11-25-14 #43

OC Board of Supervisors
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Internal Audit Department

ORANGE COUNTY

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BOARD OF SUPERVISORS

OC INTERNAL AUDIT DEPARTMENT

WHITE PAPER ON ORGANIZATIONAL PLACEMENT OF THE INTERNAL AUDIT DEPARTMENT

Since 1995 when the Board of Supervisors established the "Independent" Internal Audit Department reporting directly to the Board, a global drive to improve corporate governance has occurred. This improved governance has led to changes in professional auditing standards recognizing that anytime management undertakes audits of itself or entity-wide functions that it is responsible for managing, the independence of those audits is impaired. Over the past 19 years, the Board's foresight has withstood the test of time such that the current Internal Audit Department reporting directly to the Board is fully compliant with the recent changes pertaining to independence made in the professional auditing standards.

The auditing profession recognizes there is an important difference between the "highest governing body" such as the five elected County Supervisors who have no direct managerial duties versus the elected Auditor-Controller who has extensive financial and accounting management duties. Recognizing that the internal audit function must report to someone in a governmental or private sector organization, the relevant professional auditing standards have determined that the most independent structure in fact and in appearance is obtained by having the audit function report to the "highest governing body" with no direct management duties, which in Orange County's case is the elected Board of Supervisors.

REFERENCE: 1407-2
REPORT DATE: NOVEMBER 19, 2014

Director: Dr. Peter Hughes, MBA, CPA, CIA
Assistant Director/Senior Audit Manager: Michael Goodwin, CPA, CIA
Senior Audit Manager: Autumn McKinney, CPA, CIA
Senior Audit Manager: Alan Marcum, CPA, CIA

RISK BASED AUDITING
GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010, 2013

Award Winning Audit Function:

CPA American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management

2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays

2008 Association of Local Government Auditors' Bronze Website Award

2005 Institute of Internal Auditors' Award for Recognition of Commitment to Professional Excellence, Quality, and Outreach

Independence Objectivity Integrity

OC Internal Audit Department

GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010, 2013

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

Dr. Peter Hughes **Ph.D., MBA, CPA, CCEP, CITP, CIA, CFE, CFF, CGMA**
Director Certified Compliance & Ethics Professional (CCEP)
Certified Information Technology Professional (CITP)
Certified Internal Auditor (CIA)
Certified Fraud Examiner (CFE)
Chartered Global Management Accountant (CGMA)
Certified in Financial Forensics (CFF)

E-mail: peter.hughes@iad.ocgov.com

Michael Goodwin **CPA, CIA**
Assistant Director/
Senior Audit Manager

Alan Marcum **MBA, CPA, CIA, CFE**
Senior Audit Manager

Autumn McKinney **CPA, CIA, CISA, CGFM**
Senior Audit Manager

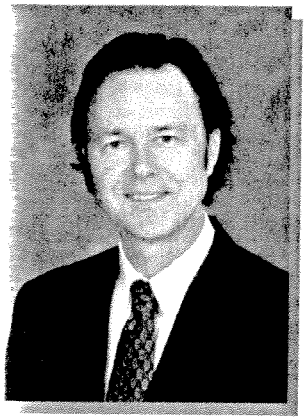
Hall of Finance & Records
12 Civic Center Plaza, Room 232
Santa Ana, CA 92701
Phone (714) 834-5475 Fax: (714) 834-2880

To access and view audit reports or obtain additional information about the OC Internal Audit Department, visit our website: www.ocgov.com/audit

OC Fraud Hotline (714) 834-3608

Letter from Director Peter Hughes

Transmittal Letter



November 19, 2014

TO: Members, Board of Supervisors

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: White Paper on Organizational Placement of the Internal Audit Department

Responding to a request from Board Offices, the Internal Audit Department is providing a "white paper" regarding the proposal submitted on November 5, 2014 by Auditor-Controller's (current and Elect), that the Internal Audit Department be organizationally removed from the Board of Supervisors' control and have it report to the elected Auditor-Controller.

The Internal Audit Department (IAD) welcomes the opportunity to discuss any aspect of our "white paper" with you, the current and newly elected Auditor-Controller, or anyone in management. IAD's intention in this paper is to share our professional expertise and perspective as regards the professional auditing standards and the continued benefits of having the Internal Audit Department report directly to the Board of Supervisors. While IAD feels confident that our observations have considerable merit and are in line with professional auditing standards, we do recognize that there may be different interpretations and viewpoints on the matters. IAD's primary objective in this paper is to provide your Honorable Board with critical information that will help in its decision on this important topic.

Because the Board of Supervisors decision regarding the placement of the County's Internal Audit Department impacts both the Auditor-Controller's Office and the Internal Audit Department, we recommend that the Board consider obtaining the opinion of a CPA firm that is independent of any California County regarding the issues raised in both the Auditor-Controller's and the Internal Audit Department's white papers.

cc: Nicholas Chrisos, County Counsel

White Paper on Organizational Placement
of the Internal Audit Department

November 19, 2014 **Reference 1407-2**

TO: Members, Board of Supervisors

FROM: Dr. Peter Hughes, CPA, Director of Internal Audit

SUBJECT: White Paper on Organizational Placement of the Internal Audit Department

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Responding to a request from Board Offices, the Internal Audit Department is providing this "white paper" containing our professional expertise and perspective regarding the proposal submitted on November 5, 2014 by the Auditor-Controller (current and Elect) to organizationally remove the Internal Audit Department from the Board of Supervisors' control and have it report to the elected Auditor-Controller.

The Auditor-Controller's proposal appears to be prompted by recent changes in the California Government Code. County Counsel has reviewed these changes and confirms that the Board continues to be authorized by the California Government Code to select who will perform Countywide internal audits. As a key justification for the Auditor-Controller Elect's petition seems to be founded on the misconception that the five elected County Supervisors lack the required "independence" needed to oversee the internal audit function, while the Auditor-Controller's Office possesses it, this "white paper" will primarily focus on these assertions.

Our responses to points raised regarding auditor independence and reporting models for the internal audit function made in the Auditor-Controller Elect's "white paper" are:

1) The elected five-member Board of Supervisors, as the County's highest governing body, is the only entity in the County that possesses the organizational independence to ensure their Internal Audit Department meets all relevant or required auditing standards for auditor independence.

2) The Orange County Auditor-Controller's extensive and pervasive management duties over the County's financial and accounting activities create such a significant conflict of interest that any internal audit function reporting to it would not be independent pursuant to several auditing standards, as presented below in the next section.

The analysis below sets forth IAD's reasoning for the above conclusions.

Professional Auditing Standards Require Auditor Independence

It is universally professionally recognized that the most important quality of an audit function and auditor is that they are "independent," that is to say they are free from management influences and direct reporting relationships to management that could, even in appearance, seem to pressure them to withhold from the governing Board any report that would reveal control deficiencies, policy violations, or management's misconduct or lapses in judgment or duties.

The Auditor-Controller Elect's proposal to change the audit function by taking possession of the County's Internal Audit Department runs contrary to authoritative auditing standards regarding audit independence. These audit authorities include the American Institute of Certified Public Accountants (AICPA) and the United States' Government Auditing Standards, as well as guidance by the Institute of Internal Auditors.

1. U.S. Government Auditing Standards state that "*If an auditor were to assume management responsibilities for an audited entity, the management participation threats created would be so significant that no safeguards could reduce them to an acceptable level.*" U.S. Government Auditing Standards provide examples of management duties that "*would impair independence if performed for an audited entity.*" Examples cited in the standards include designing, implementing, or maintaining internal controls; setting policies; and directing or supervising routine, recurring management functions, all of which are management duties the Auditor-Controller performs. U.S. Government Auditing Standards also state "*...some services involving preparation of accounting records always impair an auditor's independence with respect to an audited entity.*" These services include approving and modifying accounting transactions; performing account reconciliations; preparation of the financial statements; and designing and implementing financial systems, all of which are management duties the Auditor-Controller performs.

2. AICPA Rule 101 states that "*If a member were to assume management responsibility for an attest client, the management participation threat created would be so significant that no safeguards could reduce the threat to an acceptable level.... Examples of activities that would be considered a management responsibility and would, therefore, impair independence if performed for an attest client include ... authorize and approve accounting transactions; implement or maintain internal controls; design or develop a financial information system; and operate a local area network system,*" all of which are management duties the Auditor-Controller performs.

3. The Institute of Internal Auditors Research Foundation's Auditing Section Task Force of the American Accounting Association report titled Independence and Objectivity: A Framework for Internal Auditors states "*...if the Internal Audit Unit is situated in the Controller's department with the Director of Internal Auditing reporting directly to the Controller, it is difficult, if not impossible, for the Internal Auditor to objectively evaluate the performance of peer offices under the Controller.*" Examples of peer offices or functions of the Auditor-Controller's Office include vendor payments, payroll, general ledger, allocation of property taxes to schools and cities, bond accounting, and Mello-Roos tax assessments for Community Facility Districts. It is important to note that the Auditor-Controller also provides accounting and other financial related services under contract to seven different County departments: Health Care Agency, Social Services Agency, OC Public Works, OC Community Resources, OC Waste & Recycling, John Wayne Airport, and CEO/Public Finance.

   To give the readers of this paper a sense of the size and extensive duties of the Auditor-Controller's Office, the Auditor-Controller's recommended budget for FY 2014-2015, including approved augmentations, was $14,765,538 and the number of authorized positions was 418. In addition, the FY 2014-2015 recommended budgets for the Auditor-Controller's two additional "budget controls" of the CAPS Project (System) was $11,425,456 and the Property Tax System Centralized O&M Support was $3,325,822.

4. The Institute of Internal Auditors (IIA) standards state that "*Organizational independence is effectively achieved when the Chief Audit Executive reports functionally to the Board, this includes approving decisions regarding the appointment and removal of the Chief Audit Executive,*" as well as "*approving the annual compensation and salary adjustment of the Chief Audit Executive,*" all of which presently happens under the Board but will cease to happen if the Auditor-Controller is awarded the Countywide internal audit function. Additionally, the IIA standards state "*A conflict of interest is a situation in which the internal auditor, who is in a position of trust, has a competing professional or personal interest.*"

The Countywide Controller's management duties assigned to the County Auditor-Controller, such as keeping the accounting records, setting accounting policies, designing and maintaining controls, and preparing the County's financial statements present exactly this type of conflict. The remedy the IIA presents to this type of impairment to independence is to employ an auditor outside of the Controller's Office to conduct the entity's internal audits, which is currently done by the Auditor-Controller as further discussed in the next section below.

Conflict of Duties Inherent in Controller's Office

Professional auditing standards specify, or clearly imply that an entity's Controller cannot be viewed as independent enough to be impartial and unbiased when "auditing" themselves or the entity in which they work.

In essence, based upon the Auditor-Controller's extensive and Countywide management duties, there may be no greater "conflict-of-interest" of duties that exists elsewhere in the County. It is for this reason that the auditing profession precludes management, and in this case, the County's Controller from auditing themselves. This position by the auditing profession is based on the direct and extensive inherent management duties of the Controller's Office. No one else in the County, but the Controller, is given the corporate or centralized task of making and reviewing tens of thousands, and even millions, of original, adjusting and correcting journal entries into the County's official accounting books and records; preparing the County's financial statements that account for billions of dollars of taxpayers monies; writing and enforcing all accounting policies including internal control requirements for the entire County; as well as designing and implementing the Countywide accounting systems and extensive internal controls. To provide a reference point and underscore just how pervasive the Auditor-Controller's duties are, the Auditor-Controller's Office has a staff of 418 accountants and staff.

It is our understanding that because the Auditor-Controller has conflicting management duties (such as providing IT support and maintenance to the Treasurer-Tax Collector's information systems under a contract with the T-TC), the Auditor-Controller contracts with an external CPA firm to perform its sole and most critical mandated "audit" performed under U.S. Government Auditing Standards, the Audit of the Schedule of Assets Held by the County Treasury as of June 30th. For the other three quarterly "reviews" of the Statement of Assets, the Auditor-Controller contracts with the Board's "Independent" Internal Audit Department (IAD) to "audit" the reconciliation of cash and investments since the Auditor-Controller prepares this reconciliation between the Auditor-Controller's general ledger and the Treasurer-Tax Collector's records.

Prior to contracting with IAD and the external CPA firm for independent audit services, the Auditor-Controller qualified its audit opinions to notify the Board, investors of County bonds, and the general public that because the Auditor-Controller's General Ledger Unit prepares the reconciliation of Treasury's cash fund balances to the Auditor-Controller's general ledger, "*the Controller's role may be perceived as a potential impairment to our independence.*" However, the Board's Internal Audit Department is unquestioned in this regard because it has no such conflicting management duties and has never had to make such a disclosure regarding lack of independence.

Both the AICPA and the U.S. Government Auditing Standards recognize that the Board's Internal Audit Department possesses all requisite independence to conduct "audits" and cite unqualified compliance when reporting directly to the 'highest governing body," i.e. the elected Board of Supervisors, who have no direct management duties such as those possessed by the Auditor-Controller. For the past 19 years the Board's "Independent" Internal Audit Department has conducted over one hundred critical AICPA and U.S. Government Auditing Standards audits that have inspired the trust and confidence of both the Board and the public. This trust is founded on both the appearance and fact of "independence" due to the fact that the Internal Auditor does not work for anyone in management that they audit.

Internal Audit Serves as the "Eyes and Ears" of the Board

By many measures, the internal audit function is considered indispensable to the boards of both governmental and corporate organizations because it is the only function to which the board grants unrestricted access to audit the books, records and personnel for the entire entity and empowers, with few limitations, to audit any department, any activity, or any fiscal, accounting or financial issue. To support its internal audit function, the Board also has the statutory authority to compel the cooperation and written response of all County personnel and management, elected and appointed. The internal audit function is known throughout the world as the board's "eyes and ears" and is considered to be an irreplaceable and powerful administrative tool possessed by the board.

The driving force behind this model is the need for assurance that the internal audit findings are not filtered or that the auditors' conclusions are not interpreted, altered, or softened by someone in management prior to release to the Board and public. It is important to note that in 1995, the Orange County District Attorney charged two members of the Board of Supervisors and the Auditor-Controller for the failure to exercise proper stewardship over the bankrupt County Investment Pool even though the pool was the responsibility of the elected Treasurer-Tax Collector, and even though it was the elected Auditor-Controller (not the Board) that was responsible for the Internal Audit Department and its audits of the Investment Pool at that time.

The widely held perspective of the Board members immediately following the 1995 Bankruptcy was if the Board is going to be the body ultimately held accountable or blamed for short-comings throughout the County, then it must have its own eyes and ears, i.e. the Internal Audit Department to protect itself. To date and nearly two decades later, the merits of that perspective have not been forgotten.

Important Difference between the Controller as a Manager and the Board as Legislators

The auditing profession recognizes there is an important difference between the "highest governing body" such as the five elected County Supervisors who have no direct managerial duties versus the Auditor-Controller who has extensive financial and accounting management duties. Recognizing that the internal audit function must report to someone in a governmental or private sector organization, the relevant professional auditing standards have determined that the most independent structure in fact and in appearance is obtained by having the audit function report to the "highest governing body" with no direct management duties, which in Orange County's case is the Board of Supervisors.

Thus, the AICPA, the U.S. Government Auditing Standards, and the Institute of Internal Auditors either require or strongly recommend that the internal audit function report directly to the Board of Supervisors or the corporate Board of Trustees. It is important to point out that, as far as the AICPA and the U.S. Government Auditing Standards are concerned, an "audit" of any operation within the same entity that is managed by the Controller of that entity cannot be referred to as an unqualified "independent audit."

The Board's Independence Cannot be Transferred to Management/Controller

To be clear, the "independence" that the Board's Internal Audit Department currently possesses is due to the fact that it reports to the Board of Supervisors, the "highest governing body" of the County, and does not report to the Auditor-Controller. Pursuant to auditing standards, this "independence" should not "transfer" to the Auditor-Controller due to the fact that the Auditor-Controller, elected or appointed, has an overwhelming conflict of interest as the "County's Chief Accountant" that "keeps the books" and directly manages the County's key accounting systems and related internal controls.

The proposal by the Auditor-Controller Elect to hire and fire the Internal Auditor and take possession of the Board's critical audit function would compromise this independence immediately upon receipt of it.

The AICPA's first and most important auditing standard, explicitly states that:

> "*The auditor must maintain independence in mental attitude in all matters relating to the audit.... It is of utmost importance to the profession that the general public maintain confidence in the independence of independent auditors.... Independent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence.*"

The U.S. Government Auditing Standards' first and most important auditing standard, explicitly states that:

> "*The credibility of auditing in the government sector is based on auditor's objectivity in discharging their professional responsibilities.... Auditors should avoid situations that could lead reasonable and informed third parties to conclude that the auditors are not independent...*"

Key Points for the Board's Consideration

In summary there are eleven (11) points that merit the Board's consideration:

1) The original Board of Supervisors' Resolution 95-271 (1995) establishing the Internal Audit Department was passed unanimously in public and is unambiguously clear that it was intended to be a permanent change in the County governance structure that was designed to empower the Board to better fulfill its stewardship and leadership responsibilities. Contrary to the statement made and/or implied in the Auditor-Controller Elect's "white paper," the establishment of the Internal Audit Department as a direct report to the Board was not a temporary "deal" made behind closed doors to placate "Wall Street." The Board's resolution makes it clear that this was a permanent commitment to embrace "best practices" of the corporate world in this regard.

2) The Board of Supervisor's 1995 decision to establish an independent internal audit function was astute and has withstood the test of time such that the current Internal Audit Department reporting directly to the Board is fully compliant with recent changes pertaining to independence made to the professional auditing standards. Giving the internal audit function to the Auditor-Controller would be reversing the foresight and wisdom of prior Boards of Supervisors and would be contrary to professional auditing standards and best practices. Orange County is the sixth largest County in the U.S. and has played a leadership role in audit independence for nearly two decades. The most widely used model for Internal Audit in the 30 largest Counties and Cities is the same as Orange County, underscoring the widespread recognition and wisdom of Orange County's decision in this regard.

3) The Board's Internal Audit Department is fully independent pursuant to all pertinent auditing standards and is able to issue unqualified audit opinions under all relevant auditing standards. In contrast, the Auditor-Controller contracts out certain "audits" requiring unqualified independent audits under AICPA or U.S. Government Auditing Standards, the types of audits that have been performed by the Internal Audit Department for two decades.

    a) The Internal Audit Department reporting to the Board of Supervisors can and has conducted over seventy AICPA compliant audits. However, due to the lack of independence, the AICPA, with few exceptions, prohibits a CPA, whether working as an elected or appointed Controller, from conducting an unqualified "independent audit" under AICPA standards for that entity.

b) The Internal Audit Department reporting to the Board of Supervisors can and has conducted numerous U.S. Government Auditing Standards compliant audits. However, due to the lack of independence the U.S Government Auditing Standards, with few exceptions, precludes a Controller of a governmental entity, whether elected or appointed, from conducting an "unqualified independent audit" of themselves or their entity under U.S Government Auditing Standards.

c) The Internal Audit Department reporting to the Board of Supervisors can and has conducted hundreds of the Institute of Internal Auditors compliant audits. Institute of Internal Auditors standards strongly recommend, as does U.S. Government Auditing Standards, that the internal audit function report directly to the "highest governing body" of the organization. The Institute of Internal Auditors standards state, in part, that "*Organizational independence is effectively achieved when the Chief Audit Executive reports functionally to the Board.*" The key to the word "functionally" is that the CAE or head of internal audit is hired, evaluated, paid, and fired by the Board and not someone in management, like the Controller of an organization, and that the Board directs the internal audit function.

4) The Internal Audit Department has been "audited" five times by independent Peer Reviewers and found to be clearly independent and "fully compliant with all relevant auditing standards." They have cited Internal Audit Department's innovative approaches to internal auditing, its cost effectiveness, and the unparalleled caliber of its auditors (all 15 auditors are CPAs, the "gold standard" for auditing). All five independent Peer Reviewers have praised the Orange County Internal Audit Department as an exceptionally well managed and effective audit group. All of the Internal Audit Department's auditors, from the Director down to the Senior Auditor, are actively engaged in conducting audits or Countywide Hotline investigations for the vast majority of their time. By several measures, the Internal Audit Department has an extremely high level of audit, investigation, and project productivity.

5) Driving the Internal Audit Department's (IAD) high level of productivity is the fact that by several County benchmarks, the IAD has one of the highest level of certified and experienced auditors in the Country for audit functions of similar size. *The OC IAD is the only large County internal auditing department in the Country that we are aware of in which 100% of its auditors are CPA's, "the gold standard" for auditors worldwide.* In addition, each auditor also possesses a second earned professional certification such as the designation as a Certified Internal Auditor or Certified Information System Auditor. By possessing this level of professionalism, the IAD's CPAs are at the "top of their learning curve" and able to rapidly grasp complex accounting and management issues and write clear and constructive audit reports with minimum supervision or "overhead." This extraordinary level of professionalism enables the IAD to audit the most significant, complex, demanding, high risk and vulnerable activities in the County. Employing less experienced non-CPAs as planned by the Auditor-Controller Elect in his "white paper," will impede and in some cases prohibit such audits. In addition, the unrivaled caliber of the IAD's auditors enables them to participate on multiple audits concurrently with minimum supervision, thereby minimizing supervisory costs or "overhead."

   As a point of clarification, the Internal Audit Department uses the word "manager" in all of its auditors' job titles to show respect to their high level of professional experience and certifications as well as their ability to play a leadership role on complex and sensitive audits. The use of the word manager by the Internal Audit Department should not be misinterpreted to mean, as suggested in the Auditor-Controller Elect's "white paper," that they are not auditors but rather "office administrators" or unnecessary and unproductive "overhead."

6) The Internal Audit Department has received an average of a 96% grade (4.8 out of 5) from its clients in their assessment of the "tremendous value" the Internal Audit Department provides to its clients and the Internal Audit Department's "helpfulness and professionalism." This high praise comes from both elected and appointed department heads such as the District Attorney, Treasurer-Tax Collector, Auditor-Controller, Sheriff-Coroner, John Wayne Airport, OC Public Works, OC Dana Point Harbor, OC Community Resources, Health Care Agency, Social Services Agency, and Probation.

   The most common and frequent praise offered the Internal Audit Department is that it is highly responsive to the Board's and Department/Agency requests for assistance and that we provide timely and invaluable insights into their processes and control issues. The Audit Oversight Committee and management Countywide, as well as each Board member, have complimented the IAD at one point or another for the depth and breadth of its comprehensive Audit Plan. The fact that the IAD conducts five different types of audit services which include audits of financial records, internal controls, Information Technology controls and new system implementations, revenue generating leases, and the provision of expert facilitators to help management conduct Control Self Assessment workshops is viewed as a best practice and a clear sign of how "fresh" and "robust" the IAD staff is. The criticism made in the Auditor-Controller Elect's "white paper" that the IAD's staff and its audit plan are stagnant and the audits are slow has not been voiced in any of the hundreds of the IAD's Client Evaluations, nor voiced by any one of the members of the Audit Oversight Committee, which includes the position of elected Auditor-Controller, at any of the past sixty (60) AOC Quarterly Meetings.

7) The Internal Audit Department has the authority to initiate audits that originate from the request of a single Board member and has done many times in the past. Any individual Board member may request an audit at a Board meeting, through the Audit Oversight Committee (AOC), or during annual meetings held to gather individual Board member's input on the Audit Plan development. The Internal Audit Department with the support of the AOC has conducted dozens of audits that originated with individual Supervisors in the manner described above and then added to the Audit Plan. Some of the audits of this nature include the Internal Audit Department's audit of the Clerk-Recorder's Restricted Revenue Funds, the audit of the Pension Pick Up by Employees, and the audit of the Mello-Roos tax assessments determined by CEO/Public Finance for the Community Facilities Districts. Additionally, the Board has the authority per the Internal Audit Department charter as a majority to direct the Internal Audit Department to conduct an audit of their choosing.

8) Sensitive to the bankruptcy in 1994 and its adverse financial and reputational impact to Orange County and its citizens, the Treasurer-Tax Collector and the Treasury Oversight Committee selected the Internal Audit Department, rather than turn to a private sector CPA firm, to conduct over 70 critical audits of the $7 billion County Investment Pool using AICPA auditing standards. These audits have been of the highest sensitivity, complexity and importance and have provided critical audit services of the highest professional caliber. Due to a lack of independence, none of these critical audits could have been similarly conducted by the Auditor-Controller using AICPA standards.

9) The Internal Audit Department as a department as well as its individual auditors have been recognized with a variety of competitive awards by numerous international professional associations as among the *most innovative and effective professionals* in local government. The Internal Audit Department has repeatedly been noted as a "role model" for the internal audit profession and is the only County internal audit department in California that developed and successfully provided the leading best practice of conducting facilitated Control Self Assessment and Process Improvement (CSA) workshops. To date, the Internal Audit Department has offered over 112 such workshops to 1,365 county staff and managers. IAD's clients without a single exception rated the value and contribution of the Internal Audit Department in this regard as an A or A+. Through these CSA workshops, the Internal Audit Department has helped management identify hundreds of ways to improve their business processes and operations.

   The Internal Audit Department also has implemented another "leading edge, best practice" by developing several Computer Assisted Audit Techniques (CAAT) for data analysis that have proven to be invaluable to the Board and to the Auditor-Controller. In fact, the former Auditor-Controller praised the Internal Audit Department for conducting these CAAT routines. For example, one of the CAATs developed and performed by IAD reviewed over 1.4 million invoices amounting to over $15 billion dollars, and identified over $1 million of duplicate payments made to vendors that were later recovered. Without the automated querying software used to develop the CAAT, a manual review for duplicate payments of this population would have taken hundreds, if not thousands, of hours.

   In addition, several peer reviewers have verbally shared that IAD has one of the most innovative and responsive IT audit functions in County auditing. The Internal Audit Department's value to the County has been confirmed by such prestigious bodies as the Association of Local Government Auditors, the Association of Certified Fraud Examiners, the Institute of Internal Auditors, the American Institute of Certified Public Accountants, the Government, Risk & Compliance Group, and the Information Systems Audit and Control Association.

   The Internal Audit Department's implementation and use of CAATs and CSA workshops is considered a best practice in the audit profession and demonstrates the enthusiasm, innovation, and professionalism of the audit staff.

10) The Internal Audit Department is one of the most transparent audit functions among Counties. The annual Risk Assessment and Audit Plan is approved in public by the Board of Supervisors and the Audit Oversight Committee. Audit reports issued are submitted to the Board of Supervisors once a month during a public Board meeting. A quarterly status report of each individual audit and the resources used (budgeted and actual to date hours) are provided in a public meeting to the Audit Oversight Committee. The Internal Audit Department's website is extremely informative and includes a copy of each report issued for the public to access. The Internal Audit Department's website received an award of excellence by the Association of Local Government Auditors. A review of other County internal audit function websites clearly illustrates and provides evidence that the Orange County Internal Audit Department's website is a leader and model of transparency.

11) The Auditor-Controller Elect's "white paper" asserts that having the Board's Countywide internal audit function will help the Auditor-Controller Elect recruit qualified accountants. In the past the Auditor-Controller has been able to recruit highly qualified staff and accountants, all while the Internal Audit Department has reported exclusively to the Board. Past Auditor-Controllers have even mentioned that in some instances they had nearly 100 qualified applicants for just one position. As regards the Auditor-Controller Elect's stated training needs, the Internal Audit Department has provided training on internal controls that hundreds of County employees have taken, including numerous staff from the Auditor-Controller's Office. As such, the Internal Audit Department is willing to tailor-make courses specifically for the Auditor-Controller's staff if requested.

Summary

Our responses to points raised regarding auditor independence and reporting models for the internal audit function made in the Auditor-Controller Elect's "white paper" are:

1) The elected Board of Supervisors as the County's highest governing body is the only entity in the County that possesses the organizational independence to ensure their Internal Audit Department meets all relevant auditing standards regarding independence.

2) The Orange County Auditor-Controller's extensive and pervasive management duties create such a significant conflict of interest that any internal audit function reporting to it would not be independent pursuant to several auditing standards.

The Internal Audit Department as a direct report to the five elected Board of Supervisors, who constitute the County's "highest governing body," is recognized as possessing full "independence" by the AICPA, the U.S. Government Auditing Standards, and the Institute of Internal Auditors. This reporting model is the recognized "best practice" and the most widely used model in the U.S. for all cities and counties of the same size as Orange County.

The Board of Supervisors has spent 19 years developing one of the most independent, innovative, productive, responsive and professional internal audit departments in the entire Country. Its auditors are all CPAs, have an average of 20 years auditing experience, and tackle the most important and complex audits that few if any other County internal audit functions could or do undertake. Both elected and appointed Departments have rated the Internal Audit Department's audit value to them as "A" quality. The five independent and different Peer Reviewers over the course of the past 15 years have "audited the auditors" and reported to the Board that the Board's Internal Audit Department was innovative, professionally managed and staffed, and responsive to the Board and management's needs. The five independent and different Peer Reviewers did not report a single short-coming in the Board's Independent Internal Audit Department; nor did they cite any concerns with independence and the current reporting model.

Internal Auditor Welcomes Independent Review of Facts

The Internal Audit Department (IAD) welcomes the opportunity to discuss any aspect of our "white paper" with you, the current and newly elected Auditor-Controller, or anyone in management. IAD's intention in this paper is to share with you our professional expertise and perspective as regards the professional auditing standards and the continued benefits of having the Internal Audit Department report directly to the Board of Supervisors. While IAD feels confident that our observations have considerable merit and are in line with professional auditing standards, we do recognize that there may be different interpretations and viewpoints on the matters.

IAD's primary objective in this paper is to provide your Honorable Board with critical information that will assist you in your decision regarding the placement of the audit function that best serves you, the Board, while preserving the "independence" and effectiveness of your Internal Audit Department.

Because the Board of Supervisors decision regarding the placement of the County's Internal Audit Department impacts both the Auditor-Controller's Office and the Internal Audit Department, we recommend that the Board consider obtaining the opinion of a CPA firm that is independent of any California County regarding the issues raised in both the Auditor-Controller's and the Internal Audit Department's white papers.