



County of Riverside

AUDIT REPORT

2011-601

External Quality Assessment of San Luis Obispo County's Internal Audit Department

March 2, 2011

Office of
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County Auditor-Controller

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March 2, 2011

Gere W. Sibbach, CPA
County of San Luis Obispo
Office of the Auditor-Controller
1055 Monterey Street Room D220
San Luis Obispo, Ca 93408

Subject: Audit Report 2011-601: External Quality Assessment of San Luis Obispo County's Internal Audit Department

Dear Mr. Sibbach,

At your request, we conducted an external quality assessment review (peer review) of the County of San Luis Obispo's Internal Audit (IA) Department as prescribed by the Institute of Internal Auditor's (IIA) Professional Practices Framework. We conducted the peer review during the period of December 1, 2010, through December 29, 2010, for current internal audit operations.

We utilized the IIA *Quality Assessment Manual*, 6th edition as well as the IIA's *Professional Practices Framework* (January 2009 edition, which can be viewed at <http://www.theiia.org/guidance/standards-and-guidance/ippf/standards/>) as primary criteria for performing the assessment. The assessment was conducted in accordance with auditing standards prescribed by the Institute of Internal Auditors.

Based on the information evaluated during the external quality assessment review, the County of San Luis Obispo's IA activity generally conforms with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*. This means that policies, procedures and practices are in place to implement the standards and requirements necessary for ensuring the independence, objectivity and proficiency of the IA function.

We appreciate the courtesy and cooperation extended to us by the Auditor-Controller, Assistant Auditor-Controller, internal audit manager, internal audit staff, chairman of the Board of Supervisors, and county managers who participated in the interview process. The feedback from the surveys and the interviews provided valuable information regarding the operations of the Internal Audit Department and its relationship with management.

Paul Angulo, CPA, MA
County Auditor-Controller

A handwritten signature in black ink that reads "Melissa S. Bender". The signature is written in a cursive, flowing style.

By: Melissa S. Bender, CIA
Audit Manager

Enclosure: Appendix IIA Standards

Overview

The IIA's *Standards* require that internal audit functions obtain external quality assessments to assess compliance with standards and to appraise the quality of their operations once every five years. A periodic external quality assessment, or peer review, of the internal audit function is an essential part of a comprehensive quality assessment program.

The quality assessment for the County of San Luis Obispo's Internal Audit Department was performed during the period December 1, 2010, through December 29, 2010, in accordance with the IIA's Professional Practices Framework as well as the IIA's *Quality Assessment Manual, 6th edition*. This process was requested by the San Luis Obispo County Auditor-Controller.

Objective, Scope and Methodology

The primary objective of the quality assessment was to evaluate the Internal Audit Department's compliance with auditing standards during FY2009/10. Additional objectives included identifying best practices and opportunities for improvements.

We used various approaches to perform the quality assessment review including:

1. Requested and reviewed responses to the IIA's *Tool 2 Quality Assessment and Tool 3 Chief Audit Executive Questionnaire*.
2. Reviewed key documentation related to IA activity including:
 - internal audit charter and legal requirements;
 - county and internal audit organizational charts;
 - audit personnel position descriptions;
 - operating policies and procedures;
 - annual audit plan and management reports;
 - staff development and training documentation;
 - staff performance appraisals; and
 - prior peer review report.
3. Conducted interviews with key county officials and IA personnel, including:
 - Chairman of the Board of Supervisors;
 - the Auditor-Controller;
 - the Assistant Auditor-Controller;
 - acting Chief Audit Executive of Internal Audit;
 - selected members of county executive management;
 - the county's external auditor; and
 - Internal Audit personnel.
4. Administered and summarized surveys to selected IA customers and IA personnel; and

5. Reviewed selected FY2009/10 audit reports and supporting working papers.

Results

Based on the information received and evaluated for FY2009/10, the Internal Audit Department generally conforms to the IIA Standards. This means that policies, procedures and practices are in place to implement the standards and requirements necessary for ensuring the independence, objectivity and proficiency of the internal audit function. The internal audit function is well managed, utilizes a systematic approach to improve the county's operations and is viewed as adding value to county's operations by county management and audit clients. The internal audit activity has established relationships within the county based on mutual respect and commitment to improving controls within the county and has employed professional auditors. Emphasis is placed on continuing professional development for each of the audit staff. The Internal Audit Department has developed procedures to ensure efficient and effective operations.

Our review identified opportunities for improvement related to some professional standard areas that are intended to build upon the foundation already established by the internal audit activity. Specifically, we identified the following areas for improvement: a formal audit charter and code of ethics, documentation of risk assessments, monitoring of audit results, and expanded use of information technology. These areas are briefly discussed below.

Observations for Improvements

- Formal Audit Charter and Code of Ethics

The internal audit activity has developed a comprehensive internal audit manual that serves as the audit charter. The audit manual was last updated in July 2009 to reflect the revisions to the IIA's *Professional Practices Framework* (including a reference to the definition of internal auditing) and includes all relevant policies and procedures to guide the internal audit activity. However, there is no reference to the IIA's Code of Ethics as required by the IIA's Standard 1000 (see appendix page 1), nor is the manual readily shared with parties outside of the Auditor-Controller's Office.

- Documentation of Risk Assessments

The Internal Audit Department has developed a comprehensive annual audit planning session to discuss risks to the county, audit findings and departmental operations. As a result of this planning session, the annual audit plan is developed. However, the results of this comprehensive session are not documented as required by the IIA's Standard 2010 (see

appendix page 1). Additionally, the internal audit activity has not developed a formal risk-assessment policy.

- **Monitoring of Audit Results**

According to internal audit management, their current process is to ensure corrective action is taken to address findings noted prior to report issuance. Furthermore, the annual audit planning session includes discussions of previous audit findings and departments are selected based upon the previous findings. However, since the annual planning session is not documented, we are unable to confirm the monitoring of results occurs during the annual audit planning session. Additionally, a provided sample follow-up report showed that a finding still existed after being reported seven years previously. Several of the survey respondents also noted that a formal follow-up process did not exist. The Internal Audit Department should develop and implement a rigorous audit follow-up process to guarantee the timely and effective implementation of audit recommendations in addition to ensuring management's responsibility and accountability as required by the IIA's Standard 2500 (see appendix page 2).

- **Information Technology**

Currently, the usage of information technology is limited for internal audit activities. We did note internal audit staff was utilizing data analytical tools to automate some of their audit procedures. Moreover, the internal audit staff is not utilizing an automated work paper system to maintain audit files. Use of an automated work paper system would enhance audit efficiencies, automate audit processes and satisfy records retention requirements.

While we were told that part of the annual audit planning session includes focus on areas that have information technology and/or security risks, we were unable to confirm since the annual audit session is not documented.

Moreover, it was noted that while the county does not currently expect the internal audit function to perform information technology audits, the county's information technology officer would like the Internal Audit Department to perform a countywide information security and cell phone audit to ensure compliance with the county's policies and procedures. The Internal Audit Department should develop and implement procedures to provide appropriate resources and audit coverage to address information systems risks as required by the IIA's Standard 2120 (see appendix page 2).

IIA's Standard 1000

1000-Purpose, Authority, and Responsibility¹

The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the *Standards*. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

Interpretation:

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization, including the nature of the chief audit executive's functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board.

1000.A1 - The nature of assurance services provided to the organization must be defined in the internal audit charter. If assurances are to be provided to parties outside the organization, the nature of these assurances must also be defined in the internal audit charter.

1000.C1 - The nature of consulting services must be defined in the internal audit charter.

IIA's Standard 2010

2010-Planning

The chief audit executive must establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.

Interpretation:

The chief audit executive is responsible for developing a risk-based plan. The chief audit executive takes into account the organization's risk management framework, including using risk appetite levels set by management for the different activities or parts of the organization. If a framework does not exist, the chief audit executive uses his/her own judgment of risks after consultation with senior management and the board.

¹ Excerpts from the Standards were obtained at <http://www.theiia.org/guidance/standards-and-guidance/ippf/standards/>

2010.A1- The internal audit activity's plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process.

2010.A2 – The chief audit executive must identify and consider the expectations of senior management, the board, and other stakeholders for internal audit opinions and other conclusions.

2010.C1- The chief audit executive should consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value, and improve the organization's operations. Accepted engagements must be included in the plan.

IIA's Standard 2500

2500 – Monitoring Progress

The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.

2500.A1- The chief audit executive must establish 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.

2500.C1- The internal audit activity must monitor the disposition of results of consulting engagements to the extent agreed upon with the client.

IIA's Standard 2120

2120-Risk Management

The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.

Interpretation:

Determining whether risk management processes are effective is a judgment resulting from the internal auditor's assessment that:

Organizational objectives support and align with the organization's mission;

Significant risks are identified and assessed;

Appropriate risk responses are selected that align risks with the organization's risk appetite; and

Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities.

The internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization's risk management processes and their effectiveness.

Risk management processes are monitored through ongoing management activities, separate evaluations, or both.

2120.A1- The internal audit activity must evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the:

Reliability and integrity of financial and operational information.

Effectiveness and efficiency of operations and programs:

Safeguarding of assets; and

Compliance with laws, regulations, policies, procedures, and contracts.

2120.A2 - The internal audit activity must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.

2120.C1 - During consulting engagements, internal auditors must address risk consistent with the engagement's objectives and be alert to the existence of other significant risks.

2120.C2 - Internal auditors must incorporate knowledge of risks gained from consulting engagements into their evaluation of the organization's risk management processes.

2120.C3 - When assisting management in establishing or improving risk management processes, internal auditors must refrain from assuming any management responsibility by actually managing risks.