processes in the audit universe and including engagements in the annual plan to specifically assess these processes. Also, standard steps could be included in all audit engagement programs to assess elements of governance, whenever the opportunity exists.

Internal Audit Division

Concur. The IAD will consider inclusion of assessments of County governance in future audits and engagement work programs.

2. Strengthen Procedures for Approving Engagement Work Programs

Based on a review of IAD audit engagement work papers, the work performed was found to be well planned and supported by detailed audit work programs that are effective in achieving the objectives of the engagements. The programs properly include procedures for identifying, analyzing, evaluating and documenting information during the engagement. However, the procedures in place do not provide for sufficient documentation to determine audit work programs are formally approved by appropriate supervisory staff prior to implementation.

Recommendation

The DIAD should revise audit engagement procedures to ensure that the supervisory review and approval of engagement work programs, and any subsequent changes to these programs, are properly documented within the engagement work papers before audit staff can proceed with performing their audit work. The DIAD could consider imbedding this procedure within the IAD's audit software package.

Internal Audit Division

Concur. The IAD will retrain staff and engagement supervisors to ensure engagement work programs are approved in a timely manner and as required by policy.

PART III – OPPORTUNITIES TO ENHANCE THE INTERNAL AUDIT DIVISION

1. Consider Activities to Enhance Staff Proficiency

Potential opportunities for enhancement of staff proficiency, including staff empowerment and professional development should be considered.

Recommendation

Consider the following to enhance staff proficiency:

- *Assign audit staff members as liaisons to County operating departments to maintain communication links, answer questions, and provide advice. Also, the liaisons should be made part of the IAD annual planning process as a source of information to help identify audit engagements that are focused on operational need.*
- *Encourage and support audit staff members to assume leadership roles in professional organizations such as the IIA, ALGA, and ISACA. These staff members should be*

utilized as sources of information to keep current with professional practice and to benchmark IAD with other audit organizations.

Internal Audit Division

Concur. The IAD will analyze the feasibility of assigning departments to staff as liaisons and IAD will consider increasing participation in professional organizations.

2. Consider Actions to Enhance Efficiency and Effectiveness

There are potential opportunities to enhance IAD efficiency and effectiveness in adding value to County operations.

Recommendation

Consider the following initiatives:

- *Develop additional performance metrics to increase ability to identify areas of continuous improvement, and provide expanded status reporting.*
- *Utilize the DIAD web page of the A-C Office to develop the capability to advise County management on emerging issues and audit findings that could relate to their own operations. The DIAD could consider using the capability of the IAD audit software package.*
- *Increase effort to leverage work of the external financial statement auditors. This would include reviewing their engagement plan, audit programs, and engagement work papers as appropriate.*
- *Increase communication and status reporting with operating management throughout all stages of audit engagements to ensure the closing meeting and report drafting process minimize delays in finalizing and issuing audit reports. Emphasis on communication could be especially beneficial on occasions when audit work is stopped for a period.*

Internal Audit Division

Concur. The IAD will consider additional key performance metrics, increasing communications with departments on emerging issues and engagement status, and increasing involvement with the external auditor.

County of Orange

		GC	PC	DNC
OVERALL EVALUATION		x		
ATTRIBUTE STANDARDS		x		
1000	Purpose, Authority, and Responsibility	x		
1010	Recognition of the Definition of Internal Auditing	x		
1100	Independence and Objectivity	x		
1110	Organizational Independence	x		
1111	Direct Interaction with the Board	x		
1112	CAE Roles Beyond Internal Auditing	x		
1120	Individual Objectivity	x		
1130	Impairments to Independence or Objectivity	x		
1200	Proficiency and Due Professional Care	x		
1210	Proficiency	x		
1220	Due Professional care	x		
1230	Continuing Professional Development	x		
1300	Quality Assurance and Improvement Program	x		
1310	Requirements of the Quality Assurance and Improvement Program	x		
1311	Internal Assessments	x		
1312	External Assessments	x		
1320	Reporting on the Quality Assurance and Improvement Program	x		
1321	Use of "Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	x		
1322	Disclosure of Nonconformance	x		
PERFORMANCE STANDARDS		x		
2000	Managing the Internal Audit Activity	x		
2010	Planning	x		
2020	Communication and Approval	x		
2030	Resource Management	x		
2040	Policies and Procedures	x		
2050	Coordination	x		
2060	Reporting to Senior Management and the Board	x		
2070	External Service Provider and Organizational Responsibility for Internal Auditing	x		

2100	Nature of Work	x		
2110	Governance		x	
2120	Risk Management	x		
2130	Control	x		
2200	Engagement Planning	x		
2201	Planning Considerations	x		
2210	Engagement Objectives	x		
2220	Engagement Scope	x		
2230	Engagement Resource Allocation	x		
2240	Engagement Work Program		x	
2300	Performing the Engagement	x		
2310	Identifying Information	x		
2320	Analysis and Evaluation	x		
2330	Documenting Information	x		
2340	Engagement Supervision	x		
2400	Communicating Results	x		
2410	Criteria for Communicating	x		
2420	Quality of Communications	x		
2421	Errors and Omissions	x		
2430	Use of "Conducted in conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	x		
2431	Engagement Disclosure of Nonconformance	x		
2440	Disseminating Results	x		
2450	Overall Opinions	x		
2500	Monitoring Progress	x		
2600	Management's Acceptance of Risks	x		
	IIA Code of Ethics	x		