



May 24, 2004

Dr. Peter Hughes,
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 an independent Peer Review of the Internal Audit Department. We reviewed for compliance with The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*, and we ensured our review addressed all aspects of the *Government Auditing Standards* detailed and discussed in the United States General Accounting Office (GAO) "*Yellow Book*."

Persons independent of your Internal Audit Department performed this review and covered audit work performed during 2001, 2002 and 2003. The scope of the review was restricted to reviewing selected documents, reviewing the work papers 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 during the period covered in this review did fully comply with IIA *Standards and GAO's "Yellow Book"*. 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,

A handwritten signature in dark ink, appearing to read 'Jim Jimenez', is written over a light-colored background.

Jim Jimenez, CPA
Director of Internal Audit
Jefferson Wells International

Attachment



COUNTY OF ORANGE

EXTERNAL PEER REVIEW OF THE INTERNAL AUDIT DEPARTMENT

MAY 24, 2004

Submitted by

**Jefferson Wells International
2 Park Plaza
Suite 950
Irvine, CA 92614**

INTRODUCTION

The *International 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 review conducted February 4th through February 13th, 2004. Peggy Dionne, CPA 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 and the Government Accounting Office (GAO) in their “Yellow Book”. 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 general information and documents gathered by the Internal Audit Department during the performance of their comprehensive self-review.
- Reviewing selected audits and control self-assessments performed during 2001, 2002 and 2003 audit years.
- Interviewing key management and personnel of the Internal Audit Department and Board of Supervisors.

CONCLUSIONS

Our overall evaluation of the Internal Audit Department is that it did fully comply with IIA *Standards* and the GAO “Yellow Book” for the period under review. This overall evaluation was derived from separate evaluations for each of the eleven general and thirty-four 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 eleven general IIA *Standards: Purpose Authority and Responsibility, Independence and Objectivity, Proficiency and Due Professional Care, Quality Assurance and Improvement Program, Managing the Internal Audit Activity, Nature of Work, Engagement Planning, Performing the Engagement, Communicating Results, Monitoring Progress, and Resolution of Management’s Acceptance of Risk.* For each standard, the review team identified the conditions observed and, where appropriate, made recommendations for enhancing the efficiency and effectiveness of operations.

ATTRIBUTE STANDARDS

1000 PURPOSE, AUTHORITY AND RESPONSIBILITY – THE PURPOSE, AUTHORITY AND RESPONSIBILITY OF THE INTERNAL AUDIT ACTIVITY SHOULD BE FORMALLY DEFINED IN A CHARTER, CONSISTENT WITH THE STANDARDS, AND APPROVED BY THE BOARD.

Observations: The nature of assurance services provided to the County of Orange are defined in the Audit Charter, which was adopted and approved by the Board of Supervisors in December, 2002.

1100 INDEPENDENCE AND OBJECTIVITY – THE INTERNAL AUDIT ACTIVITY SHOULD BE INDEPENDENT, AND INTERNAL AUDITORS SHOULD BE OBJECTIVE IN PERFORMING THEIR WORK.

Observations: The Internal Audit Department demonstrates independence from the activities they audit. This includes an annual signed confirmation, from each Internal Audit Department member, confirming such independence. In addition, Internal Audit Department members will submit specific references – as needed – to ensure exclusion from audits in which they lack independence (i.e. a reserve sheriff’s department employee indicating that he could no longer participate on any audit of the sheriff’s department).

The Director of Internal Audit reports directly to the Board of Supervisors, with “dotted line” responsibility to the Audit Oversight Committee (“AOC”). Please note that the AOC is an advisory committee to the Board of Supervisors and provides oversight of the County’s Internal Audit Department and external audit

coverage. This committee assists the Board in ensuring the independence of the Internal Audit function and ensuring that appropriate action is taken on audit findings.

The Director of Internal Audit meets monthly with each member of the Board of Supervisors, as well as participating in quarterly meetings with the AOC. The AOC is composed of the Chair and Vice Chair of the Board of Supervisors, with 4 additional members - the Auditor-Controller, the Treasury-Tax Collector (a non voting member), the County Executive Officer and a Public Member.

1200 PROFICIENCY AND DUE PROFESSIONAL CARE – ENGAGEMENTS SHOULD BE PERFORMED WITH PROFICIENCY AND DUE PROFESSIONAL CARE.

Observations: The Internal Audit Department demonstrates proficiency and due professional care in the audits that they perform. The department possesses the knowledge, skills and other competencies required to perform their individual responsibilities.

1300 QUALITY ASSURANCE AND IMPROVEMENT PROGRAM – THE CHIEF AUDIT EXECUTIVE SHOULD DEVELOP AND MAINTAIN A QUALITY ASSURANCE PROGRAM THAT COVERS ALL ASPECTS OF THE INTERNAL AUDIT ACTIVITY AND CONTINUOUSLY MONITORS ITS EFFECTIVENESS.

Observations: The Internal Audit Department maintains a quality assurance and improvement program that covers all aspects of the Internal Audit activity, and continuously monitors its effectiveness. This program includes periodic internal and external quality assessments and ongoing internal monitoring.

PERFORMANCE STANDARDS

2000 MANAGING THE INTERNAL AUDIT ACTIVITY – THE CHIEF AUDIT EXECUTIVE SHOULD EFFECTIVELY MANAGE THE INTERNAL AUDIT ACTIVITY TO ENSURE IT ADDS VALUE TO THE ORGANIZATION

Observations: The Director of Internal Audit effectively manages the Internal Audit activity to ensure it adds value to the organization. This includes establishing risk-based audit plans to determine the priorities of Internal Audit activity, communication of such plans to senior management and periodic reporting of the Department’s activities to the Audit Oversight Committee and Board of Supervisors.

2100 NATURE OF WORK - THE INTERNAL AUDIT ACTIVITY SHOULD EVALUATE AND CONTRIBUTE TO THE IMPROVEMENT OF RISK MANAGEMENT, CONTROL AND GOVERNANCE PROCESSES USING A SYSTEMATIC AND DISCIPLINED APPROACH.

Observations: The Internal Audit Department evaluates and contributes to the improvement of risk management, control and governance. This includes identifying significant exposures to risk, maintaining effective controls by evaluating their efficiency and effectiveness and making appropriate recommendations for improving the governance process.

2200 ENGAGEMENT PLANNING - INTERNAL AUDITORS SHOULD DEVELOP AND RECORD A PLAN FOR EACH ENGAGEMENT, INCLUDING THE SCOPE, OBJECTIVES, TIMING AND RESOURCE ALLOCATIONS.

Observations: The Internal Audit Department develops and records a plan for each engagement, including the scope, objectives, timing and resource allocations. In planning the engagement, the Department considers the objectives and significant risks of the activity. The scope of each engagement includes consideration of relevant systems, records and personnel. Staffing of audits is based on an evaluation and complexity of each engagement, including complexity of the engagement and time constraints.

2300 PERFORMING THE ENGAGEMENT - INTERNAL AUDITORS SHOULD IDENTIFY, ANALYZE, EVALUATE AND RECORD SUFFICIENT INFORMATION TO ACHIEVE THE ENGAGEMENTS OBJECTIVES.

Observations: The Internal Audit Department identifies, analyzes, evaluates and records sufficient information to achieve the engagement's objectives. This includes identifying sufficient, reliable, relevant and useful information to achieve the engagement's objectives, basing conclusions and audit results on appropriate analysis and evaluation, recording relevant information to support those conclusions and maintaining records consistent with the organization's retention policy.

2400 COMMUNICATING RESULTS - INTERNAL AUDITORS SHOULD COMMUNICATE THE ENGAGEMENT RESULTS.

Observations: Communications by the Internal Audit Department include the engagement's objectives and scope, as well as applicable conclusions, recommendations and action plans. Dissemination of audit results are communicated to the applicable parties who can ensure that the results are given due consideration.

2500 MONITORING PROGRESS – THE CHIEF AUDIT EXECUTIVE SHOULD ESTABLISH AND MAINTAIN A SYSTEM TO MONITOR THE DISPOSITION OF RESULTS COMMUNICATED TO MANAGEMENT.

Observations: The Internal Audit Department has established a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

2600 RESOLUTION OF MANAGEMENT’S ACCEPTANCE OF RISK – WHEN THE CHIEF AUDIT EXECUTIVE BELIEVES THAT SENIOR MANAGEMENT HAS ACCEPTED A LEVEL OF RESIDUAL RISK THAT MAY BE UNACCEPTABLE TO THE ORGANIZATION, THE CHIEF AUDIT EXECUTIVE SHOULD DISCUSS THE MATTER WITH SENIOR MANAGEMENT. IF THE DECISION REGARDING RESIDUAL RISK IS NOT RESOLVED, THE CHIEF AUDIT EXECUTIVE AND SENIOR MANAGEMENT SHOULD REPORT THE MATTER TO THE BOARD FOR RESOLUTION.

Observations: In the rare event that the Internal Audit Director believes senior management has accepted a level of residual risk that may be unacceptable to the organization, the issue is reported to Audit Oversight Committee and the Board of Supervisors for ultimate resolution.

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.