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December 29, 2006

TO: Michael G. Alexander
Chief of Audits, County of Riverside

FROM: Kenneth J. Mory
Chief of Audits

FINAL REPORT: QUALITY ASSESSMENT (PEER REVIEW) OF THE COUNTY OF RIVERSIDE INTERNAL AUDIT DIVISION

Enclosed is our quality assessment (peer review) report of the County of Riverside Internal Audit Division. Based on the information received and evaluated during the external quality assessment review, it is our opinion that the County of Riverside's IA activity generally conforms to the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*. This opinion means that the County IA activity generally adheres to procedures and practices necessary for ensuring the independence, objectivity, and proficiency of the internal audit activity. Assessment activities did identify opportunities for improvement related to some professional standard areas.

The report includes our findings and recommendations as well as your response to the review's findings and recommendations. If you have any concerns about the report, please contact me at (858) 495-5662.

Thank you again for the opportunity to conduct this engagement and for the cooperation rendered and professionalism exhibited by you and your staff during the review.


KENNETH J. MORY
Chief of Audits

AUD:KRM:aps

Enclosure

c: Robert E. Byrd, Auditor-Controller, County of Riverside
Bruce Kincaid, Assistant Auditor-Controller, County of Riverside

INTRODUCTION

At the request of the County of Riverside's Chief Audit Executive, the Office of Audits & Advisory Services (OAAS) conducted an external quality assurance review (peer review) of the County of Riverside's Internal Audit (IA) activity as prescribed by the Institute of Internal Auditor's (IIA) Professional Practices Framework and as required by California Government Code, Section 1236.

QUALITY ASSURANCE REVIEW SCOPE

The objective of the quality assurance review was to assess the Internal Audit activity's compliance with professional auditing standards ("Standards") promulgated by the IIA. This assessment included:

- Assessing the efficiency and effectiveness of the Internal Audit (IA) activity in light of its charter, the expectations of the Board of Supervisors, the Executive Office and the Chief Audit Executive;
- Providing an opinion on the IA's conformance to the spirit and intent of professional audit standards; and
- Identifying opportunities and suggestions for enhancing the operations of the IA activity.

The OAAS utilized the IIA *Quality Assessment Manual, 5th edition* as well as the IIA's *Professional Practices Framework (1994 edition)* as primary criteria for performing the assessment. The assessment was conducted in accordance with auditing standards prescribed by the Institute of Internal Auditors, Inc., as required by California Government Code, Section 1236.

METHODOLOGY

OAAS used various approaches to perform the quality assurance review including:

1. Requested and reviewed County of Riverside's responses to the IIA's Tool 2 *Quality Assessment – Advanced Preparation* and Tool 3 *Chief Audit Executive Questionnaire*;
2. Reviewed key documentation related to the IA activity including:
 - IA charter and legal requirements;
 - County and IA organizational charts;
 - Audit personnel position descriptions;
 - Operating policies and procedures;
 - Annual audit plan and management reports;
 - Customer satisfaction surveys;
 - Audit recommendation tracking documentation;
 - Staff development and training documentation;
 - Staff performance appraisals;
 - Statements of Independence;
 - Record retention policies; and
 - Prior peer review report.

3. Conducted multiple interviews including:
 - The Auditor-Controller and Chief Audit Executive;
 - Selected members of County Management;
 - The County's External Auditor; and
 - IA personnel.
4. Administered and summarized surveys to selected IA audit customers and to IA personnel; and
5. Reviewed selected FY2005-06 audit reports and supporting working papers.

OVERALL OPINION

Based on the information received and evaluated during the external quality assessment review, it is our opinion that the County of Riverside's IA activity generally conforms¹ to the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*. This opinion means that the County IA activity generally adheres to procedures and practices necessary for ensuring the independence, objectivity, and proficiency of the internal audit activity. We found that the IA activity utilizes qualified personnel required to execute its mission and to proficiently perform audits. Additionally, we found that the IA unit is well managed internally, is respected throughout the County and is viewed as adding considerable value to County operations by management and audit clients. We also noted significant improvement in operations since the previous external peer review conducted in 2001.

Assessment activities did identify opportunities for improvement related to some professional standard areas. Specifically, we identified issues with the perception of the IA activity's independence, possible limitations to the scope of audit work activities, and some issues related to review and documentation standards for specific audit projects. These issues and our recommendations for improvement are briefly discussed below.

OBSERVATIONS

Perceptual Issues Exist Regarding IA's Organizational Independence (Standard 1100) –

Our review found that the Internal Audit activity is legally and organizationally structured in a manner that generally assures the independence of audit activities. The County Auditor-Controller, to whom the IA activity reports, is an independent elected official. Additionally, the County Charter along with California Government Code, clearly provide the IA activity with the authority to conduct independent audits. The Board of Supervisors ("the Board") formally approves annual audit plans. Audit reports are also filed with the Board. Further, audit personnel, including the CAE, sign statements of independence for each audit engagement.

However, an issue emerged regarding certain perceptions regarding the independence of the IA activity. The Executive Officer and all but two senior managers interviewed believed the IA activity was independent, and the external auditors were not aware of any circumstances that negatively impact the internal audit activity's independence. However, a perception exists with two senior managers that internal audits could be hindered, delayed or cancelled by the

¹ Per IIA guidelines "Generally conforms" means that an internal audit activity has a charter, policies, and processes that are judged to be in accordance with the *Standards*, with some opportunities for improvement.

Executive Office. In forming our opinion that the IA activity generally conforms with the independence standard, we considered: that neither of these managers were able to identify any specific examples of audits being impeded or cancelled, that other County personnel, including the CAE, firmly believed that independence exists, and that there appears to be other non-IA activity related disagreements that could account, at least in part, for this perception.

Limitations May Exist with the Scope of Audit Activities (Standard 2100) – Review activities identified potential limiting factors regarding the scope of IA audit activities related to audit workload demand vis-à-vis available IA resources as well as on the performance of specific types of audits. While the IA activity does prioritize audit projects based on risks and available resources, the Board Resolution (i.e., the audit charter) establishing the IA activity essentially requires an audit of every County Department biennially.² The IA activity was not able to meet this requirement for the period reviewed owing to resource limitations.

Further, there appears to be disagreement between the Auditor and Controller and the Executive Office regarding the types of audits that can be performed by the IA activity. As a result, the IA activity is currently not issuing “operational” (i.e., performance) audits even though such audits are authorized and required by Board Resolution.³ Performance audits provide independent assessments on financial and non-financial performance, including such issues as customer satisfaction, cost-benefit and cost-effectiveness, profit, quality, quantity, economy, achievement of organizational mission and goals, return on investment, financial condition, and timeliness.⁴

Additionally, IIA standard 2120.A1 states that “based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization’s governance, operations, and information systems.” IT audits would examine applications, systems and communication software, desktop, and infrastructure to ensure the County’s assets and operations are being effectively and efficiently utilized. The County of Riverside’s IA activity is currently only able to perform limited general IT control assessments owing to resource and IT audit skill limitations. When a need arises for a more detailed review of IT controls, the IA activity elicits the assistance of the County’s Information Security Office (ISO).⁵ While IT audits are not specifically identified in the Charter, IT is so pervasive in the County’s current operational environment that the absence of IT audits could hinder the IA activity from obtaining sufficient evidence for evaluating risks and controls associated with key County processes and systems.

Audit Project Review and Documentation Issues Identified (Standard 2300) – A review of selected audit project files from the quality assessment review period, interview data and a review of IA documentation determined that the IA activity generally conforms with professional

² Resolution #83-338 states “the financial accounts and records of all officers having responsibility for the care, management, collection, or disbursement of money belonging to the county, or money received or disbursed by them under authority of law shall be audited biennially.”

³ Resolution #83-338 authorizes the following categories of audit scope: (1) Reliability and integrity of financial and operating information; (2) Compliance with policies, plans, procedures, laws, and regulations; (3) Safeguarding of assets; (4) Economical and efficient use of resources and; (5) Accomplishment of established objectives and goals for operations and programs.

⁴ The Institute of Internal Auditors, *Performance Auditing: A Measurement Approach*.

⁵ The ISO performs reviews and assessments of IT systems under ISO standards (ISO 17.799). However, this activity does not perform IT audits or develop Countywide IT risk assessments.

performance standards including standards governing: the management of the IA activity, audit engagement planning, engagement scope, resource allocation, engagement work programs and communications and coordination. However, review activities did identify a few areas where the IA activity can enhance audit project management processes. Specifically:

- Working papers for selected audit projects reviewed sometimes lacked required elements such as source, purpose and conclusion statements;
- A timely review of working papers was not always performed. Often as many as five weeks elapsed between work paper sign off and review. This is of particular concern with regard to providing adequate supervision to less experienced personnel classified as an Accountant I or II, who prepared working papers and performed the majority of fieldwork activities; and
- Audit reports were not cross-referenced to supporting working papers. As a result, it was difficult to validate report statements and findings to supporting evidence.

Current Continuous IA Improvement Activities – The IA activity was in the process of implementing several continuous improvement activities at the time of the quality assessment. The OAAS considered these efforts in performing our compliance assessment to individual standards as well as to developing our opinion of the overall compliance of the IA activity. The successful implementation of these activities will further enhance the IA activity's compliance with standards. Specifically, the IA activity was in the process of:

- Revising and updating operating policies and procedures;
- Developing a comprehensive professional development plan for IA personnel;
- Recruiting additional qualified audit personnel. Part of the effort to recruit personnel included a request for the County Human Resources Department to reclassify audit positions⁶ and to perform a salary study; and
- Refocusing efforts to obtain and track customer satisfaction surveys.

RECOMMENDATIONS

The OAAS offers the following recommendations for the County of Riverside's consideration for enhancing the IA activity's compliance with professional standards and for strengthening the efficiency and effectiveness of internal audit activities.

1. Owing to perceptions expressed by two senior managers regarding potential IA independence limitations, we recommend that the Board formally convey to senior management the authority and responsibility of the IA activity to perform and issue

⁶ The IA activity utilizes Accountant I and II classifications for entry level audit staff positions. While permitted by the County's Human Resources Department, the use of classifications that do not require specific audit professional skills sets could potentially impair the ability of the IA activity to consistently meet Standard 1200, "proficiency and due professional care."

independent audits of all types (including operational audits) authorized and required by Board Resolution 83-338 and California Government Code.

2. The IA activity should prepare a comprehensive audit resource plan needed to meet the current biennial audit requirement for the Board of Supervisor's consideration. Such a plan should address specific IA training (e.g., IT audit skills), co-sourcing and/or outsourcing requirement options;
3. The IA activity should prepare and submit a comprehensive risk assessment of County operations as part of the annual audit plan development and Board approval process;
4. The IA activity should complete development and implement updated IA operating policies and procedures, which would include comprehensive training of IA personnel on such policies and procedures;
5. The IA activity should ensure all working papers have required elements that meet professional documentation requirements;
6. The IA activity should perform timely supervisory reviews of working papers; and
7. The IA activity should cross-reference audit reports to supporting working papers.

REPORT DISTRIBUTION

This report is intended solely for the information of the County of Riverside's Internal Audit Division. Further distribution of this report is at the discretion of the County of Riverside's Chief Audit Executive.

COMMENDATION

We would like to thank the County of Riverside's Auditor and Controller, Chief Audit Executive, the Executive Office and IA personnel for the courtesies extended to us while performing the quality assessment.

REVIEW TEAM

Kenneth Mory, Chief of Audits
Kip Memmott, Internal Audit Manager
Josh Zender, Associate Performance Auditor

COUNTY OF RIVERSIDE RESPONSE



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ASSISTANT AUDITOR-
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December 21, 2006

Kenneth J. Mory, Chief of Audits
County of San Diego Auditor and Controller
1600 Pacific Highway Ste. 166
San Diego, CA 92101-2478

Subject: Response to Final Draft Report – Quality Assessment (Peer Review) of the County of
Riverside Internal Audit Division

Dear Mr. Mory:

We thank you, Mr. Memmott and Mr. Zender for the professionalism with which you conducted the quality assurance review. The results of your assessment are very helpful in improving the services we provide to our customers.

The following comments are provided in response to your recommendations:

Recommendation 1: Owing to perceptions expressed by two senior managers regarding potential IA independence limitations, we recommend that the Board formally convey to senior management the authority and responsibility of the IA activity to perform and issue independent audits of all types (including operational audits) authorized and required by Board Resolution 83-338 and California Government Code.

Response: Concur. We are aware that a disagreement exists between the Office of the Auditor-Controller and the Executive Office on the types of audit reports that can be issued by Internal Audits. However, Board of Supervisors' Resolution 83-338 conveys the authority and responsibility to Internal Audits to perform a broad range of audits with a scope including the following: reliability and integrity of financial and operating information; compliance with policies, plans, procedures, laws and regulations; safeguarding of assets; economical and efficient use of resources; and, accomplishment of established objectives and goals for operations or programs.

Recommendation 2: The IA activity should prepare a comprehensive Audit Resource Plan needed to meet the current biennial audit requirement for the Board of Supervisor's consideration. Such a plan should address specific IA training (e.g., IT audit skills), co-sourcing and/or outsourcing requirement options.

Response: Concur. Two years ago, the Board of Supervisors approved an Audit Resource Plan. The plan included the addition of six internal audit positions in fiscal year 2004/05 and the subsequent addition of staff through fiscal year 2008/09 to achieve a staffing level of 24 Internal Auditors. We are having greater successes in recruiting qualified Internal Auditors and will be fully staffed up to the original 14 authorized positions. We are also in the process of securing funding for an additional six positions authorized by the Board of Supervisors as part of the resource plan.

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We will include a resource plan as part of our Annual Audit Activity Report to the Board of Supervisors. This plan will include training, co-sourcing and outsourcing requirements applicable to the Audit Plan that is presented to the Board of Supervisors along with the Annual Audit Activity Report.

Recommendation 3: The IA activity should prepare and submit a comprehensive risk assessment of County operations as part of the annual audit plan development and Board approval process.

Response: Concur. Our Audit Plan is based on a risk assessment; however, that assessment has not been included in our submittal to the Board of Supervisors. Future Audit Plans will include the risk assessment.

Recommendation 4: The IA activity should complete development and implement updated IA operating policies and procedures, which would include comprehensive training of IA personnel on such policies and procedures.

Response: Concur. We have completed the revision of the internal audit operating policies and procedures. Upon completion of our final review, we will train all existing internal audit personnel on the new policies and procedures, and will include that training in the orientation for new employees.

Recommendation 5: The IA activity should ensure all working papers have required elements that meet professional documentation requirements.

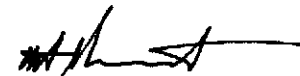
Response: Concur. Actions have been taken to ensure that all required elements are consistently included in working papers.

Recommendation 6: The IA activity should perform timely supervisory reviews of working papers.

Response: Concur. With the addition of a second Principal Accountant/Audit Manager, we have been able to review all working papers more timely.

Recommendation 7: The IA activity should cross-reference audit reports to supporting working papers.

Response: Concur. We are now cross referencing all Draft Internal Auditor's Reports to the supporting working papers.



Michael G. Alexander
Chief Internal Auditor

c: Robert E. Byrd, Auditor-Controller, County of Riverside
Bruce Kincaid, Assistant Auditor-Controller, County of Riverside