Internal Audit Department

O R A N G E C O U N T Y
6th Largest County in the USA

Revised Audit Plan and Risk Assessment FY 2014-15

Discussion, Review and Approval
by the Audit Oversight Committee
September 25, 2014, Item 7

Presented to the Board of Supervisors
July 22, 2014

Approved by the Audit Oversight Committee
June 3, 2014, Item 10

Report No. 1301

Risk Assessment Team
Dr. Peter Hughes, Director of Internal Audit
Michael Goodwin, Senior Audit Manager
Wilson Crider, IT Audit Manager
Michael Dean, Audit Manager
Carol Swe, Audit Manager
Renee Aragon, Administrative Manager

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

AICPA 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 to IAD for Recognition of Commitment to Professional Excellence, Quality, and Outreach

OC Internal Audit Department

ORANGE COUNTY BOARD OF SUPERVISORS'

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

Providing Facts and Perspectives Countywide

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

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

Michael Goodwin	**CPA, CIA**
Senior Audit Manager	

Alan Marcum	**MBA, CPA, CIA, CFE**
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

TRANSMITTAL LETTER

Report No. 1301   October 28, 2014

TO: Honorable Members, Board of Supervisors
Members, Audit Oversight Committee

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

SUBJECT: Revised FY 2014-15 Audit Plan and
Risk Assessment

Per Resolution No. 95-271, the Board directed the Audit Oversight Committee (AOC) to act in an oversight capacity to the Internal Audit Department (IAD) and to approve the Annual Audit Plan.

For the 15th consecutive year as the Director of Internal Audit, I am pleased to present the *FY 2014-15 Audit Plan and Risk Assessment.* This comprehensive report details our plan for audits and reviews in the upcoming fiscal year.

The AOC reviewed and approved the *FY 2014-15 Audit Plan and Risk Assessment* on June 3, 2014. On July 22, 2014, the Board of Supervisors directed Internal Audit to reagendize the FY14-15 Audit Plan for the next AOC meeting on September 10, 2014. Accordingly, we present our revised FY 14-15 Audit Plan to the Audit Oversight Committee for further review and discussion. See AOC Agenda Item #10 for a description of the revisions made, which are also highlighted in yellow in this document (pgs. 5-9).

In accordance with the Board's adopted Internal Audit Department Charter, "*The Internal Audit Department reserves resources to accommodate Board of Supervisors' requests. Individual Board members desiring specific audit projects shall place on the Board Agenda their proposal for review and approval by Board majority. The Director of Internal Audit reserves the right to determine how to best fit the Board directed review into the audit plan.*" Any revisions or changes to the audit plan throughout the year are made in IAD's Quarterly Status Report and presented to the AOC for approval.

We would like to acknowledge the professionalism and cooperation extended to us by the management of County agencies/departments during our Risk Assessment process. I look forward to another successful year of audit coverage and service to Orange County.

cc: <u>Audit Oversight Committee Members</u>
AOC Chairman, Mark Wille, Public Member
AOC Vice-Chairman, Shari Freidenrich, Treasurer-Tax Collector
Supervisor Shawn Nelson, Chairman of the Board
Supervisor Patricia Bates, Vice-Chair of the Board
Jan Grimes, Auditor-Controller
Michael Giancola, County Executive Officer
Philip Cheng, Performance Audit Director (Ex-Officio)
Dr. David Carlson, Private Sector Member
Sarah J. "Sally" Anderson, Private Sector Member
Gary Caporicci, Private Sector Member

Revised Audit Plan and Risk Assessment FY 2014-15

TABLE OF CONTENTS

EXECUTIVE SUMMARY

MISSION STATEMENT

The mission of the OC Internal Audit Department is to provide **reliable, independent, objective evaluations** and business and **financial advisory services** to the Board of Supervisors and County management. Our role is to assist both parties with their important business and financial decisions, as well as to contribute to protecting and safeguarding the County's resources and assets.

We support and assist the **Board of Supervisors** and **County Executive Management** in the accomplishment of their functional business goals and objectives by helping implement best business practices with regard to internal controls, accounting systems, and business processes. Our contribution to this effort is testing and reporting on their internal control systems and processes. County executive management is responsible for establishing and maintaining these control processes because they must rely on these processes in managing their organizations. These systems and processes are used for safeguarding the County's assets and resources, and for reasonable, prudent, and effective financial stewardship and for accurate recording and reporting.

PUBLIC SECTOR GOVERNANCE AND THE ROLES OF INTERNAL AUDIT
Public sector governance encompasses the policies, procedures, processes and internal controls used to direct an organization's activities to provide *reasonable assurance* that objectives are met and that operations are carried out in an ethical and accountable manner. Governance relates to the means by which goals are established and accomplished; ensures government credibility; and assures appropriate behavior of government officials by reducing the risk of public corruption. *Government auditing (both external and internal) is a cornerstone of good public sector governance by providing unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results.* Government auditing supports the governance roles of <u>oversight</u>, <u>insight</u>, and <u>foresight</u>.

► **Oversight.** Auditors provide oversight of County management by evaluating whether department/agencies are doing what they are supposed to do, spending funds for intended purposes, and complying with laws and regulations.

► **Insight.** Auditors provide insight to assist County management by assessing which programs, policies and internal controls are working and which are not; sharing best practices and benchmarking information; and looking across department/agencies to find opportunities to borrow, adapt, or re-engineer management practices.

► **Foresight.** Auditors help County management look forward by identifying trends and bringing attention to emerging challenges before they become crises. These issues often represent long-term risks that may far exceed the terms of office for most elected officials, and can sometimes receive low priority for attention where scarce resources drive more short-term focus on urgent concerns.

The OC Internal Audit Department is committed to serving the Board and County management in helping ensure effective public sector governance.

IAD'S EXPERTISE IN FINANCIAL/BUSINESS PROCESSES AND CONTROLS

The OC Internal Audit Department (IAD) is recognized for our financial expertise and knowledge in business cycle internal controls and processes. We apply this expertise in assisting County executive management in enhancing their business processes and constantly improving and strengthening the internal control environment the public expects, relies upon, and demands of its government. We are committed to a process of continuous learning and improvement, and we keep ourselves updated on relevant issues in business and industry with regard to accounting trends and developing financial best practices.

To meet our clients' expectations for integrity, objectivity, and independence and to function effectively with consistent reliability and credibility, the IAD applies professional auditing standards to all engagements. This allows us to ensure audits of County operations are always informative, accurate, and objective. Where required, the IAD follows the ethical and professional standards promulgated by the **American Institute of Certified Public Accountants (AICPA)**, the **Institute of Internal Auditors (IIA)**, and the **Government Accountability Office (GAO)**. Moreover, the quality of IAD operations is regularly and independently assured by rigorous Peer Reviews conducted by outside CPA firms or by the California Counties Audit Chief's Committee. We have successfully passed five such peer reviews to date, with the last one conducted in April 2014.

ANNUAL RISK ASSESSMENT FOR DEVELOPMENT OF AUDIT PLAN

Each year, IAD conducts an interactive, countywide Risk Assessment that includes members of the **Board of Supervisors**, the **County Executive Office**, and **all Department/Agency executive management** regarding risks affecting their respective areas. We rank and tabulate the results to develop a "risk-based" Annual Audit Plan.

We have conducted comprehensive risk assessments for the past 15 years. This year, our risk assessment was limited to sending risk assessment surveys to the Board of Supervisors, the County Executive Office and Chief Operating Officer, and to all departments/agencies, and reviewing financial data for FY 12-13. In addition, in prior years we conducted a separate ***Information Technology Inventory and Assessment*** where we prepared an inventory of key systems based on information received from each department. Last year in collaboration with CEO/Information Technology, we had departments/agencies utilize the **Application Portfolio Management (APM)** system to provide their information. This year, we did **not** conduct a separate Information Technology Inventory and Assessment, and instead included an Information Technology question in the survey sent to all departments.

---

*We note in our Risk Assessment that **the County's control environment is an ever-changing and a dynamic environment.*** Our County continues to face challenges in the coming year with the budget situation; transitions in IT sourcing and human resource services; department reorganizations; and turnover of County executive management. All of these can impact processes, controls, morale and productivity in County operations.

ANNUAL AUDIT PLAN & KEY AUDIT CATEGORIES

We design our "risk-based" Audit Plan to address what we consider to be the highest priority areas and audits requested by departments/agencies, while limiting the scope of work to what can realistically be accomplished with the staff resources available. Our risk ratings are based on current information that fluctuates frequently given the nature, diversity, size and impact of County operations on the public, as well as the "risk appetite" of the Audit Oversight Committee.

Our Audit Plan is submitted, publicly discussed, reviewed and approved at the beginning of each fiscal year by the AOC. We are dedicated to completing our Audit Plan while continuing to be flexible and responsive to the Board of Supervisors' requests for audit services. The Audit Plan also includes some flexibility to be responsive to directives for audit services from the Board of Supervisors or AOC.   For each audit in the Audit Plan, we have listed the proposed audit objectives, dollar impact and estimated audit hours.

Our Audit Plan has as its foundation the traditional internal audits of "hard-control areas" such as segregation of duties, limiting access to cash, accurate originating accounting entries and transactions, and key reconciliations. Examples of such traditional audits in our Audit Plan include the *Financial Audits and Mandates, Internal Control Audits, Information Technology Audits, and Revenue-Generating Lease Audits*. These audit reports contain opinions regarding the status of internal controls or the County's compliance with grant or other governing provisions, and include recommendations to management regarding improvements to specific processes and internal controls in order to enhance or strengthen them. Starting in FY 2010-11, we reinstated our *Control Self Assessment & Process Improvement* facilitated workshops based on requests received from various departments/agencies. In this Audit Plan, we are modifying the workshops to focus on "*Process Improvement and Innovation*."

FY 14-15 Audit Plan Highlights
Because of recent issues identified in our audits of Special Revenue Funds in the Clerk-Recorder and District Attorney, this year, we are focusing on *Special Revenue Funds* in our Internal Control & Compliance Audits category. We have identified the County's population of Special Revenue funds and have included a sample from the top fourteen (14) funds in our FY 14-15 Audit Plan. We are also modifying our Control Self Assessment workshops to "*Process Improvement & Innovation*," which will consist of shorter workshops focused on process improvement and development of action plans.

Our **Follow-Up Audit** process ensures that our audit recommendations are implemented satisfactorily. Our **First Follow-Up Audit** begins about six months following the release of an audit report. If necessary, a **Second Follow-Up Audit** will be conducted about six months following the release of the First Follow-Up Audit report. At the request of the AOC, we are to bring to their attention any audit recommendations we find still not addressed, resolved or mitigated after the Second Follow-Up Audit.

> *Based on our Follow-Up Audits, we can state that **County management substantially implements our report recommendations on a timely basis.** We attribute this level of implementation to the reliability and usefulness of our audit findings and recommendations. We also compliment County management in partnering with us in this effort to be responsive.*

DEDICATION OF RESOURCES TO AUDIT-RELATED SERVICES

Our Audit Plan is based on **15,000 direct audit hours** to be provided by eight (8) audit professionals, a Fraud Hotline Manager and two Senior Audit Managers. Because of budget constraints, we utilize audit positions to perform administrative duties such as budgeting and human resources and adjust the Audit Plan accordingly. We also adjust the Audit Plan as needed to reserve for voluntary work furloughs and vacancies. Audit hours for the Director of Internal Audit are not included in the above total, while the time for the two Senior Audit Managers is adjusted to allow time for administrative duties.

Because of our budget and staffing constraints, we prioritize our audits to areas that are assessed a high level of risk (such as Special Revenue Funds for this year) and limit the work to what realistically can be accomplished with the staff resources available.

Audit Plan hours are allocated to the audit areas as follows:

Internal Control Audits (ICA):	3,100	20%
Financial Audits and Mandates (FAM):	3,150	21%
Revenue Generating Lease Audits (RGL):	1,900	13%
Information Technology Audits (IT):	1,900	13%
Fraud Hotline	2,000	13%
Process Improvement & Innovation (PI&I)	1,000	7%
Reserve for BOS and AOC Directives	500	3%
Other Audit Activities*:	1,450	10%
	15,000	100%

*The Audit Plan allocates an additional **1,450 hours** for Other Audit Activities such as tracking **Cash Losses**, providing **Technical Assistance to Departments** on practical internal control concepts and application, performing the **Annual Risk Assessment**, **HIPAA Administration**, coordinating with the **Performance Audit Department** on emerging audits and issues, and compiling and presenting **External Audit Activity Reports** to the Board of Supervisors and Audit Oversight Committee. In addition, this year we will conduct a **Peer Review/Quality Assessment** for San Bernardino County Audit Division as part of our agreement with the California County Audit Chiefs Association.

Included in the Audit Plan is **500 hours** reserved to respond to Board of Supervisors and/or Audit Oversight Committee requests for audit services. Our *FY 2014-15 Audit Plan* is detailed beginning on page 5.

OC INTERNAL AUDIT DEPARTMENT
FY 2014-15 AUDIT PLAN

Audit Name	Budgeted Hours	Percent of Total
INTERNAL CONTROL AUDITS (ICA) **20% OF AUDIT COVERAGE** Validate, substantiate, and confirm the <u>adequacy of critical internal controls</u> to ensure accurate, complete and timely processing of County financial transactions; ensure County <u>assets are safeguarded from loss</u>, waste, and abuse; <u>determine compliance</u> with department and County policies; evaluate process efficiency and effectiveness.		
<u>**Fiduciary and Special Revenue Funds:**</u> Audit of the largest fiduciary and special revenue funds to ensure revenues and expenditures are proper and in compliance with County and departmental procedures, laws, etc.		
1 **HCA Mental Health Svcs Fund 13Y** - $150M revenues; $91M expenditures; $197M fund balance	400	
2 **OC Flood Fund 400** - $105M revenues; $87M expenditures; $146M fund balance	400	
3 **OCCR/OC Parks Fund 405** - $74M revenues; $72M expenditures; $60M fund balance	400	
4 **OC Dana Point Harbor Fund 108** - $24M revenues; $21M expenditures; $50M fund balance	400	
5 **Auditor-Controller Fiduciary/Special Revenue Funds** - $309M in fund disbursements (**carry-over audit** from FY 13-14)	350	
6 **Social Services Agency Fiduciary/Special Revenue Funds** - $447 in fund disbursements (**carry-over audit** from FY 13-14)	200	
<u>**Purchasing and Contracts:**</u> Audits of procurement processes and systems for compliance with requirements in the County Purchasing Manual and for contract administration to ensure vendor payments are properly reviewed, authorized, valid to contract terms, and timely. Includes sole source contract administration.		
7 **OC Community Resources - Purchasing/Contract Administration** - $330M in dept. procurements. Audit of selected aspects of Human Services contracts. (**Dept Request**)	300	
8 **CEO/County Procurement Office – Cooperative Purchase Agreements** – Review of the revised Cooperative Contracting Program Usage Authority and Policy and related guidelines.	100	
9 **CEO/Public Finance – SEC Disclosures for Bond Issuances** – Audit of controls and procedures regarding SEC disclosures pertaining to County bond issuance. (**Dept Request**)	100	
<u>**Follow-Up Audits (First):**</u> 10 **OCWR La Pata Contract Administration** (1334) 11 **Probation Public Safety Realignment AB 109** (1323) 12 **OCPW Procurement and Contracts** (1225) 13 **SSA Special Revenue Funds** (1336)	300	
<u>**Follow-Up Audits (Second):**</u> 14 **OCCR Fee Generated Revenue** (1222)	100	
15 **Work Paper Close-Out & Final Report Issuance** (audits from prior year plan)	50	
Subtotal	**3,100**	**20%**

Audit Name	Budgeted Hours	Percent of Total
FINANCIAL AUDITS & MANDATES (FAM) **16% OF AUDIT COVERAGE** Determine that financial statements are fairly stated in accordance with applicable professional standards; financial statements are supported by sound internal controls; and management complied with applicable laws, regulations and grant requirements. These audits are conducted in accordance with generally accepted auditing standards of the United States and/or Governmental Auditing Standards issued by the U.S. Comptroller.		
District Attorney Grants - $6.4M: Audit the financial statements for four grants to determine that budgeted amounts, revenues and expenditures are recorded accurately, completely, and timely and review controls and test compliance with rules and regulations.		
1 **DA Grant**: **Workers Comp Fraud** - 6/30/15	200	
2 **DA Grant**: **Health & Disability Insurance Fraud** - 6/30/15	200	
3 **DA Grant**: **Auto Insurance Fraud** - 6/30/15	200	
4 **DA Grant**: **Auto Fraud Activity Interdiction** - 6/30/15	200	
5 **Treasurer-Tax Collector: Annual Investment Compliance Audit (2013) - $7.2 billion** (**carry-over audit** from FY 13-14). Audit of the Treasury's compliance with Government Code Sections and provisions of the OC Treasurer Investment Policy Statement.	100	
6 **Calculation of Reverse Pension Pickup - $7.1 million** (**carry-over audit** from FY 13-14).	50	
7 **Retiree Medical Plan – Annual Required Contribution - $36 million** (**carry-over**)	50	
8 **Treasurer-Tax Collector: Annual Investment Compliance Audit (2014) - $7.2 billion.** Audit of the Treasury's compliance with Government Code Sections and provisions of the OC Treasurer Investment Policy Statement.	750	
9 **Triennial Audit of Tax Redemption Officer - $268 million.** Audit of Tax Collector's Redemption Section to evaluate the reliability/integrity of tax redemption records and compliance with laws/regulations pursuant to Section 4108.5 of the Rev. & Tax. Code	750	
10 **Auditor-Controller Quarterly Cash and Investment Reconciliations - $7.2 billion.** Quarterly audits to provide an opinion whether the A-C complied with the requirements of California Government Code Section 26905.	200	
11 **Auditing & Accounting Standards Update:** Review of Statements on Auditing Standards regarding risk assessment and internal controls requirements.	50	
Follow-Up Audits (First): 12 **Retiree Medical Plan - ARC** (1316) 13 **Community Facilities Districts/Mello Roos** (1317) 14 **Clerk-Recorder Review of Fund 12 D - Other Accounting Issues** (1159-B) (**carry-over audit** from FY 13-14)	200	
Follow-Up Audits (Second): 15 **Clerk-Recorder Review of Fund 12 D - Purchase of Building** (1159-A) 16 **Clerk-Recorder Review of Fund 12 D - Other Accounting Issues** (1159-B)	150	
17 **Work Paper Close-Out & Final Report Issuance** (audits from prior year plan)	50	
Subtotal	**3,150**	**21%**

Audit Name	Budgeted Hours	Percent of Total

REVENUE GENERATING LEASE (RGL) AUDITS 13% OF AUDIT COVERAGE
Audit the supporting records of businesses with revenue generating leases to ensure the correct amount of rent is paid to the County based on a percentage of gross revenue, and that internal controls are adequate to ensure the integrity of records used to report gross revenues. Our audits also identify ambiguities and omissions in the contracts that may disadvantage the County. These critical audits are performed at the request of *JWA, OC Public Works, OCCR/OC Parks, and OC Dana Point Harbor* on a rotational basis. The County receives about **$149 million** annual rent, or $1.5 billion a decade, from all revenue leases. About **$98 million** of the annual rent is based on a percentage of gross revenue, with the remaining **$51 million** from "flat" rent leases, which we do not audit. Over the last **5** years, we have performed 16 audits covering 17% of the $98 million annual rent. Over the last **10** years, we have audited 77% of the $98 million annual rent. For the following leases, annual rent paid is **$7.2 million** or $72 million a decade.

1	**OCPW – Lake Forest Golf/Practice Center** (carry-over audit from FY 13-14)	50
2	**OCCR – Peacock Hill Equestrian Center** (carry-over audit from FY 13-14)	50
3	**OCCR - David L. Baker Golf Course**	250
4	**OCDPH - Pacific Asian Enterprises (PAE)**	250
5	**OCDPH - Dolphin Safari**	250
6	**OCDPH - Dana Point Yacht Club**	250
7	**OCDPH - Dana Point Marina Inn**	250
8	**JWA - Avis Rent A Car**	250
9	**JWA - Dollar Rent A Car**	250
10	<u>**Follow-Up Audits**</u> - Perform on selected recommendations as deemed warranted.	0
11	**Work Paper Close-Out & Final Report Issuance** (audits from prior year plan)	50
	Subtotal	**1,900** **13%**

INFORMATION TECHNOLOGY AUDITS (IT) 13% OF AUDIT COVERAGE
Audit of IT controls (i.e., general controls, application controls, system developments).

<u>**Computer-Assisted Audit Techniques (CAATs)**</u> is a cited as a best practice and provides critical continuous audit coverage on the entire population of selected transactions. CAATs are automated queries applied to large amounts of electronic data and the resulting output (matches) are further reviewed and validated.

1	**CAATs - Develop New Routines -** Develop on-going CAAT routines for selected financial activities to monitor for unusual activity and transactions and for compliance with process objectives and management's expectation.	300
	<u>**General Control Reviews:**</u> Audit IT general controls in the areas of security management, access controls, configuration management, segregation of duties, and continuity planning.	
2	**Sheriff-Coroner –** Houses and/or maintains key applications essential to the Sheriff's operations including Sheriff's Data System (carry-over audit from FY 13-14)	200
3	**Auditor-Controller -** Houses and/or maintains County's key financial systems including CAPS+. In addition, it now administers the IT systems for the **Treasurer-Tax Collector,** including Quantum (investment transactions, accounting, and cash management) and numerous in-house and purchased applications.	300
4	**John Wayne Airport -** Houses and/or maintains key systems over airport operations, parking, facilities, maintenance, and management.	300

Audit Name	Budgeted Hours	Percent of Total
Application Control Reviews: Review selected controls over the input, processing, and output of data/transactions. Areas to review will be focused and may include segregation of duties, reviews and approvals, key edits/validation rules, audit trails, and balancing.		
5 **OC Waste & Recycling - Paradigm A/R System** - $104M in receipts & $10M in receivables (**Dept Request by Auditor-Controller**)	250	
6 **CEO/IT - DMV Information Security Agreements** – Assist CEO/IT in validating department IT security agreements on systems authorized to process, store and transmit DMV information **(Dept. Request)**	250	
7 **CEO/IT - Iron Mountain Cooperative Agreement – Offsite Data Storage & Retrieval** (**BOS Directive; June 17, 2014**) BOS directed Internal Audit or Performance Auditor to conduct an analysis of County records stored with Iron Mountain to determine their condition, location and if maintained.	100	
Follow-Up Audits (First):	100	
8 **Auditor-Controller – Access Request Application (ARA)** (1357)		
Follow-Up Audits (Second):	50	
9 **To be determined.**		
10 **Work Paper Close-Out & Final Report Issuance** (audits from prior year plan)	50	
Subtotal	**1,900**	**13%**

PROCESS IMPROVEMENT & INNOVATION (PII) 11% OF AUDIT COVERAGE Facilitated workshops conducted by Internal Audit utilizing a balanced approach to discuss strengths, concerns and what the group can do to improve operations. The process draws upon the expertise of employees and managers and encourages a team approach to identifying issues and problem solving. IAD has facilitated over 110 Control Self-Assessment & Process Improvement workshops, from which these workshops are derived.		
Process Improvement Workshops:	1,000	
1 **HCA - Custodian of Records**		
2 **HCA - Contract Development & Management Procurement Process**		
3 **OC Public Works CSA Follow-Up Survey** (Follow-up of four workshops conducted in Oct. - Nov. 2013)		
Subtotal	**1,000**	**7%**

FRAUD HOTLINE 14% OF AUDIT COVERAGE The OC Fraud Hotline is staffed by professionals to ensure proper handling of all reports of possible waste, fraud, and abuse of County resources by employees or vendors. The monitoring is provided by an outside vendor 24 hours, 7 days a week and is staffed in-house by a Fraud Hotline Manager. In addition, we provide oversight, training, assessments, actual investigations and advisement as warranted for hundreds of complaints annually. We prepare semi-annual Hotline status reports for the AOC and BOS.		
1 **Administration & Operation of Fraud Hotline**	2,000	
Subtotal	**2,000**	**13%**

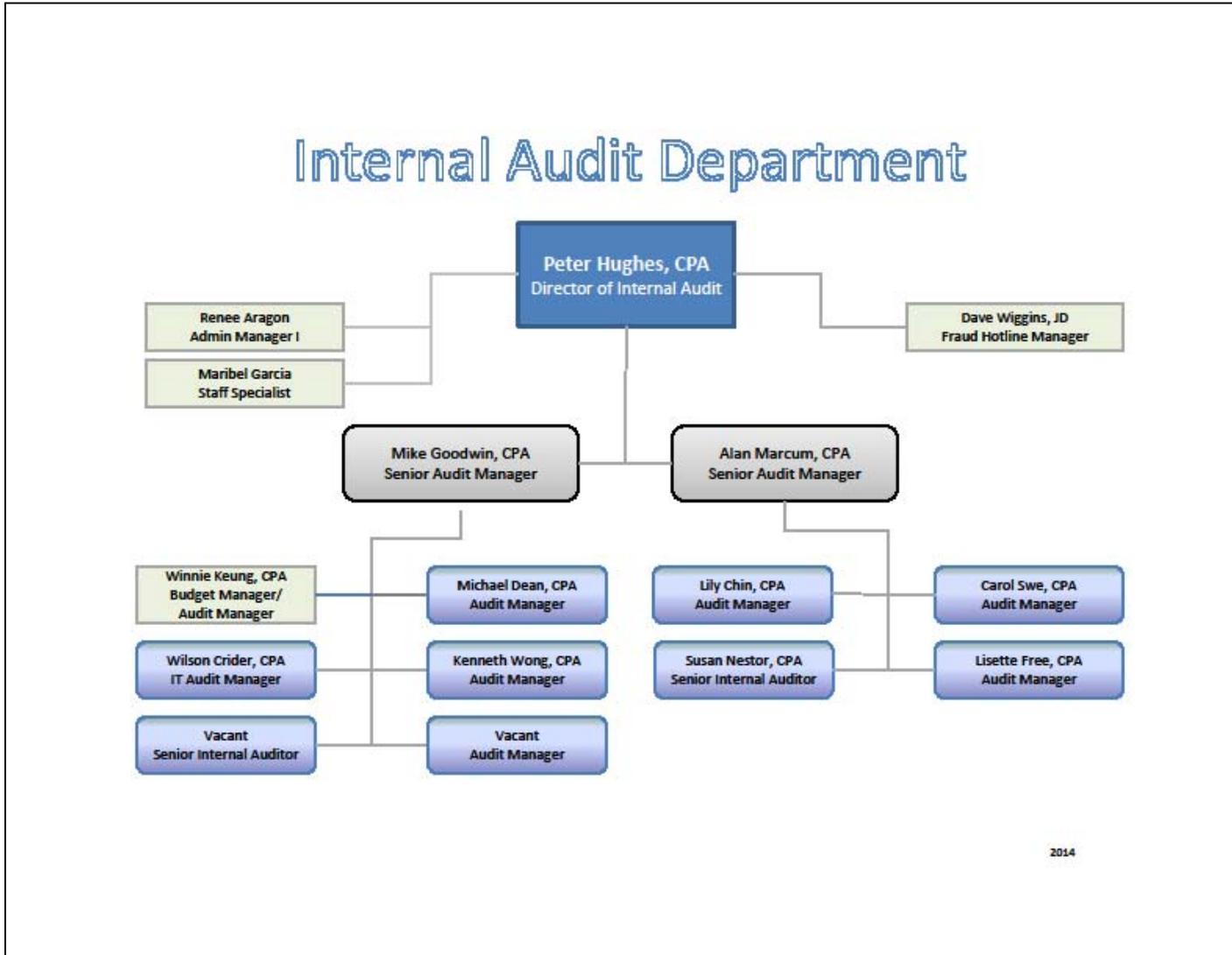| Audit Name	Budgeted Hours	Percent of Total
RESERVE FOR BOS AND AOC DIRECTIVES **3% OF AUDIT COVERAGE**		
Hours for special requests from the Board of Supervisors and Audit Oversight Committee.		
1 **Reserve for BOS and AOC Directives**	500	
Subtotal	**500**	**3%**
OTHER AUDIT ACTIVITIES **10% OF AUDIT COVERAGE**		
1 **Annual Risk Assessment - Audit Plan**	400	
We conduct a comprehensive and interactive Risk Assessment, including input from the Board of Supervisors; sending Risk Assessment Questionnaires to 21 departments and agencies; reviewing Business Plans; compiling financial information and key information systems, reviewing prior audit coverage by IAD and external auditors. This critical process determines how we allocate audit resources among competing issues and risks.		
2 **Coordination with Performance Audit Department**	100	
We communicate regularly with the Performance Auditor on emerging audits and issues and are prepared to assist or initiate our own audit in coordination when warranted.		
3 **Cash Losses**	50	
We monitor all cash losses reported to the Auditor-Controller for consideration during our annual Risk Assessment and when conducting our Internal Control Reviews.		
4 **External Audit Reporting**	200	
Internal Audit compiles and reviews a quarterly status report of "third party" external audits conducted in County departments/agencies. The County typically undergoes 100+ external audits each year. We also monitor the status of material audit findings and question costs. We consider these audits when developing our annual audit plan and our scope of work for any related audits so as to eliminate unnecessary duplication.		
5 **Technical Assistance to Other Dept/Agencies**	100	
To advise on business, accounting, and compliance issues as requested by departments. Areas under consideration this year include CEO/County Procurement Office's countywide launch of the Expediter System and CEO/IT's policies over County IT software licenses.		
6 **HIPAA Administration**	50	
IAD is designated as a covered component under HIPAA and must abide by HIPAA rules and regulations. These are hours set aside for the IAD's HIPAA Coordinator.		
7 **Reports for Board, AOC, EA Meetings**	250	
We report quarterly to the AOC. The AOC provides executive oversight and guidance to the IAD. We compile and report our progress to the AOC regarding the Audit Plan and provide Executive Summaries on audit activity. We present to the Board of Supervisors a monthly report of all audits issued each month. We also prepare an annual Audit Plan/Risk Assessment and Internal Auditor's Report to the Board of Supervisors.		
8 **Peer Review of San Bernardino County Audit Division**	300	
Conduct a Peer Review on San Bernardino County Audit Division as part of a cooperative agreement with the California County Audit Chiefs Committee (CCACC) where peer reviews are conducted by other County audit peers in exchange for receiving a "free" peer review in lieu of fees that can exceed $60,000 for a private contractor.		
Subtotal	**1,450**	**10%**
Grand Total (6)	**15,000**	**100%**

FOOTNOTES:

(1) Dollar amounts shown in this Audit Plan represent the scale and magnitude of the activity audited in order to give the reader a sense of the financial impact and significance of the area or activity audited. In those audits where we test a sample of transactions and not the entire population, we clarify this point in the scope of our final Audit Report.

(2) We reserve time in our Audit Plan for Board of Supervisors and Audit Oversight Committee directives and audit adjustments. We also identify other areas or activities for possible audit should we have available time or as substitutes.

(3) The Orange County Internal Audit Department (OCIAD) generates several different types of reports including audit reports, audit alerts, and status reports. In addition, OCIAD undertakes several different projects including audits of financial statements, audits of internal controls, audits of transactions through the use of computer programs, audits of lessee compliance with County contracts, and audits of IT controls. OCIAD receives and oversees Hotline calls up through resolution.   A total project count therefore includes all assignments completed; not just released audit reports. Each year, OCIAD prepares an *Annual Internal Audit Report* in addition to its Quarterly Status Report. The Annual Internal Audit Report is for the general public in content and tone.

(4) The annual Audit Plan is subject to change for such events where the Director of Internal Audit, Audit Oversight Committee (AOC), or Board majority assesses if it is warranted to substitute, postpone or cancel a scheduled audit due to timing, priority, resource, and other risk considerations. Such modifications will be noted in the "Milestones & Comments" section of the Quarterly Status Reports submitted to the AOC. The acceptance of the Quarterly Status Report by the AOC authorizes any changes noted.

(5) For purposes regarding Fiscal Year-End reporting, we consider audits completed (**Done**) as of the official release of a completed pre-draft or draft audit report to the Department/Agency Director, and are shown as such in our Milestones & Comments column of the AOC Quarterly Status Report.

(6) We use an industry best practice in estimating the available hours at 77% for audit staff to conduct audits by deducting all paid personal leave training and administration so as to better estimate the direct hours available to conduct field work and write audit reports. We also deduct a vacancy factor based on historical trends and actual occurrences. We reflect any material changes in our estimates as warranted in our quarterly reports.

(7) The Annual Audit Plan is based on 15,000 direct audit hours to be provided by eight (8) audit professionals, a Fraud Hotline Manager and 2 Senior Audit Managers. The direct hours exclude time charges for vacation, holidays, training, administrative time, and other time not directly charged to an audit. This approach and percentage are standard within the industry.

DEPARTMENT ORGANIZATION CHART

COUNTYWIDE RISK ASSESSMENT METHODOLOGY

A Risk-Based Approach to Determine Audit Priorities

Generally Accepted Government Auditing Standards and the Institute of *Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing* require the Chief Audit Executive to establish a risk-based approach to determine the priorities for internal audit activities. The Internal Audit Department has completed a Risk Assessment as a means to help identify, measure, and prioritize potential audits based on the level of risk to the County and for preparing the FY 2014-15 Audit Plan.

Risk Assessment Analysis for FY 2014-15

Our Risk Assessment for FY 2014-15 found that the County continues to be impacted by challenging economic times. Potential budget cuts from the recent Vehicle License Fees (VLF) ruling, elimination of positions, planned system upgrades/implementations put on hold; new rules & regulations; and turnover in key executive and management positions in several County departments/agencies (including Auditor-Controller, Clerk-Recorder, Health Care Agency, Human Resources, OC Public Works, and Public Administrator/Public Guardian). All of these can impact workloads, morale, decrease the level and timeliness of supervision, lower proficiency on new business systems, decrease continuity of operations and retention of "corporate" memory, and increase the overall learning curve of County staff and management.

> *Given these factors, we adjust our risk ratings annually and audit the fundamental business processes such as cash receipts, disbursements, purchasing and contract administration, and fee-generated revenue.*

Risk Assessment Methodology

A comprehensive, countywide Risk Assessment was conducted that solicited input from the **Board of Supervisors,** the **County Executive Office, Chief Operating Officer, Chief Financial Officer, Chief Information Officer,** and **all Department/Agency Directors** on risks affecting their respective areas. For our second year, we sent out Risk Assessment Questionnaires via **Survey Monkey** for input on risks and areas of audit interest in their business operations. We reviewed the completed survey comments and audit requests. We additionally compiled financial information for business processes in each department/agency (e.g., cash receipts, disbursements, payroll, purchasing, fiduciary funds, contracts and budgets.

Audit Universe

There are several approaches on defining an audit universe (all areas subject to risk assessment and audits). We defined the County audit universe as **21 departments/agencies.** This excludes Internal Audit, the Office of the Performance Auditor, and the Office of Independent Review, and accounts for the reorganization of the Public Administrator/Public Guardian. In March 2014, the Public Administrator was combined with the District Attorney and the Public Guardian was combined with the Health Care Agency. Our audit universe is further defined by **standard eight (8) business processes/cycles** (see table below) common to all departments and agencies, with our primary emphasis on **financial and accounting controls.** We also conduct **Revenue Generating Lease Audits** in four (4) departments. This results in an **audit universe consisting of 172 auditable business processes.**

Cash Receipts & Receivables – Includes the receipting, recording, transferring, depositing, safeguarding, and reconciling of monies and fees received in depts./agencies. Cash receipts have a high inherent risk of misuse.	**Cash Disbursements & Payables –** Includes verifying receipt of goods/services, adequacy of supervisory reviews and approvals, timeliness of invoice processing, completeness and accuracy of payments, proper reconciliations and safeguarding of assets.
Fee-Generated Revenue - Includes audits of department/agency fee studies and fee development processes, methodologies, and assumptions used for establishing cost-recovery fees charged to the public for "Licenses, Permits and Franchises," and "Charges for Services," and are submitted to the Board of Supervisors for approval.	**Purchasing and Contracts –** Includes use of County-issued purchasing cards; vendor payment review/approval process; ensuring terms of contracts were met prior to issuing payments; reviewing justification of Sole Source contracts; and monitoring CEO/Procurement's oversight responsibilities.
Revolving Funds – Includes validating compliance with County Accounting Procedures, ensuring revolving fund disbursements are proper, approved, monitored, and safeguarded.	**Payroll –** Includes timekeeping practices in depts./agencies that use either the VTI time reporting system or in-house developed payroll system (i.e Sheriff); premium and overtime pay practices; payroll unit supervision and payroll reports, Central Payroll's role in processing payroll; and monitoring for unauthorized payroll changes.
Fiduciary Funds – includes validating the purpose/objectives of fiduciary/special use funds; ensuring sources and uses of the funds are in accordance with stated use; reconciliations are prepared timely/completely to safeguard funds.	**Revenue Generated Lease Audits –** Audit the records of businesses with revenue generating leases to ensure the correct amount of rent is paid to the County based on a percentage of gross revenue, and that internal controls are adequate to ensure the integrity of records used to report gross revenues.
Information Technology Systems & Controls – Audit of IT controls including general controls, application controls, and system developments. Include use of Computer Assisted Audit Techniques (CAATs) that is cited as a best practice and provides continuous audit coverage applied to large populations of data and the resulting output is further verified and validated.	

Our *Risk Assessment Schedule* shown on page A-1 shows the **172 auditable business processes** and assigned risk ratings. We consider the following factors in assigning risk levels:

- **Department/Agency Changes**: Assessed factors such as management and/or organizational changes, significant increases/decreases in staffing and workloads, new/eliminated programs, and significant changes in laws/regulations.
- **Operating Environment**: Assessed factors related to the department's operating environment such as public image, laws/regulations, safety and environmental issues, sensitivity to economic factors, pending litigation, and business continuity.
- **Last Audit Performed**: Identified all Internal Control Audits and Financial/Mandated Audits conducted in the last 10 years, and assessed risk higher in areas with old or no prior audits.
- **Financial Activity/Volume**: We compiled and assessed financial information (dollar volume, number and nature of transactions) for each process in departments/agencies.

Results of Risk Assessment
Using the above criteria, an overall risk and audit priority level is then assigned as **High Risk**, **Moderate Risk**, or **Low Risk**. The overall risk levels we assign determine our where we focus our audit resources and audit priorities.

Of the 172 auditable business processes we identify in our *Risk Assessment Schedule:*
21 (12%) are High Risk, 106 (62%) are Moderate Risk, and **45 (26%) are Low Risk.**

Risk Assessment Analysis and Trends

The departments/agencies with a high risk score merely indicates that the services or functions they are responsible for are by nature a **high priority activity** because of such factors as having a large amount of expenditures and revenues, having a high level of liquid assets such as cash, management's assessment of the control environment, or a high degree of public interest. A risk score indicates that if something were to go wrong, it could have a greater impact. A high risk score does <u>not</u> mean that a business process is being managed ineffectively or that internal controls are not adequate. As such:

1. We are committed to prioritizing and auditing business activities or processes identified as "high risk" within the current year. Our approach is to provide coverage of the most critical or sensitive aspect of the activity identified. We do make exceptions to this in regards to any audits that are "carry-overs" from the prior year, where there has been recent audit coverage, or if our professional judgment determines otherwise.

2. Any audit requests made by the Board of Supervisors, Audit Oversight Committee or Department/Agency Directors become a "high priority" area to audit.

3. Our commitment is to perform focused audits that address the most critical areas of operations to provide a quick turnaround time to the auditee. We are striving to minimize the disruption to auditee operations through this approach.

4. Except in instances like the District Attorney grants, we do not audit areas unless the risk assessment identifies them as high priority. The passage of time is not a key factor in allocating audit resources. Our risk-based assessment is driven by numerous risk factors and is the reason we do not have a firm cycle of audits.

Based on our FY 14-15 Survey Monkey Risk Assessment Questionnaire, the following trends were reported by departments/agencies and the percent of responses:

1. **Significant Reorganization** (in management, duties, positions, functions)	**73%**
2. **Budget/Staff Reductions** (in accounting, budgeting, compliance operations)	**13%**
3. **Risk of Exposure to Loss, Regulatory Sanctions, and Penalties**	**53%**
4. **Risk of Exposure to Loss, Embarrassment** (by level of public visibility)	**73%**
5. **Significant Changes to Key IT Systems, Applications**	**53%**
6. **Reported Fraud, Losses, Misappropriations in Depts./Agencies**	**13%**
7. **Areas of Audit Interest** (requested by Depts./Agencies)	**7%**

We have a history of fifteen years of audit reports and audit findings and have concluded that the departments and agencies have dedicated and control conscious managers overseeing their main business processes. In the audit reports issued, we noted that less than 10% of the findings are "Significant Issues" and less than 1% of the findings are "Material or Critical." The Internal Audit Department's historical basis for assessing the competence of management found that the overall County control environment is positive and effective and helps offsets the inherent internal control risks associated with many of the County's business processes. In our opinion, we can assert that County Management has demonstrated an increasing awareness of internal controls and our audit results have verified this achievement.

SEE ATTACHMENT - RISK ASSESSMENT SCHEDULE A-1

Risk Assessment Schedule for Fiscal Year 2014-15

This Risk Assessment schedule provides a summary of risk ratings (High, Moderate, Low) based on the results of our FY 14/15 risk assesment, primarily for audits of Internal Controls, Information Technology and Financial/Mandates. The schedule also shows the planned audits for FY 14-15. Because staffing resources are limited, we use this risk-based approach for purposes of audit planning and allocating staffing resources.

BUSINESS PROCESSES:	1. Assessor	2. Auditor-Controller	3. Child Support Services	4. Clerk of the Board	5. Clerk-Recorder	6. County Counsel	7. County Executive Office	8. District Attorney	9. Health Care Agency	10. Human Resources	11. John Wayne Airport	12. OC Community Resources	13. OC Dana Point Harbor	14. OC Public Works	15. OC Waste & Recycling	16. Probation	17. Public Defender	18. Registrar of Voters	19. Sheriff-Coroner	20. Social Services Agency	21. Treasurer-Tax Collector
1 CASH RECEIPTS & ACCOUNTS RECEIVABLE ($13.3 Billion in FY 12-13)	L	M	L	L	M	L	M	H (5)	M	M	M	M	L	M	H (16)	M	L	L	M	M	H (18, 20)
2 CASH DISBURSEMENTS & PAYABLES ($5.5 Billion in FY 12-13)	L	M	L	L	M	L	M	H (5)	M	M	M	M	L	M	L	M	L	L	M	M	H (18, 20)
3 FEE GENERATED REVENUE ($665 Million in FY 12-13)	M	M	L	L	M	L	M	M	M	M	M	M	M	M	M	M	M	L	M	M	M
4 PURCHASING & CONTRACTS ($3.5 Billion in FY 12-13)	L	M	M	L	M	L	H (4.A, B, C)	M	H (6)	M	L	H (10)	L	M	M	M	M	L	M	M	M
5 REVOLVING FUNDS ($5.7 Million in FY 12-13)	M	L	L	L	M	L	M	M	M	L	M	M	L	M	M	M	M	L	M	M	L
6 PAYROLL ($1.9 Billion in FY 12-13)	M	M	M	L	L	L	M	M	M	L	M	M	L	M	M	M	M	L	M	M	M
7 FIDUCIARY & SPECIAL REVENUE FUNDS ($1.2 Billion in FY 12-13)	M	H (1,2)	M	L	M	L	M	M	H (7)	M	L	H (11)	H (13)	H (15)	L	M	L	L	M	H (17)	H (18)
8 INFORMATION TECHNOLOGY SYSTEMS & CONTROLS (918 key IT Systems identified)	M	H (3)	M	M	M	L	M	M	M	M	H (8)	M	M	M	H (16)	M	M	M	M	M	H (19)
9 REVENUE GENERATING LEASE AUDITS ($146 Million in annual rent)		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	H (9)	H (12)	H (14)	M	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Legend:
- **High-priority audit areas** (as determined by risk assessment and/or dept/agency request)
- **Moderate-priority audit areas** (as determined by risk assessment)
- **Low-priority audit areas** (as determined by risk assessment)
- **2014-15 Planned Audits** (includes all High priority audit areas and dept/agency requests)

Comments:

CASH RECEIPTS & ACCOUNTS RECEIVABLE — Reflects all cash receipt transactions posted to "8010" (Cash Account) by the dept/agency that processed the transaction. Accts. Recevables reported as year-end balances.

CASH DISBURSEMENTS & PAYABLES — Reflects all cash disbursements including automatic (A/P) disbursements, manual disbursements, and EFT/Wire transfers.

FEE GENERATED REVENUE — Relects revenue from cost-recovery fees (Licenses, Permits, Franchises and Charges for Services) that are charged to the public and require BOS.

PURCHASING & CONTRACTS — Reflects all purchases and contracts processed by depts/agencies including purchase orders, price agreements, negotiated contracts.

REVOLVING FUNDS — Reflects the total revolving fund replenishments to all depts/agencies.

PAYROLL — Reflects total payroll for our audit population of the 21 depts/agencies.

FIDUCIARY & SPECIAL REVENUE FUNDS — Reflects amounts disbursed from Agency/Department Funds, Private Purpose trust funds designated for restricted purposes and use.

INFORMATION TECHNOLOGY SYSTEMS & CONTROLS — The County has 11 Higher Risk systems; 229 Moderate Risk systems, and 678 Lower Risk systems.

REVENUE GENERATING LEASE AUDITS — Lease audits are performed at the request of **John Wayne Airport, OC Community Resources, OC Dana Point Harbor and OC Public Works**. Others are N/A.

PLANNED AUDITS ON FY 2014-15 PLAN:

(1) Fiduciary & Special Revenue Funds;
(2) AC Quarterly Reconciliation;
(3) IT General Controls (includes T-TC IT)
(4.A) CEO/Public Finance - SEC Disclosures;
(4.B) DMV Information Security Agreements;
(4.C) Iron Mountain Off-Site Storage
(5) DA Grants
(6) Process Improvement Workshops;
(7) Spec Revenue Fund 13Y Med Hlth Svcs
(8) IT General Controls;
(9) Revenue Generating Lease Audits
(10) OCCR Contract Administration;
(11) Spec Revenue Fund 405 OC Parks;
(12) Revenue Generating Lease Audit
(13) Special Revenue Harbor Fund 108;
(14) Revenue Generating Lease Audits
(15) Special Revenue Fund 400 - OC Flood
(16) Paradigm Acct. Rec. System
(17) Fiduciary/Special Revenue Funds
(18) Annual Investment Compliance Audit;
(19) General Computer Controls;
(20) Tax Redemption Officer

Risk Assessment Approach:
Risk ratings were based on meetings with BOS, reviews of Business Plans and department/agency survey information using the following factors:

- Department/Agency Changes
- Operating Environment
- Prior Internal & External Audits
- Financial Volume and Activity
- Department Audit Requests

All these factors form our basis for judging both the likelihood and impact of internal control weaknesses for each respective activity.

Total Depts./Agencies (excl IAD, Perf. Audit)		21
Total Auditable Business Processes:		172
Low Priority Processes:	45	26%
Moderate Priority Processes:	105	61%
High Priority Processes:	22	13%

ORANGE COUNTY BOARD OF SUPERVISORS' Internal Audit Department