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Vicki Crow, C.P.A.

Auditor-Controller/Treasurer-Tax Collector

May 7, 2014

Dr. Peter Hughes,
Director, Internal Audit Department
Orange County, California

AUDIT REPORT: EXTERNAL QUALITY ASSESSMENT REVIEW OF THE ORANGE
COUNTY INTERNAL AUDIT DIVISION

Dear Dr. Hughes,

At your Department's request, we conducted an external quality assessment review (peer review) of the Orange County Internal Audit Department (IAD) as prescribed by the Institute of Internal Auditors' Professional Practices Framework. We conducted the peer review during the period of January 3, 2014 through May 7, 2014, for the period from July 1, 2010, through June 30, 2013.

We utilized the Institute of Internal Auditors' Quality Assessment Manual, 6th edition as well as the Institute of Internal Auditors' Professional Practices Framework as primary criteria for performing the assessment. The assessment was conducted in accordance with auditing standards prescribed by the Institute of Internal Auditors. Furthermore, for those audit engagements using Generally Accepted Government Auditing Standards, we used the Government Accountability Office's *Government Auditing Standards*.

Based on the information evaluated during the external quality assessment review, the Orange County's Internal Audit activity generally conforms to the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*, as well as the Government Accountability Office's *Government Auditing 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.

We appreciate the courtesy and cooperation extended to us by yourself and all of your staff throughout the assessment. We would also like to thank the members of the Board of Supervisors, Audit Oversight Committee, County Executive Office, and the Auditor-Controller's Office who participated in the interview process. The feedback from the interviews provided valuable information regarding the operations of the IAD and its relationship with management.

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OVERVIEW

The Institute of Internal Auditors' (IIA) Standards require that internal audit function obtain external quality assessments to assess compliance with standards and to appraise the quality of their operations once every five years. The Government Accountability Office's *Government Auditing Standards* (GAO Standards) require that audit organizations performing audits and attestation engagements in accordance with Generally Accepted Government Auditing Standards (GAGAS) have an external peer review at least once every three 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 Orange County's Internal Audit Department (IAD) was performed during the period January 3, 2014 through May 7, 2014, in accordance with the Institute of Internal Auditors' Professional Practices Framework, the Institute of Internal Auditors' Quality Assessment Manual, 6th edition, and GAO Standards. The process was requested by the Orange County Director of Internal Audits.

OBJECTIVE, SCOPE AND METHODOLOGY

The primary objective of the quality assessment, for the period from July 1, 2010 through June 30, 2013, was as follows:

- Determine whether the IAD's quality control system for audit engagements is suitably designed and operating effectively to provide reasonable assurance of compliance with the Institute of Internal Auditor's *International Standards for the Professional Practice of Internal Auditing* (IIA Standards); and
- Determine whether the IAD was in material compliance with GAO Standards for the audits that were performed utilizing GAGAS.

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

1. Reviewed the IIA Standards (including practice advisories), the IIA Quality Assessment Manual, and GAO Standards to identify the primary criteria for the assessment
2. Reviewed key documentation related to the Orange County IAD activity including:
 - Internal audit, charter and legal requirements;
 - County and internal auditor organizational charts;
 - Audit personnel position descriptions;
 - Operating policies and procedures
 - Annual audit plan and management reports;
 - Staff development and training documentation;
 - Staff performance appraisals

3. Conducted interviews with key Orange County officials and IAD personnel, including:
 - A member of the Board of Supervisors;
 - The Auditor-Controller;
 - A public member of the Audit Oversight Committee;
 - The Chief Executive Officer;
 - The County's Director of Internal Audits; and,
 - Internal Audit staff and managers
4. Administered and summarized surveys of selected customers and personnel of the Orange County IAD.
5. Reviewed selected working papers, audit reports and supporting documentation for engagements performed between July 1, 2010 and June 30, 2013.

RESULTS

Based on the information received and evaluated for the period from July 1, 2010, through June 30, 2013, it is our opinion that:

- Orange County's IAD activity generally conforms to the IIA Standards and Code of Ethics. This opinion means that policies, procedures and practices have been designed and implemented in conformance with the IIA Standards.
- Orange County's IAD system of quality control is adequately designed and implemented to provide the IAD with reasonable assurance of conforming to the GAO Standards.

Our review revealed an internal audit function that is professional, well-managed, progressive, and effective. Based on interviews conducted with personnel both inside and outside of the IAD, we found that Orange County's management feels that the IAD adds significant value and helps improve operations. Further, the IAD works in a transparent and accountable manner, from its risk assessment process to the issuance and communication of its various audit reports. The IAD has worked diligently to implement leading practices, which are outlined on the following page.

As noted in its previous quality assessment, Orange County's IAD utilizes a paper-based working paper system. This continues to be an area that can be considered a reasonable opportunity to enhance current practices. Use of an electronic/automated audit management system is a leading practice identified by the IIA and the Association of Local Government Auditors (ALGA), and is also a best practice of most external audit functions as well. Utilization of an automated system allows for greater portability and greater ease of understanding of working papers. Further, the system creates a more secure working paper environment (with data backups for disaster recovery), and facilitates easier file retention practices. We feel it would be of great value to Orange County's IAD to investigate implementation of an automated system.

LEADING PRACTICES

During our review, we identified certain successful practices by Orange County's IAD that we felt were particularly notable. These practices include:

- **Organizational Independence (IIA Standard 1110)** – the Director of Internal Audits reports directly to the Board of Supervisors and is organizationally independent of County operations. This allows the IAD to operate independently of all County operations, freeing it of potential County bias and interference.
- **Policies and Procedures (IIA Standard 2040)** – The IAD's Audit Manual is comprehensive and well-designed to guide the IAD's activity.
- **Communication (IIA Standards 2020, 2060, 2420)** – The IAD's risk assessment and audit plan processes are impressively designed and implemented. The IAD seeks input from various sources, including the Board of Supervisors, Audit Oversight Committee, and County managers in assessing risk within the County. It also provides its audit plan for quarterly approval to the Audit Oversight Committee. The level of organization and communication was noted as incredibly effective.
- **Audit Oversight Committee Structure** – the Committee is comprised of five members internal to Orange County, as well as four public members with accounting and auditing expertise. Both the level of expertise of the members of the Committee and the use of public members contribute to an increased assurance of quality and transparency within the internal audit function.