

February 21, 2001

Peter Hughes, PhD  
Director, Internal Audit  
County of Orange  
400 Civic Center Drive West  
Building 12, Room 232  
Santa Ana, CA 92701

Dear Dr. Hughes,

At your request, we have conducted a quality assurance review of the work of your internal audit department. We reviewed for compliance with *The Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing*, and based our review on the Association of College and University Auditor's *Quality Assurance Review Handbook*. Additionally, we ensured the Quality Assurance Review addressed all aspects of the *Government Auditing Standards* discussed in *The Yellow Book*.

Persons independent of your internal audit department performed the review and covered audit work performed during 1999 and 2000. The scope of the review was restricted to reviewing selected documents, reviewing the workpapers of a sample of audit projects, interviewing key personnel and reviewing the documents compiled during the Self Review completed by the internal audit department.

Based on the scope of our review, we determined that, the work of the internal audit department did comply with IIA *Standards* during the period under review. Additional information is provided in the attached report.

We appreciate the cooperation and assistance provided to us throughout the course of our review. All individuals interviewed offered candid and constructive comments. We will be pleased to review any of the information in the attached report with you at your convenience.

Sincerely,



Nancy Johnson  
Director Of Audit  
Jefferson Wells International

Attachment

## INTRODUCTION

The *Standards for the Professional Practice of Internal Auditing (Standards)*, issued by The Institute of Internal Auditors (IIA), require internal audit departments to develop and maintain a quality assurance program to ensure the quality and credibility of their work. According to the IIA, a comprehensive quality assurance program includes the following elements:

- Ongoing supervision of internal audits
- Periodic internal reviews of the work of the internal audit department.
- Periodic external reviews or peer reviews of the work of the internal audit department.

This report presents the results of a peer review conducted February 9 through February 16, 2001. Nancy Johnson and R. Matthew Byers of Jefferson Wells International performed the review.

## OBJECTIVES

The primary objective of this review was to determine whether the internal audit department was in compliance with the *Standards* established by the IIA. A secondary objective was to foster the sharing of experiences, ideas, and approaches with directors of other internal audit departments, in order to provide additional recommendations for improving the internal audit function.

## SCOPE

The scope included:

- Reviewing the general information and documents gathered by the internal audit department during the performance of their self-review.
- Reviewing selected audits and control self-assessments performed during the 2000 audit year.
- Interviewing key management and personnel of the internal audit department.

<sup>1</sup> Taken from the *Standards for the Professional Practice of Internal Auditing* as published by the Institute of Internal Auditors.



## CONCLUSIONS

Our overall evaluation of the internal audit department is that it did comply with the IIA *Standards* for the period under review. This overall evaluation was derived from separate evaluations for each of the five general and 25 specific standards that comprise the IIA *Standards*, and was limited to the scope of our review.

## OBSERVATIONS AND RECOMMENDATIONS

Following are the observations of the review team as they relate to the five general IIA *Standards: Independence, Professional Proficiency, Scope of Work, Performance of Audit Work, and Management of the Internal Auditing Department*. For each standard, the review team identified the conditions observed and, where appropriate, made recommendations for enhancing the efficiency and effectiveness of operations.

### 100 **INDEPENDENCE** – INTERNAL AUDITORS SHOULD BE INDEPENDENT OF THE ACTIVITIES THEY AUDIT<sup>1</sup>.

**Observations:** The internal audit department demonstrates independence from the activities that they audit. Their reporting relationship to the Board of Supervisors enables them to carry out their work responsibilities freely and objectively and enables them to render impartial and unbiased judgements and conclusions.

However, the Audit Charter of the internal audit department has not been reviewed and approved by the Board of Supervisors or the Audit Oversight Committee. The internal audit department was formed based upon the Board Resolution 95-271, which addresses the requirements of the *Standards*.

Also, internal audit department management does not discuss independence and objectivity on a regular basis with the staff auditors. Reliance is placed on the initial independence and objectivity statement that all new auditors sign upon accepting employment and on the auditor's judgment to disclose any potential conflicts of interest.

**Recommendations:** We are recommending that the Audit Charter from 1997 in the Audit Manual be updated to include the new definition of internal audit provided by the IIA and the current goals and objectives of the internal audit department and presented to the Board of Supervisors and/or the Audit Oversight Committee for approval. This would assist in presenting the current goals and objectives of the internal audit department and document that the Board of Supervisors and the Audit Oversight Committee has agreed to the goals and objectives presented.

<sup>1</sup> Taken from the *Standards for the Professional Practice of Internal Auditing* as published by the Institute of Internal Auditors.

**Internal Audit Department's Response:** *We concur with this recommendation and will pursue updating our Audit Charter and having it approved by the Board of Supervisors and the Audit Oversight Committee. The deputy director of the department has taken the initiative of updating the Audit Charter to conform it to the new definitions provided by the IIA and have it approved by the Board of Supervisors and the Audit Oversight Committee by December 31, 2001. He will also include a section in next year's audit plan and will present and discuss the current goals and objectives of the internal audit department. We feel that keeping the Audit Charter in conformance with IIA guidelines and general in nature, while at the same time presenting and discussing goals and objectives annually in the audit plan will appropriately address the points raised in the above recommendation.*

We are recommending that the internal audit department add an item to the Staff section of the Audit Planning Checklist discussing potential conflicts of interest and/or bias. This would assist in maintaining objectivity in all audits performed.

**Internal Audit Department's Response:** *We concur and the deputy director will immediately implement this recommendation by adding this section to the planning checklist and begin including the revised checklist in all new audit initiatives.*

**200**    **PROFESSIONAL PROFICIENCY – INTERNAL AUDITS SHOULD BE PERFORMED WITH PROFICIENCY AND DUE PROFESSIONAL CARE<sup>1</sup>.**

**Observations:** The internal audit department demonstrates due professional care and audit proficiency in the audits they perform. They possess the necessary knowledge, professional skills, and recognized professional certifications to competently undertake their audit assignments. There are additional tools available that may assist the internal audit department in performing their audits.

**Recommendations:** We are recommending that the internal audit department begin utilizing the Audit Planning and Program Development Checklists on each audit performed. These checklists would assist in guiding the auditors through the planning and development stages of the audit without missing key audit steps.

We are also recommending that should the internal audit department decide to not utilize the Audit Planning checklist that they perform a documented Risk Assessment, detailing the development of the audit plan and program.

**Internal Audit Department's Response:** *We will implement the recommendation above by directing the Audit Managers to use the Audit Planning and Program Development Checklists on each new audit started.*

<sup>1</sup> Taken from the *Standards for the Professional Practice of Internal Auditing* as published by the Institute of Internal Auditors.

300 **SCOPE OF WORK** – THE SCOPE OF INTERNAL AUDITING SHOULD ENCOMPASS THE EXAMINATION AND EVALUATION OF THE ADEQUACY AND EFFECTIVENESS OF THE ORGANIZATION’S SYSTEM OF INTERNAL CONTROL AND THE QUALITY OF PERFORMANCE IN CARRYING OUT ASSIGNED RESPONSIBILITIES<sup>1</sup>.

**Observations:** The annual audit plan developed by the internal audit department in conformance with expectations provided by the Board of Supervisors and the Audit Oversight Committee encompasses the examination and evaluation of the adequacy and effectiveness of the County’s systems of internal control. The audit plan systematically addresses the major business functions with the greatest impact and importance to the County. The effectiveness and efficiency of audited entities and accomplishment of goals by audited entities are not included in standard audits, because these types of reviews are conducted by consultants engaged individually by the Departments in coordination with the CEO. This was a decision made by the Board of Supervisors and has been implemented into the standard audit plan of the internal audit department. These areas would be reviewed if requested specifically by management.

**Recommendations:** We are recommending that the Audit Charter and Audit Plan be updated to reflect that the internal audit department does not perform ‘efficiency and effectiveness’ or ‘validation of the measurement and tracking of goals and/or objectives’. This would document that the Board of Supervisors and the Audit Oversight Committee acknowledges and accepts that these areas are not going to be covered. Also, as discussed in section 100 above, this would clarify the current focus of the internal audit department.

We are recommending that the internal audit department begin utilizing the Segregation of Duties Matrix for all audits to provide additional support to their validation of appropriate segregation.

**Internal Audit Department’s Response:** *We concur and the deputy director will update the Audit Charter as previously discussed and he will also present and discuss the annual audit goals and objectives beginning with the next Audit Plan. This way the Audit Oversight Committee has annual visibility and awareness of the audit department’s goals and objectives as well as each audit scheduled.*

*We will also begin using the Segregation of Duties Matrix in all new audits started.*

400 **PERFORMANCE OF AUDIT WORK** – AUDIT WORK SHOULD INCLUDE PLANNING THE AUDIT, EXAMINING AND EVALUATING INFORMATION, COMMUNICATING RESULTS, AND FOLLOWING UP<sup>1</sup>.

<sup>1</sup> Taken from the *Standards for the Professional Practice of Internal Auditing* as published by the Institute of Internal Auditors.

**Observations:** The work performed by the internal audit department is clearly documented and includes all aspects discussed in the *Standards*. Their audits are well planned, supervised and properly staffed. Their audit objectives are achieved as evidenced by documentation and other support assembled in the working papers. The audit reports are balanced, objective and clear. The audit recommendations are well developed and would add value to the organization.

**Recommendations:** As discussed in section 200 above, we are recommending the internal audit department begin utilizing the Planning and Program Development Checklists during the planning phase of the audit to ensure all risk areas are covered and documented.

**Internal Audit Department's Response:** *We will immediately incorporate the Planning and Program Development Checklist in new audit initiatives. The audit managers were instructed accordingly.*

500 **MANAGEMENT OF THE INTERNAL AUDIT DEPARTMENT – THE DIRECTOR OF INTERNAL AUDITING SHOULD PROPERLY MANAGE THE INTERNAL AUDITING DEPARTMENT<sup>1</sup>.**

**Observations:** The Director properly manages the internal audit department. The responsibilities approved by the Board of Supervisors and the Audit Oversight Committee are accomplished in the annual audit plan. In addition, the Director manages the resources of the audit department efficiently and effectively demonstrated by completing last year's plan on time and on budget.

**Recommendations:** We are recommending that the internal audit department continue its efforts in compiling policies and procedures in an easy to use, easy to find, standard format for the audit staff.

**Internal Audit Department's Response:** *We will continue our efforts to incorporate and employ the Best Business Practices to the Internal Audit Department.*

## ACKNOWLEDGEMENTS

The team conducting this quality assurance review wishes to thank all internal audit personnel for their cooperation and assistance throughout the course of this review.

<sup>1</sup> Taken from the *Standards for the Professional Practice of Internal Auditing* as published by the Institute of Internal Auditors.

