

**Quality Assessment/Peer Review
Internal Audit Department
County of Orange, California
For the 3-year Period Ended
December 31, 2003**

Submitted by

**Thompson, Cobb, Bazilio & Associates, PC
1101 15th Street, N.W. Suite 400
Washington D.C. 20005**

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.
- An external quality assurance or peer review of the Internal Audit Department performed every 5 years. *Government Auditing Standards* require a peer review every 3 years.

Thompson, Cobb, Bazilio & Associates, P.C. (TCBA) performed the external review for the 3-year period ended December 31, 2003. This report presents the result of that review. The objective of the review was to determine whether the Internal Audit Department of Orange County (the “Department”) was in material compliance with the *Standards* established by the IIA and with U.S. Government Accountability Office’s *Government Auditing Standards* for those audits that must meet those standards.

CONCLUSIONS

TCBA’s overall evaluation of the Department is that its system of quality control in effect for the 3-year period ended December 31, 2003, adhered to the Standards and provided reasonable assurance of material compliance with professional auditing standards in the conduct of its audits. Our evaluation was based on our assessment of the Department’s compliance with the 11 general and 34 specific IIA *Standards* and with *Government Auditing Standards*.

SCOPE

The scope of TCBA’s review included:

- Reviewing a sample of 14 audits with supporting work papers, 2 Control Self-Assessments and the Department’s review of reported County cash losses (see following chart). For the audits, we used either a checklist based on the *Standards* or, for the audits done in accordance with *Government Auditing Standards*, a President’s Council on Integrity and Efficiency checklist.
- Evaluating the Department’s self assessment.
- Evaluating the Department’s annual risk Assessments.
- Reviewing the Department’s Audit Manual, other policies and procedures, and various related documents.

- Discussing audits and Department policies and procedures with the Internal Audit Director, Deputy Director and Audit Managers.
- Interviewing a sample of governance and client officials to include all members of the County Board of Supervisors, all members of the Audit Oversight Committee (AOC), the County Chief Executive Office, and officials of some audited organizations.

Audits and Other Products Reviewed
For the period 1/1/01 to 12/31/03

Report No. Date Issued Title

Audits

2139	5/23/01	Treasury Investment Process Review
2133	7/18/01	John Wayne Airport – Cash Receipts
2205	8/31/02	Treasury Funds Audit (Quarter Ending 3/31/02)
2212	12/27/02	DA Spousal Abuser Prosecution Grant
2244	3/27/03	Limited Review of Clerk-Recorder Cashiering System Upgrade
2247	3/27/03	Report on Risk Assessment for County Accounting and Personnel System’s (CAPS) Payroll Application
2208	5/1/03	Treasury Funds Audit (Quarter Ending 12/31/02)
2230	5/21/03	Limited Review of Operating Agreement Fees for Smarte Carte, Inc.
2211	7/31/03	Annual Treasury Investment Compliance (2 years Ending 12/31/02)
2245	9/4/03	Prevailing Wages Review
2326	9/23/03	Auditor-Controller Laser Check Printing
2312	10/31/03	DA Workers Comp/Auto Insurance Fraud Grant
2330	11/30/03	Child Support Services – Cash Receipts, Disbursements and Trust Funds
2329	1/9/04*	Limited Review of Revenue for Dana Point Marina Inn

Other

2120	5/31/01	Control Self-Assessment – Treasurer-Tax Collector
2111	12/31/01	Review of County Cash Losses
N/A	12/17/03	Control Self-Assessment – Internal Audit Department

* Audit was completed prior to December 31, 2003

DISCUSSIONS ON STANDARDS

Following is a summary of TCBA's scope of review and results for the 11 general *Standards*, which encompass the 34 specific standards.

ATTRIBUTE STANDARD 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.*

We found that the nature of assurance services provided to the County of Orange is defined in the Audit Charter, which was adopted and approved by the Board of Supervisors.

ATTRIBUTE STANDARD 1100

INDEPENDENCE AND OBJECTIVITY – *The internal audit activity should be independent, and internal auditors should be objective in performing their work.*

The Internal Audit Department is independent. The Director of Internal Audit reports to the County Board of Supervisors and meets monthly with each Board member.

There is also an advisory Audit Oversight Committee (AOC) which provides oversight to the County's Internal Audit Department and assists the Board by ensuring that appropriate action is taken on audit findings. The AOC is composed of six members – the Chair and Vice-Chair of the Board of Supervisors, the County's Auditor-Controller, the Treasury-Tax Collector, the Chief Executive Officer, and a Public Member. The Director of Internal Audit meets quarterly with the AOC.

Internal Audit Department staff demonstrate objectivity in conducting audits. We verified that all staff had signed the required annual independence statement, and we noted that procedures were in place for circumstances that required a staff member to seek exclusion from a specific audit due to a conflict. We also verified that employees required to file County financial disclosure statements had done so. Officials interviewed all felt that the staff demonstrated objectivity on audits.

ATTRIBUTE STANDARD 1200

DUE PROFESSIONAL CARE – *Engagements should be performed with proficiency and due professional care.*

The Internal Audit Department staff are very well credentialed. The majority of staff are Certified Public Accountants (CPAs) and Certified Internal Auditors (CIAs). Several staff have passed the exam to become Certified Information System Auditors (CISAs) and two have been certified. The Department also uses outside consultants when additional expertise is required.

In conducting audits, the Department uses standardized work papers and quality control checklists. In the sample of audits we reviewed, we found that the staff exercised due professional care. Officials interviewed were very satisfied with the quality of individual audits performed.

The *Standards* also requires that each staff member enhance their knowledge, skills, and other competencies through continuing professional education. In practice, each staff member must meet the number of education hours required to maintain his or her certifications. We reviewed the overall staff records for these continuing professional education requirements (indicated by the number of hours) and also sampled the supporting documentation. We found that all staff members met their certification training requirements.

ATTRIBUTION STANDARD 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.*

This quality assurance program should include both internal and external assessments. For internal assessments, each audit uses quality control checklists. In our audit sample, we found that they were almost always used. The Department also does a self-assessment on an ongoing basis. This self-assessment follows the *Standards*, and we validated the assessment by reviewing the supporting documentation.

The Department follows the external requirement specified in *Government Auditing Standards* that requires a quality assessment/peer review every 3 years. The previous review was done in 2001 and met this requirement.

PERFORMANCE STANDARD 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.*

The Department's planning process uses an annual risk assessment which results in an annual audit plan. The risk assessment is based on analysis of County finances and operations and includes input from County agencies. In addition, planning provides for audit resources to respond to Board inquiries that may result during the course of County operations and, as the need arises, the Audit Director has also initiated audits.

The annual audit plan is approved by the AOC, and the Audit Director provides the AOC with quarterly updates. The Audit Director also meets monthly with each Board member.

The Department has an audit manual and other policies and procedures that guide the internal audit activity.

PERFORMANCE STANDARD 2100

NATURE OF THE 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.*

The Department uses a formalized risk assessment process which analyzes County agency's business plans, finances and operations. The Department also meets with agency officials to understand their operations and audit needs. Our review of the process showed that it assigns valid risk factors to analysis and also includes history of audit coverage as a factor. The areas of highest risk are then included in the annual audit plan.

Recognizing the growing importance of information technology, the Department trained its staff in information technology auditing and several have passed the exam to become Certified Information System Auditors. In addition, the Department (1) published an "Information Technology Self-Assessment Questionnaire" for use within the County and (2) issued an advisory memorandum to begin discussion of fundamental information technology governance issues for the County.

The Department's risk assessment and planning process addresses the required audit scope of:

- Reliability and integrity of financial and operational information.
- Safeguarding of assets.
- Compliance with laws, regulations, and contracts.
- Effectiveness and efficiency of operations.

This last area – effectiveness and efficiency of operations – is addressed through Control Self-Assessments (CSAs). Rather than being audits, CSAs are agency workshops facilitated by the Internal Audit staff. The workshops address specific issues and/or areas such as communications. Action plans may be developed, but there are no formal external results other than noting that the CSA was conducted. CSAs are a best practice within the internal audit community and received high marks during our interviews.

PERFORMANCE STANDARD 2200

ENGAGEMENT PLANNING – *Internal auditors should develop and record a plan for each engagement, including the scope, objectives, timing and resource allocations.*

The Department requires that an audit program be prepared and approved by the Audit Manager for each audit. During the planning phase of the audit, the staff complete several tasks as required by the Audit Manual. Finally, there is a checklist for audit planning.

For the audits we sampled, most of the audit planning requirements were met and the checklist used. There were no instances where any missing items adversely impacted on the audit.

PERFORMANCE STANDARD 2300

PERFORMING THE AUDIT – *Internal auditors should identify, analyze, evaluate and record sufficient information to achieve the engagement objectives.*

We found that the Department used quality assurance checklists to facilitate its compliance and, for the audits we sampled, the Department met the *Standards and Government Auditing Standards'* requirements. Our tests included verifying information in audit reports back to the original supporting documentation.

PERFORMANCE STANDARD 2400

COMMUNICATING RESULTS – *Internal auditors should communicate the engagement results.*

The audit reports in our sample included the engagement's scope, applicable conclusions and recommendations. Agency comments were sought and included. The reports were clear and easy to read.

The reports were provided to the audited entities, the County Chief Executive Officer, the Auditor-Controller, each member of the Board of Supervisors, and AOC members.

PERFORMANCE STANDARD 2500

MONITORING PROGRESS – *The chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management.*

The Department has an effective follow-up process that monitors the response to audit findings to ensure that County management has effectively implemented the recommendations or that senior management has accepted the risk of not taking action.

The Department maintains a log of follow-ups, and follow-up actions are provided a staff-day budget and are accomplished by internal audit staff. The follow-ups are documented in the work papers and the results communicated to the AOC. We tested follow-ups from the log and found that the work papers and follow-up results were well done.

PERFORMANCE STANDARD 2600

RESOLUTION OF MANAGEMENT'S ACCEPTANCE OF RISK – *When the chief audit executive believes that senior management has accepted a level of 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.*

The Department's follow-up process provides that, if after two follow-ups, the audit recommendations are still applicable and not fully implemented, the AOC is notified and a letter prepared to the agency director. The Department policy also provides that if the Internal Audit Director and the auditee "agree to disagree" on a finding and recommendation, it will be documented and brought to the attention of the AOC for resolution.

Washington, D.C.
August 31, 2004

Thompson, Cobb, Bazilio + Associates, P.C.