COUNTY OF MONTEREY
OFFICE OF THE AUDITOR-CONTROLLER
INTERNAL AUDIT DIVISION
POLICY AND OPERATIONS MANUAL

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Introduction

Internal audits are a key element in the achievement of effective governance and oversight. They enhance the public trust by providing independent, objective, analysis, advice and insight needed to make informed decisions necessary to effectively and efficiently administer Monterey County's (County) resources. The oversight support provided by internal audits delivers much needed assistance to the County's Board of Supervisors, and department heads, in their efforts to combat the dynamic and complex challenges of today.

The Internal Audit Policy and Operations Manual (IAPOM) has been prepared to reflect the roles and responsibilities of the Auditor-Controller's Internal Audit Division (IAD). In accordance with California Government Code, section 1236,[1] this IAPOM has been prepared in line with the standards and guidelines promulgated by The Institute of Internal Auditor's (IIA) International Professional Practice of Internal Auditing *(Standards)* also referred to as the International Professional Practices Framework (IPPF),[2] and Generally Accepted Government Auditing Standards (GAGAS) issued by the U.S Government Accountability Offices' (GAO) Comptroller General of the United States.[3]

Overall the IPPF and GAGAS standards are comparable, however there are differences. In cases where one standard requires more detailed or stringent criteria, that standard will be followed. The IIA has issued supplemental guidance on how to converge the two standards.[4] [5] The supplemental guidance contains comparative matrices that align/compare the IPPF to GAGAS. It also includes specific recommendations in areas the two standards diverge. This IAPOM incorporates both standards based on recommendations made in the supplemental guidance. References to both standards as well as state and local law are made throughout this IAPOM.

Other authoritative guidance, such as the American Institute of Certified Public Accountants' (AICPA) Auditing Standards Board, Generally Accepted Auditing Standards (GAAS), and the International Standards on Auditing (ISA) set by the International Auditing and Assurance Standards Board (IAASB) under the authority of the International Federation of Accountants (IFAC), will also be considered when applicable.

The purpose of this IAPOM is to provide structure and accountability to the County's internal audit activity and to ensure the County is properly supported by the IAD. The *Standards* presented in this IAPOM provide a framework for performing independent,

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[1] Government Code Title 1, Division 4, Chapter 1, Article 8, Section 1236

[2] Refer to Exhibit I – International Standards for the Professional Practice of Internal Auditing 2016 Revision, Effective January 2017

[3] Refer to Exhibit II – Government Audit Standards 2011 Revision, Effective December 2011.

[4] Refer to Exhibit III – Supplemental Guidance IIA International Standards/Government Audit Standards - A Comparison, 2nd Ed. December 2011

[5] Refer to Exhibit IV – IIA's American Center for Government Auditing: Meeting the Expectations of the IPPF and the GAGAS, Copyright © 2017

high-quality, internal audit work by competent, objective, auditors whose professional and ethical responsibility is to adhere to the *Standards* and maintain a high degree of integrity.

For the proper conduct of internal audits and to ensure adherence to IIA *Standards* and GAGAS, internal audit staff should understand the policies and procedures outlined in this manual. It delineates those standards which govern the internal audit function and provides a clear understanding of how internal auditors should proceed with the conduct of their assignments. At the same time, internal auditors are encouraged to develop innovative audit approaches and use their knowledge and experience to identify new audit initiatives.

This IAPOM will be continuously reviewed, updated and enhanced to ensure compliance with the IPPF, GAGAS, state and local laws and regulations, and County policies and procedures as warranted.

Executive Summary

1. Monterey County's Internal Audit Division (IAD) falls under the Office of the Auditor-Controller (ACO) and is responsible for the County's internal audit function. The IAD's mission is to help the County's Board of Supervisors (Board) and department heads achieve their stated initiatives and goals by providing effective audit and consulting services designed to provide objective assurance, advice, and insight. The IAD aims to be effective in its mission and whole-heartedly adopts the core principles of IIA *Standards* and GAGAS as follows:

IPPF[6]	GAGAS[7]
The IIA *Standards* core principles include: a) demonstrating integrity; b) demonstrating competence and due professional care;[8] c) being objective and free from undue influence (independent);[9] d) aligning with the strategies, objectives, and risks of the organization; e) being appropriately positioned and adequately resourced; f) demonstrating quality and continuous improvement; g) communicating effectively; h) providing risk-based assurance; i) being insightful, proactive, and future-focused; and j) promoting organizational improvement.	GAGAS ethical principles include: a) the public Interest; b) integrity; c) objectivity; d) proper use of government information, resources, and positions; and e) professional behavior.

2. The objectives of internal audit are to:

    a) evaluate control systems;

    b) ensure compliance to rules, procedures, and regulations;

    c) evaluate organizational efficiency and effectiveness;[10]

    d) assess accuracy and reliability of reporting processes;

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[6] IIA International Professional Practices Framework, *Standards* and Code of Ethics 2017
[7] GAGAS, paragraph 1.14 – Foundation and Ethical Principles
[8] Government Code Title 1, Division 4, Chapter 1, Article 8, Section 1236(a)(2)
[9] Government Code Title 1, Division 4, Chapter 1, Article 8, Section 1236(a)(1)
[10] Government Code Title 1, Division 4, Chapter 1, Article 8, Section 1236(a)(3)

e) evaluate effectiveness of accountability framework, and the extent of adherence to ethical standards; and

f) recommend courses of action that add value to the organization.

3. Establishing the County's rules, procedures, control systems, and risk and fraud mitigating measures, is management's primary responsibility. The IAD, by their roles, responsibilities and position within the organization, are expected to contribute positively towards improving governance, risk assessment and internal controls within the County. These expectations require the IAD to develop a risk-based audit plan which may contain stand alone or integrated financial, operational, performance, compliance, or special purpose audits and special projects.

4. Fraud, waste, and abuse prevention is not the responsibility of internal audit however the detection of fraud, waste, and abuse indicators is. The IAD is expected to investigate and report any serious acts of omission or commission that come to our attention. Fraud, waste, and abuse risk factors will be considered on all engagements conducted at the County and appropriately evaluated to determine if conditions exist for the potential of fraud, waste, or abuse, or evidence reveals that actual fraud, waste, or abuse occurred.

5. It is essential that the IAD continuously assesses and reviews its priorities, threats and challenges, and adopts appropriate practices and systems. The IAD must equip itself with adequate and competent resources, the latest tools, techniques and methods, and must set proper policies, procedures, and rules to facilitate the performance of quality audits.

Internal Audit

The Institute of Internal Auditors (IIA) defines internal audit as follows:

"Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Assurance Services

Assurance services comprise of an independent, objective assessment of evidence for the purpose of providing opinions or conclusions regarding an entity, operation, function, process, system, or other subject matter. The nature and scope of an assurance engagement are determined by the internal auditor based on analysis of risk to the achievement of objectives. Generally, three parties are participants in assurance services: 1) the person or group directly involved with the entity, operation, function, process, system, or other subject matter - the process owner, 2) the person or group making the assessment - the internal auditor, and 3) the person or group using the assessment - the user.

Consulting/Non-Audit Services

Consulting services are generally performed at the specific request of an engagement client. The definition of Internal Audit describes consulting as one of two major types of audit services. The IIA refers to consulting as "advisory, or client servicing," in nature. Consulting services generally involve two parties: 1) the person or group offering the advice - the internal auditor, and 2) the person or group seeking and receiving the advice - the engagement client. The scope and objectives of consulting engagements are usually subject to agreement with the client. Internal auditors are expected to maintain their objectivity and not assume management responsibility when performing consulting engagements. In doing so the IIA does not regard independence to be impaired for related client's assurance engagements.

By comparison, GAGAS do not use the term consulting. Such services are referred to as "non-audit services" and defined as "professional services other than audits or attestation engagements. When performing non-audit services for an entity for which the audit organization performs a GAGAS audit, audit organizations should communicate with requestors and those charged with governance to clarify that the work performed does not constitute an audit conducted in accordance with GAGAS."[11] Internal auditors must also evaluate whether providing such non-audit service may create threats to the auditor's independence."[12]

As it relates to consulting/non-audit service engagements, the key differences between IPPF and GAGAS are: 1) the IPPF uses the term consulting in the context of two major audit services internal audit organizations can provide. GAGAS does not use the term consulting. GAGAS describes professional services, other than audit and attestation engagements as "non-audit" services; and 2) if the auditor does not assume management responsibility as part of the consulting engagement, the IIA does not consider independence impaired when performing assurance services for clients for whom a consulting engagement was previously performed. GAGAS has more stringent requirements and guidance for evaluating threats to independence related to non-audit services provided by auditors to audited entities.[13] Due to more detailed standards, the IAD will follow GAGAS when performing consulting/non-audit service engagements.

Governance

1. Governance is the system by which organizations are directed and controlled. Monterey County's Board consist of independently elected officials who are responsible for the governance of the County. The responsibilities of the Board include setting the County's strategic initiatives, providing leadership that will affect the implementation of processes designed to achieve those initiatives, and supervising senior management in their efforts to execute processes and controls in the achievement of initiatives. The Board's actions are subject to laws and

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[11] GAGAS, paragraph 2.12 – Non-audit Services Proved by Audit Organizations
[12] GAGAS, paragraph 3.33 – Provision of Non-Audit Services to Audited Entities
[13] GAGAS, paragraphs 3.33 – 3.58

regulations and it is their duty to oversee the County's affairs for the exclusive interest of the County and its citizens, within that framework.

2. "The concept of accountability for use of public resources and government authority is key to our nation's governing processes. Management and officials entrusted with public resources are responsible for carrying out public functions and providing service to the public effectively, efficiently, economically, ethically, and equitably within the context of the statutory boundaries of the specific government program."[14] As reflected in applicable laws, regulations, agreements, and standards, management and officials of government programs are responsible for providing reliable, useful, and timely information for transparency and accountability of these programs and their operations. "Legislators, oversight bodies, those charged with governance, and the public need to know whether:

   a) management and officials manage government resources and use their authority properly and in compliance with laws and regulations;

   b) government programs are achieving their objectives and desired outcomes; and

   c) government services are provided effectively, efficiently, economically, ethically, and equitably."[15]

3. The IAD "must assess and make appropriate recommendations to improve the organization's governance processes for:

   a) making strategic and operational decisions;

   b) overseeing risk management and control;

   c) promoting appropriate ethics and values within the organization;

   d) ensuring effective organizational performance management and accountability;

   e) communicating risk and control information to appropriate areas of the organization; and

   f) coordinating the activities of, and communicating information among, the board, external and internal auditors, other assurance providers, and management."[16]

4. The IAD "must evaluate the design, implementation, and effectiveness of the organization's ethics-related objectives, programs and activities."[17] The IAD must also

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[14] GAGAS, paragraph 1.01 - Introduction
[15] GAGAS, paragraph 1.02 - Introduction
[16] IPPF Standard # 2110 - Governance
[17] IPPF Standard # 2110.A1 - Governance

"assess whether the information technology governance of the organization supports the organizations strategies and objectives."[18]

Risk Management

1. The uncertainty of recent economic times has had a major effect on how organizations operate. The days of successfully operating using forecasts and projections are long past. Successful and forward looking organizations focus their attention on "managing risk." Risk management is important because without it objectives cannot be defined. If objectives are defined without taking risks into consideration, it is highly probable that the stated course of action will lose its direction.

2. Risk is the main cause of uncertainty in any organization. Thus, it is imperative for the County to increase its focus on identifying risks and managing them before they affect County operations. The ability to manage risk will help the County act more confidently on future decisions and provide options on how to deal with potential problems.

3. Risk can come from internal and external sources. External risks are those that are not in direct control of senior management. They include political and social risk, cyber security risk, interest rate risk, risk from natural disasters and so on. Management can control internal risk by establishing appropriate controls. Internal risks, include financial, operational, and compliance risk, and misappropriation of assets, among others.

4. Risk management is a necessary and essential activity in all organizations. To effectively identify and manage risk, it is imperative that the County develop and maintain a comprehensive county-wide risk assessment. The risk assessment should be a dynamic document flexible to changing business conditions and emerging risks. Whether, or not, a risk assessment is developed by management, the IAD must gain an understanding of key risks to the organization. The IAD's "plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the Board must be considered in this process."[19] Refer also to "risk assessment" discussion at paragraph 7b of the "Internal Control" section of this manual.

5. "The IAD must evaluate the effectiveness and contribute to the improvement of risk management processes."[20] It "must evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the:

   a) achievement of the organization's strategic objectives;

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[18] IPPF Standard # 2110.A2 - Governance
[19] IPPF Standard #2010.A1 - Planning
[20] IPPF Standard #2120 – Risk Management

    b) reliability and integrity of financial and operational information;

    c) effectiveness and efficiency of operations and programs;

    d) safeguarding of assets; and

    e) compliance with laws, regulations, policies, procedures, and contracts."[21]

6. "During consulting engagements, internal auditors must address risk consistent with the engagement's objectives and be alert to the existence of other significant risks."[22] This includes incorporating "knowledge of risks gained from consulting engagements into their evaluation of the organization's risk management processes."[23]

7. "When assisting management in establishing or improving risk management processes, internal auditors must refrain from assuming any management responsibility by actually managing risks."[24]

Internal Control

1. Internal control is broadly defined as "a process effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

    a) effectiveness and efficiency of operations;

    b) reliability of financial and operational reporting; and

    c) compliance with applicable laws and regulations.[25]

2. Effectiveness and efficiency of operations addresses the County's basic organizational objectives, including performance and safeguarding of resources. The IAD "must assist senior management in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement."[26] Reliability of financial and operational reporting relates to the preparation of relevant, dependable, and timely financial and operational information. Whereas compliance with application laws and regulations deals with those laws and regulations to which the County is subject.

3. The IAD "must evaluate the adequacy and effectiveness of controls in responding to risks within the organization's governance, operations, and information systems regarding the:

    a) achievement of the organization's strategic objectives;

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[21] IPPF Standard #2120.A1 – Risk Management
[22] IPPF Standard #2120.C1 – Risk Management
[23] IPPF Standard #2120.C2 – Risk Management
[24] IPPF Standard #2120.C3 – Risk Management
[25] GAGAS paragraph, 2.11b – Standards for Use and Application of GAGAS
[26] IPPF Standard #2130 – Control

b) reliability and integrity of financial and operational information;

c) effectiveness and efficiency of operations and programs;

d) safeguarding of assets; and

e) compliance with laws, regulations, policies, procedures, and contracts."[27]

4. "Internal auditors must incorporate knowledge of controls gained from consulting engagements into evaluation of the organization's control processes."[28]

5. While internal control is a process, its effectiveness is a state or condition of the process at one or more points in time. An internal control system, no matter how well conceived and operated, can provide only reasonable - not absolute - assurance to management regarding achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Controls can be circumvented by the collusion of two or more people, or management can simply override the system. Thus, while internal control can help an entity achieve its objectives, its limited to the extent that internal controls are carried out as intended. Another limiting factor is resource constraints. The design of an internal control system must consider the benefits of controls relative to their costs.

6. Overall internal control helps the County achieve its performance targets, and prevents loss of resources. It helps ensure reliable financial reporting and compliance with laws and regulations, avoiding damage to reputation and other consequences. In summary, internal control helps the County get to where it wants to go, and avoid pitfalls and surprises along the way.

7. Internal control consists of five interrelated components as follows:[29]

a) *Control Environment* - The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include:

   i. the integrity;

   ii. ethical values;

   iii. competence of the entity's people;

   iv. management's philosophy and operating style;

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[27] IPPF Standard #2130.A1 – Control
[28] IPPF Standard #2130.C1 – Control
[29] Committee on Sponsoring Organizations (COSO) – Internal Control Integrated Framework

    v. the way management assigns authority and responsibility, and organizes and develops its people; and

    vi. the attention and direction provided by management.

b) *Risk Assessment* - Every organization faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is the establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to the achievement of objectives, which allow for the basis of determining how risks should be managed. Because economic, social, technical, political, regulatory, and operating conditions constantly change, mechanisms are needed to identify and deal with the special risks associated with change.

c) *Control Activities* - Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to the achievement of the County's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as:

    i. approvals;

    ii. authorizations;

    iii. verifications;

    iv. reconciliations;

    v. reviews of operating performance;

    vi. security of assets; and

    vii. segregation of duties.

d) *Information and Communication* - Pertinent information must be identified, captured and communicated in a form and timeframe that enables people to carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance-related information, which make it possible to run and control the organization. They deal not only with internally generated data, but also information about external events, activities, and conditions necessary for informed decision-making and external reporting. Effective communication must occur in a broader sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators, and other stakeholders.

e) *Monitoring* – is a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs over the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management.

8. The five interrelated control components are linked and create synergies, forming an integrated system that reacts dynamically to changing conditions. The internal control system is intertwined with the entity's operating activities. Internal control is most effective when controls are built into the entity's infrastructure and are a part of the essence of the organization. "Built in" controls support quality and empowerment initiatives, avoid unnecessary costs, and enable quick response to changing conditions.

9. The internal control definition - with its underlying fundamental concepts of a process, effected by people providing reasonable assurance - together with the categorization of risks and objectives and the interrelated control components, constitute the internal control framework.

Purpose, Roles, and Responsibilities of the Internal Audit Activity

The purpose of IAD is to assist the Board and department heads achieve their stated initiatives and goals by providing an independent, objective assurance and consulting activity designed to add value and improve the County's operations. The IAD "must be independent and must be objective in performing their work."[30] By independently reviewing and evaluating the effectiveness of risk management, controls, and governance, the IAD provides objective analyses and constructive recommendations for improvement. Management retains full control over how to implement improvement recommendations.

Independence

1. Independence is a central tenet in the audit profession. "Independence is the freedom from situations that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the Chief Audit Executive (CAE) and Internal Audit Divisions' (IAD) Chief Deputy should have direct and unrestricted access to senior management and the Board. This can be achieved through a functional reporting relationship with the Board, or designee.

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[30] IPPF Standard #1100 – Independence and Objectivity

Threats to independence must be managed at the individual auditor, engagement, functional, and organizational levels."[31]

2. Internal auditors should be independent from the audited entity during the time that falls within the period covered by the subject matter of the audit and the period of the professional engagement. This period starts when the auditors either sign an initial engagement letter or other agreement to perform an audit or begin to perform an audit, whichever is earlier, and ends with the formal or informal notification, either by the auditors or the audited entity, of the termination of the professional relationship or by the issuance of a report, whichever is later.[32]

3. Internal audit members must maintain "independence of mind"[33] and "independence in appearance."[34] Internal auditors are required to identify threats to independence, evaluate the significance of the threats[35] identified, both individually and in the aggregate, and apply safeguards[36] as necessary to eliminate the threats or reduce them to an acceptable level. The IAD will conduct "Self-Reviews" with all auditors conducting assurance services who have previously performed non-audit services. Threats to independence will be managed at the individual auditor, engagement, functional, and organizational levels.

4. The CAE, and IAD Chief Deputy, who operates under the Officer of the Auditor-Controller and is responsible for directing the County's internal audit function, must maintain organizational independence, "which requires reporting to a level within the organization that allows the IAD to fulfill its activities"[37] and "to be free from interference in determining the scope of internal auditing, performing work, and communicating results."[38] This is achieved by requiring the CAE and IAD Chief Deputy report functionally to the Board of Supervisors and Budget Committee in compliance with IPPF *Standard* 1111 – Direct Interaction with the Board.

5. Functional reporting to the Board and Budget Committee should not be construed to mean the Board and Budget Committee direct the day-to-day operations of the IAD. Functional reporting should be interpreted to mean required periodic reporting of the risk-based internal audit plan, audit and special project results, status of corrective actions, internal audit performance, resource needs and constraints, and conformance to the Code of Ethics, IPPF *Standards* and GAGAS. Functional reporting should not be construed to mean directing the operations of the IAD. IAD operations will be directed by the CAE and IAD Chief Deputy and driven by assessed risks determined in collaboration with, and approved by, the Board, Budget Committee and

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[31] IPPF Standard #1100 – Independence and Objectivity (Implementation Guide)
[32] GAGAS, paragraph 3.05b. – Independence
[33] GAGAS, paragraph 3.03a. – Independence of Mind
[34] GAGAS, paragraph 3.03b. – Independence of Appearance
[35] GAGAS, paragraph 3.14 - Threats
[36] GAGAS, paragraph 3.16 - Safeguards
[37] IPPF Standard #1110 – Organizational Independence
[38] IPPF Standard #1110.A1 – Organizational Independence

senior management. Although IAD operational engagements are determined collaboratively, the IAD is the final determiner of the scope and objectives to be included on individual engagements. Such determinations by the IAD must be documented and based on sound rational of those areas that contain the most risk and exposure to the County in alignment with the approved risk assessment.

6. The IAD's authority and responsibility is set out in the Office of the Auditor-Controller's Internal Audit Division Charter, which is reviewed and approved by the Auditor-Controller's Office and the Board.[39] To establish, maintain, and assure that Monterey County's IAD has sufficient authority to fulfill its duties, the Board will:

   a) Approve the IAD's charter;

   b) Approve the risk-based internal audit plan;

   c) Approve the IAD's budget and resource plan;

   d) Receive communications from the CAE and IAD Chief Deputy on the IAD's performance relative to its plan and other matters;

   e) Make appropriate inquiries of management and the IAD to determine whether there is inappropriate scope or resource limitations.

Objectivity

1. "Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. Threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels."[40]

2. The credibility bestowed on internal audit reports is directly related to the auditors' "objectivity in discharging their professional responsibilities. Maintaining objectivity includes a continuing assessment of relationships with audited entities and other stakeholders in the context of the auditors' responsibility to the public. The concepts of objectivity and independence are closely related. Independence impairments impact objectivity."[41]

3. It is crucial to the success of the IAD, and to ensure compliance with the *Standards,* that any duties which may risk harming internal audit staff's objectivity and independence be carefully evaluated. Activities such as training personnel, accounting duties, providing staff support in operational areas, and developing systems, procedures, and policies are the responsibilities of senior management. Internal audit staff should therefore not perform duties that are part of regular line operations. Where an audit staff member believes that a specific task entrusted to

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[39] IPPF Standard #1000 – Purpose, Authority, and Responsibility
[40] IPPF Standard #1100 – Independence and Objectivity (Implementation Guide)
[41] GAGAS, paragraph 1.19 - Objectivity

him/her falls outside the scope of normal internal audit work, he/she should seek the advice of the CAE or IAD Chief Deputy.[42]

Review and Evaluation

1. The IAD must evaluate processes for controlling operations throughout the County. That responsibility is carried out in three distinct steps:

    a) ascertaining that control design is adequate in relation to associated risk;

    b) determining, through compliance testing and other procedures, that the process is operating as intended in an effective and efficient manner; and

    c) reporting the results of audit work performed and offering recommendations for improving the controlling processes.

2. A comprehensive risk-based internal audit program will be pursued to provide senior management with evaluations on the effectiveness of internal controls over finance, accounting, operations, compliance, and administrative functions. The internal audit activity is to be conducted with the highest standards of ethics, integrity, and honest dealings in all areas and functions within the County as well as with all outside parties.

Management Responsibilities

1. "Management of the organization sets the tone for ethical behavior through the organization by maintaining an ethical culture, clearly communicating acceptable behavior and expectations to each employee, and creating an environment that reinforces and encourages ethical behavior throughout all levels of the organization. The ethical tone maintained and demonstrated by management and staff is an essential element of a positive ethical environment of the audit organization."[43]

2. Management is charged with the responsibility of controlling operations in a manner that:

    a) safeguards resources;

    b) ensures the accuracy and reliability of data, information, and reporting;

    c) ensures compliance with applicable laws and regulations;

    d) promotes efficient and effective operations; and

    e) contributes to the attainment of County objectives.

3. Internal control is an integral part of managing operations. It is the responsibility of management at all levels of the County to:

    a) identify and evaluate the exposures related to the conduct of its operations;

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[42] IPPF Standard #1100 – Independence and Objectivity
[43] GAGAS, paragraph 1.11 – Ethical Principles

b) specify and establish the policies, operating standards, procedures, systems, and other disciplines to be used to limit the risks associated with the exposures identified;

c) establish practical controlling processes that require and encourage employees to perform their tasks in a manner that achieves a positive control result; and

d) maintain the adequacy and effectiveness of the control processes that have been established.

4. To ensure an adequate and effective process for controlling operations, managers at all levels of the County have the following responsibilities:

   a) foster an environment conducive to control. Managers who demonstrate high ethical and personal standards, integrity, diligence, loyalty, and honor will create an environment that encourages adequate and effective controlling processes within his or her sphere of influence;

   b) identify exposures to loss and assess risks involved in conducting operations. Each exposure to loss or impediment to obtaining an objective, whether in the marketplace or internal, must be identified for each, function, activity, department, and/or system in the County. Each exposure must then be evaluated for its impact on the County, the probability of occurrence, and its controllability from a cost-effective basis;

   c) Establish an infrastructure of fundamentals comprised of policies, operating and performance standards, budgets, plans, systems, procedures, etc., that addresses the exposures identified and reduces them to an acceptable level of risk;

   d) Establish practical (cost effective) controlling processes that motivate, channel, and/or otherwise direct employees to perform their work in a manner that achieves a positive control result;

   e) Establish an ongoing monitoring program to determine and report on the effectiveness with which the controlling processes accomplish their intended purpose.

Management Responsibilities to the Internal Audit Activity

1. The responsibilities of management towards the IAD include:

   a) taking corrective actions to address recommendations made by the IAD, according to an agreed upon implementation time schedule;

   b) where improvement action is not deemed appropriate by management, the reasons, including any risks accepted, must be documented, and addressed in management's response to the internal audit report;

   c) actively supporting the internal audit activity as an executive tool;

d) providing internal auditors with full cooperation to ensure its responsibilities can be accomplished effectively and efficiently; and

e) informing the IAD of any matter concerning changes in the scope and operations of the County.

Internal Audit Policies[44]

Vision Statement

To be a customer oriented internal audit activity providing value-added internal audit and consulting services in accordance with The Institute of Internal Auditor's, International Professional Practice *Standards* and Code of Ethics.

Mission Statement

To help Monterey County's Board and department heads achieve their stated initiatives and goals by providing effective audit and consulting services designed to provide risk-based, objective, assurance, advice, and insight.

Operating Policy

1. Internal audit activities are to be performed in a manner that provides reasonable assurance that audit work complies with the, IIA *Standards* and Code of Ethics, GAGAS, the internal audit charter, and policies and procedures as outlined in this manual. The Board, senior management, external stakeholders, government and regulatory agencies, all rely on audit performance consistent with the *Standards* and GAGAS*.*

2. "The internal audit activity must evaluate and contribute to the improvement of the County's governance, risk management, and control processes using a systematic, disciplined, and risk-based approach. Internal audit credibility and value are enhanced when auditors are proactive and their evaluation offer new insights and consider further impact."[45] Internal auditing is primarily one of information gathering, review, analysis, evaluation, appraisal, and testing the adequacy of managerial systems and controls put in place to mitigate risks to the achievement of County objectives. Internal audit is a staff advisory function and, therefore, does not exercise authority over other persons in the County nor establish and implement policies and procedures outside of the internal audit function. The internal audit activity is free to review and appraise policies, plans, procedures, and other internal controls in any area of the County, and to report audit observations and recommendations for improvement to the Board, Budget Committee, and senior management. This review and appraisal in no way relieves other persons in the County of responsibilities assigned to them.

Organization

The CAE is responsible for maintaining a high level of professional standards and quality assurance within the IAD. Internal audit staff working within the IAD shall report directly to the CAE and IAD Chief Deputy unless otherwise directed. The CAE and the IAD Chief Deputy will report functionally to the Board, Budget Committee or body designated by the

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[44] IPPF Standard #2040 – Policies and Procedures
[45] IPPF Standard #2100 – Nature of Work

Board.[46] The IAD must be free from interference in determining the scope of internal auditing, performing work, and communicating results. The CAE and IAD Chief Deputy "must disclose such interference to the Board and Budget Committee and discuss the implications."[47]

Personnel

The department will be staffed with individuals who have the "necessary knowledge, skills, and core competencies to complete their individual responsibilities."[48] Staff may be required to pursue professional qualifications, and an appropriate mix of other professional certifications. Staff shall possess the professional attributes of independence and objectivity[49] and exhibit the ability to create and maintain interpersonal relationships. They shall be inquisitive, self-motivated, and have a desire to develop their ability to identify opportunities for improvement and convincingly present recommendations through written reports, oral presentations, and personal discussions. Internal audit staff "must have an impartial, unbiased attitude and avoid any conflict of interest."[50] The length of time each internal auditor spends in auditing depends on several factors, including work experience, the individual's rate of development, the need for continuity in staffing, and the desires of the individual auditors. Persons having special talents or expertise may on occasion be obtained on a loan basis from other functions within the organization to assist on a project basis.

Internal Audit Charter

1. The Internal Audit Charter provides a framework for the conduct of internal auditing and is approved and signed by the Board. The Charter:[51]

    a) defines the purpose, authority, and responsibility of the internal audit activity consistent with the IIA Definition of Internal Auditing, the Code of Ethics, and the *Standards*;

    b) establishes the internal audit activity's position within the organization;

    c) defines the nature of assurance services provided to internal and external parties[52] including consulting services;[53]

    d) authorizes access to records, personnel, and physical properties relevant to the performance of assignments; and

    e) defines the scope of internal audit activities.

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[46] IPPF Standard #1111 – Direct Interaction with the Board
[47] IPPF Standard #1110.A1 – Independence and Objectivity
[48] IPPF Standard #1210 – Proficiency
[49] IPPF Standard #1100 – Independence and Objectivity
[50] IPPF Standard #1120 – Individual Objectivity
[51] IPPF Standard #1010 – Recognizing Mandatory Guidance in the Internal Audit Charter
[52] IPPF Standard #1000.A1 – Purpose, Authority, and Responsibility
[53] IPPF Standard #1000.C1 – Purpose, Authority, and Responsibility

2. The CAE and IAD Chief Deputy will periodically review and update the Internal Audit Charter. Any changes will be presented to the Board and Budget Committee, for review and approval. Upon approval, the Internal Audit Charter will be circulated to the County's department heads and posted on the Auditor-Controller's website.

Audit Objective

1. The objective of internal auditing is to independently and objectively examine and evaluate whether the design of the County's, risk management, internal control, and governance processes are adequate and functioning properly, providing pertinent comments concerning the activities audited and recommending appropriate remedial actions.

2. During examinations, the IAD shall:

   a) review the application and effectiveness of risk management procedures and risk assessment methodologies of various programs and activities of the County;

   b) review and appraise the adequacy, soundness, and application of financial, management reporting, and other operating controls and make recommendations for improved practices and techniques where appropriate;

   c) determine that policies and procedures are being interpreted properly and carried out as established, are adequate and effective, and make recommendations for revision where changes in operating conditions have made them cumbersome, redundant, obsolete, or inadequate;

   d) determine the reliability, effectiveness, and efficiency of procedures designed to ensure the County is compliant with applicable laws and regulations;

   e) determine whether appropriate procedures exist within operations for self-assessment and continuous improvements; and

   f) review of the management and financial information systems as well as the accuracy and reliability of accounting records and financial reports and other documentation preserved in the County.

Relationship with Management

1. It is the policy of the IAD to conduct internal audits in a constructive manner. Whenever possible, the assistance of division personnel will be solicited in the planning and performance of the assignment and the development of improvement actions. A spirit of collaborative teamwork between the IAD and those audited will be adhered to. This attitude shall not alter the fact that internal auditing personnel have full access to all records, personnel, properties, and any other sources of information needed in the performance of an audit. When necessary, special arrangements will be made for the examination of confidential or classified information.

2. Prior to the start of each audit, the department head and appropriate personnel will be advised concerning the tentative time schedule and general scope of the audit. A notification memo signed by the IAD Chief Deputy will be sent to appropriate management, who in turn are responsible for conveying the audit schedule to persons affected.

Relationship to External Auditor

1. The County's Administrative Office (CAO) is responsible for coordinating the external audit relationship. An attitude of cooperation and collaboration best describes the relationship of internal auditing to the County's external auditor. The IAD "should share information, coordinate activities, and consider relying upon the work of other internal and external assurance and consulting service providers to ensure proper coverage and minimize duplication of efforts."[54] Coordination of internal audit activities with the external auditor principally involves checking and working with each other to ensure:

    a) optimum audit coverage is obtained;

    b) there is an exchange of information;

    c) a minimum duplication of effort and expense; and

    d) cost-effective reliance on the work of the audit.

2. Ongoing, direct communication between the CAO, ACO, IAD, and the external auditor are maintained to foster coordination of audit work. Annual meetings shall be conducted with assigned members from CAO, ACO, IAD and external auditor to determine appropriate areas of cooperation.

Special Assignments

A special assignment refers to any internal audit work such as an investigation, surprise check, examination or survey, the execution of which has not been provided for in the approved Annual Audit Plan. The IAD should seek prior approval of the Budget Committee and Board before undertaking any special assignment.

Internal Audit Standards

The standards set out below represent best practices and indicate the criteria by which the IAD's quality of work should be measured and evaluated. These include:

    a) professional code of conduct;

    b) performance standards;

    c) reporting standards; and

    d) quality assurance standards[55]

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[54] IPPF Standard #2050 – Coordination and Reliance
[55] Refer to discussion at page 47.

Professional Code of Ethics and Conduct[56]

"The Code of Ethics of The Institute of Internal Auditors are Principles relevant to the profession and practice of internal auditing, and Rules of Conduct that describe behavior expected of internal auditors. The Code of Ethics applies to both parties and entities that provide internal audit services. The purpose of the Code of Ethics is to promote an ethical culture in the global profession of internal auditing."[57]

1. Professional ethical behavior is a necessary and required attribute of the internal auditor. The IAD is expected to apply and uphold the following principles:

   a) Integrity – The integrity of the IAD establishes trust and thus provides the basis for reliance on their judgment. The IAD shall:

      i. perform their work with honesty, diligence, and responsibility;

      ii. observe the law and make disclosures expected by the law and the profession;

      iii. not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization; and

      iv. respect and contribute to the legitimate and ethical objectives of the organization.

   b) Objectivity – The IAD must have an impartial, unbiased attitude and avoid conflicts of interest.[58] It must exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. It must make balanced assessments of all relevant circumstances and must not be unduly influenced by their own interests or by others in forming judgments. The IAD shall:

      i. not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This includes those activities or relationships that may conflict with the interests of the organization;

      ii. not accept anything that may impair or be presumed to impair their professional judgment; and

      iii. disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

   c) Confidentiality – The IAD must respect the value and ownership of information they receive and not disclose information without appropriate authority unless there is a legal or professional obligation to do so. The IAD shall:

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[56] Institute of Internal Auditors Code of Ethics
[57] International Professional Practice Standards – October 2016
[58] IPPF Standard #1120 – Individual Objectivity

         i.   be prudent in the use and protection of information acquired during their duties;

        ii.   control access to engagement records and obtain approval from senior management or legal counsel prior to releasing records to external parties;[59] and

      iii.   not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

d) Competency/Proficiency – the IAD "must ensure engagements are performed with proficiency and due professional care."[60] "Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities,"[61] and apply those competencies with the care and skill of a reasonably prudent and competent internal auditor. The IAD shall:

         i.   utilize staff only for those services for which IAD staff has the necessary knowledge, skills, and experience;

        ii.   decline[62] or obtain competent advice and assistance for services the IAD does not have the necessary skills, and experience in accordance with *Standards*;[63]

      iii.   ensure staff has sufficient knowledge to evaluate risk of fraud and how fraud is managed in the County;[64]

      iv.   ensure staff has sufficient knowledge of key information technology risk and controls and available technology-based audit techniques;[65] and

       v.   continually improve their proficiency, effectiveness, and quality of services.

e) Due Professional Care – The IAD "must apply the care and skill expected of a reasonably prudent and competent internal auditor. Internal auditors must be alert to the significant risk that might affect objectives, or resources."[66] Due professional care does not imply infallibility." [67] The IAD "must exercise due professional care by considering the:

         i.   extent of work needed to achieve the assignment's objectives;

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[59] IPPF Standard #2330.A1 – Documenting Information
[60] IPPF Standard #1200 – Proficiency and Due Professional Care
[61] IPPF Standard #1210 – Proficiency
[62] IPPF Standard #1210.C1 – Proficiency
[63] IPPF Standard #1210.A1 – Proficiency
[64] IPPF Standard #1210.A2 – Proficiency
[65] IPPF Standard #1210.A3 – Proficiency
[66] IPPF Standard #1220.A3 – Due Professional Care
[67] IPPF Standard #1220 – Due Professional Care

ii. relative complexity, materiality, or significance of matters to which assurance procedures are applied;

iii. adequacy and effectiveness of governance, risk management, and control processes;

iv. probability of significant errors, fraud, or noncompliance; and

v. cost of assurance in relation to potential benefits."[68]

f) The IAD "must also exercise due professional care during consulting engagements by considering the:

vi. need and expectation of clients, including the nature, timing, and communication of engagement results;

vii. relative complexity and extent of work needed to achieve the engagement objectives; and

viii. cost of the consulting engagement in relation to potential benefits."[69]

g) "In exercising due professional care the IAD must consider the use of technology-based audit and other data analysis techniques."[70]

h) Continuing Professional Development – The IAD "must enhance their knowledge, skills, and other competencies through continuing professional development."[71]

i) Impairment to Independence or Objectivity – "If independence or objectivity (of an auditor) is impaired in fact or appearance, the details of such impairment must be disclosed to the auditor's immediate superior."[72] For consulting engagements the disclosure must also be made to the client prior to accepting the engagement."[73] The nature of the disclosure will depend upon the impairment. "Internal auditors must refrain from assessing specific operations for which they were previously responsible."[74] Assurance engagements for functions over which the CAE or IAD Chief Deputy has responsibility must be overseen by a party outside the internal audit activity."[75] Impairment to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on access to records, personnel and properties, and resource limitations. Impairment is not considered when the "internal audit activity is providing assurance services on previously performed consulting services, provided the nature of the consulting did not impair objectivity and provided individual objectivity is

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[68] IPPF Standard #1220.A1 – Due Professional Care
[69] IPPF Standard #1220.C1 – Due Professional Care
[70] IPPF Standard #1220.A2 – Due Professional Care
[71] IPPF Standard #1230 – Continuing Professional Development
[72] IPPF Standard #1130 – Impairment to Independence or Objectivity
[73] IPPF Standard #1130.C2– Impairment to Independence or Objectivity
[74] IPPF Standard #1130.A1– Impairment to Independence or Objectivity
[75] IPPF Standard #1130.A2– Impairment to Independence or Objectivity

managed when assigning resources to the engagement,[76] nor when internal auditors provide consulting services relating to operations for which they had previous responsibilities."[77]

Performance Standards

Managing the Internal Audit Activity

The IAD must effectively manage the internal audit activity to ensure it adds value to the organization.[78] [79] The internal audit activity is effectively managed when:

a) the results of the internal audit activity's work achieve the purpose and responsibility included in the internal audit charter;

b) the internal audit activity conforms with the Definition of Internal Auditing, the *Standards*, and Code to Ethics;

c) individuals who are part of the internal audit activity demonstrate conformance with the Code of Ethics and the *Standards*; and

d) considers trends and emerging issues that impact to organization.

Reporting Standards

1. The IAD is required to report on the results of engagements entered into by the division. The IAD must:

   a) "must communicate the results of engagements;[80]

   b) must communicate results to the appropriate parties;[81]

   c) must include applicable conclusions, recommendations and action plans;[82]

   d) is encouraged to acknowledge satisfactory performance;[83]

   e) must communicate limitation on distribution and use when releasing communications to outside parties;[84]

   f) must communicate results of consulting engagements;[85]

   g) must communicate the internal audit activity's plans and resource requirements; and

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[76] IPPF Standard #1130.A3– Impairment to Independence or Objectivity
[77] IPPF Standard #1130.C1– Impairment to Independence or Objectivity
[78] IPPF Standard #2000 – Managing the Internal Audit Activity
[79] Government Code Title 1, Division 4, Chapter 1, Article 8, Section 1236(a)(5)
[80] IPPF Standard #2400 – Communicating Results
[81] IPPF Standard #2410 – Criteria for Communicating
[82] IPPF Standard #2410.A1 – Criteria for Communicating
[83] IPPF Standard #2410.A2 – Criteria for Communicating
[84] IPPF Standard #2410.A3 – Criteria for Communicating
[85] IPPF Standard #2410.C1 – Criteria for Communicating

h) must also communicate the impact of resource limitations."[86]

2. The CAE and IAD Chief Deputy "must report periodically to the Board, Budget Committee and senior management on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan and on its conformance with the Code of Ethics, the IIA *Standards*, and GAGAS. Reporting must also include significant risk and control issues, including fraud risks, governance, and other matters that require the attention of the Board, Budget Committee and senior management ."[87]

3. The IAD is required to ensure communications are supported with reliable, relevant and useful information. Specifically, "when an overall opinion is issued, it must take into account the strategies, objectives, and risks of the organization; and the expectation of the Board, Budget Committee, senior management, and other stakeholders."[88]

Internal Audit Procedures

Preparing a Risk-based Audit Plan

1. The IAD must "establish risk-based strategic and annual plans to determine the priorities of the internal audit activity, consistent with the organization's goals."[89] The IAD's "plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of the the Board, Budget Committee and senior management must be considered."[90]

2. To develop the risk-based plan, the IAD consults with the Board, Budget Committee and senior management and obtains an understanding of the County's strategies, key objectives, associated risks, and risk management processes.[91] [92] The IAD must review and adjust the plan, as necessary, in response to changes in the County's risks, operations, programs, systems, and controls.

3. "The IAD should consider accepting proposed consulting engagements based on the potential to improve management of risks, add value, and improve the organization's operations. Accepted engagements must be included in the plan."[93]

4. The IAD should consider the County's risk management framework, including using risk appetite levels set by management for the different activities or parts of the

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[86] IPPF Standard #2020 – Communication and Approval
[87] IPPF Standard #2060 – Reporting to Senior Management and the Board
[88] IPPF Standard #2450 – Overall Opinions
[89] IPPF Standard #2010 – Planning
[90] IPPF Standard #2010.A1 – Planning
[91] IPPF Standard #2010.A2 – Planning
[92] Government Code Title 1, Division 4, Chapter 1, Article 8, Section 1236(a)(4)
[93] IPPF Standard #2010.C1 – Planning

County. If a framework does not exist, the IAD uses his/her own judgment of risks after consultation with the Board, Budget Committee and senior management.

5. GAGAS do not include specific requirements related to developing the overall audit planning, such as performing a risk assessment. Rather it focuses on planning associated with individual audits engagements.

Planning the Audit and Preparing an Engagement Work Program

1. The IAD "must develop and document a plan for each assignment, including the assignment's objectives, scope, timing, and resource allocations. The plan must consider the organization's strategies, objectives, and risk relevant to the engagement."[94] [95]

2. In planning an engagement, the IAD must consider:

   a) "the strategies and objectives of the activity being reviewed and how the activity controls its performance;

   b) the significant risks to the activity, its objectives, resources, and operations and how the potential impact of risk is kept to an acceptable level;

   c) the adequacy and effectiveness of the activity's risk management and control processes compared to a relevant control framework or model;

   d) the opportunities for making significant improvements to the activity's risk management and control processes;[96] and

   e) whether management has taken appropriate corrective action to address observations and recommendations from previous engagements that are significant."[97]

3. When planning engagements in respect to external entities operating in support of a County department, IAD should:

   a) consider the terms of reference agreed upon; or

   b) work out clear terms setting out the engagement "objectives, scope, respective responsibilities, and other expectations, including restrictions on distribution of the results of the assignment and access to assignment records;[98] and

   c) establish an understanding with consulting engagement clients about the objectives, scope, respective responsibilities, and other client expectations."[99]

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[94] IPPF Standard #2200 – Engagement Planning
[95] GAGAS, paragraphs 6.06 through 6.12 – Planning
[96] IPPF Standard #2201 – Planning Considerations
[97] GAGAS, paragraph 6.36 – Previous Audits and Attestation Engagements
[98] IPPF Standard #2201.A1 – Planning Considerations
[99] IPPF Standard #2201.C1 – Planning Considerations

4. In the case of item #3 above, the terms of reference should be endorsed by the management concerned prior to commencement of the consulting assignment.

Assignment of Objectives

1. "Objectives must be established for each engagement."[100] Audit objectives assigned must reflect the results of the "preliminary assessment of the risks relevant to the activity under review."[101] The IAD must consider the "possibility of significant errors, fraud, non-compliance, and other exposures when developing the assignment objectives."[102]

2. IAD "must ascertain the extent to which the Board, Budget Committee and management had established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, IAD must use such criteria in their evaluation. If inadequate, IAD must identify appropriate evaluation criteria through discussion with the Board, Budget Committee and management."[103]

3. Consulting assignment objectives "must address governance, risk management, and control processes to the extent agreed upon with the client[104] and be consistent with the organization's values, strategies, and objectives."[105]

Assignment of Scope

1. "The scope of the assignment must include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties."[106]

2. "If significant consulting opportunities arise during an assurance assignment, a specific written understanding as to the objectives, scope, respective responsibilities, and other expectations should be reached."[107]

3. In performing consulting engagements, the IAD "must ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If the IAD develops reservations about the scope during the engagement, these reservations must be discussed with the client to determine whether to continue with the engagement."[108]

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[100] IPPF Standard #2210.A1 – Engagement Objectives
[101] IPPF Standard #2210.A1 – Engagement Objectives
[102] IFFP Standard #2210.A2 – Engagement Objectives
[103] IFFP Standard #2210.A3 – Engagement Objectives
[104] IFFP Standard #2210.C1 – Engagement Objectives
[105] IFFP Standard #2210.C2 – Engagement Objectives
[106] IFFP Standard #2220.A1 – Engagement Scope
[107] IFFP Standard #2220.A2 – Engagement Scope
[108] IPPF Standard #2220.C1 – Engagement Scope

4. "During consulting engagements, internal auditors must address controls consistent with the engagement's objectives and be alert to significant control issues."[109]

Assignment of Resources

"The IAD Chief Deputy must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan."[110] This includes ensuring "that internal audit resources are appropriate and sufficient to achieve engagement objectives based on an evaluation of the nature and complexity of each assignment, time constraints, and available resources."[111]

Performing Audit Engagements

Opening Meeting

Early in the planning stages of the internal audit assignment, and prior to commencing the preliminary survey, the IAD should meet with the officer responsible for the unit to be audited. Topics of discussion during the opening conference include:

a) Scope and Objectives - Review the basic scope and objectives planned for the audit. Outline the general audit work plan. Emphasize that the purpose of the audit is to add value to the organization by providing analysis, appraisals, recommendations, and information concerning the activities reviewed — all designed to assist management in the attainment of their objectives.

b) Internal Audit Observations - Explain how audit observations will be handled, e.g., resolution of minor observations, discussion of all observations that permit audit customer to assist in developing the improvement actions and take timely improvement actions, the exit conference at the completion of the fieldwork to reconfirm all observations and improvement actions planned, the review of the report draft, and the distribution of the formal audit report. Obtain update on status of prior audit findings.

c) Audit Progress - Establish a clear understanding with auditee about keeping them advised of the audit progress and related observations. Determine the frequency of progress updates and management levels to be appraised of audit progress and observations improvements. Consideration should be given to providing the audit customer with an audit event timeline. This timeline should include estimated dates of fieldwork, interim meetings, exit meeting, audit report issuance, and follow-up audits.

d) Consulting Activities - Ask for suggestions of problem areas where the IAD can be of assistance to management. The IAD can often be in the position to consult with audit customers about best practices existing in other functions within the organization.

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[109] IPPF Standard #2220.C2 – Engagement Scope[109]
[110] IPPF Standard #2030 –Resource Management
[111] IPPF Standard #2230 – Engagement Resource Allocation

e) Cooperative Administration - Inquire about working hours, access to records, available work areas, auditee's work deadline requirements, and any other information that will help schedule audit activities with minimal disruption to the auditee's personnel.

f) Introduction and Tour - Arrange to meet department personnel the IAD will be working with during the audit. Also arrange for a familiarization tour of the physical facilities, necessary security clearances, and a safety orientation where appropriate. Effective communication at the beginning of the audit fieldwork can significantly influence the atmosphere in which the entire audit is conducted. It deserves the IAD's careful attention and best efforts.

Preliminary Survey

1. The IAD "must conduct a preliminary assessment of the risks relevant to the activity under review[112] and gather information required for the preparation of the audit program."[113]

2. The preliminary survey is made up of four distinct phases:

   a) familiarization;

   b) identification of potential areas of improvement;

   c) confirmation; and

   d) planning the detailed audit.

Familiarization

1. This phase consists of obtaining significant background information and a practical working knowledge of the following:

   a) department or program objectives;

   b) applicable laws, regulations, and departmental policies and procedures;

   c) management, operating, and financial controls;

   d) operating procedures;

   e) size and scope of the activities under review; and

   f) organization and staffing.

2. Specific data needed to obtain practical working knowledge of the auditee may include their statement of mission, current goals and areas of emphasis, specific objectives, significant programs and activities, and delegations of authority. Additionally, a concise picture of the organizational arrangement should be developed, particularly how the program, function, entity, or activity to be audited fits into the overall operation,

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[112] IPPF Standard #2210.A1 – Engagement Objectives
[113] IPPF Standard #2330 – Documenting Information

whether they face unusual challenges, or changes within the function are being contemplated. Some sources of information are:

    a) audit programs;

    b) prior audit work-papers;

    c) public laws, legal opinions, and special rulings;

    d) operating procedures;

    e) organizational charts;

    f) functional statements and position descriptions;

    g) process flow charts and system narratives;

    h) board and committee reports;

    i) management, budget, financial, and operating reports; and

    j) personnel.

Identification of Potential Areas for Improvement

An analytical survey of significant programs, activities, and functions should be performed to identify areas of risk and potential improvement. Programs, activities, and functions that are significant can be identified as those activities:

    a) that are indicated by existing enterprise risk management processes;

    b) that are susceptible to fraud, abuse, or mismanagement;

    c) in which there is a large volume of transactions or large investments in assets that are subject to loss if not carefully controlled;

    d) about which management has expressed concerns; and

    e) in which prior audits have disclosed major weaknesses or deficiencies.

Confirmation

Confirmation involves limited testing designed to validate critical improvement areas and the need for detailed audit work. Examination of documents, records, and reports is generally necessary to add supporting evidence to the preliminary observations during the first two phases of the preliminary survey. Tests to determine the extent and significance of such matters, however, are to be performed during the detailed audit. Problem areas should be discussed with the auditee immediately to help ensure the IAD has an accurate understanding of the situation and has obtained all available information needed to arrive at decisions on the extent of audit work needed.

Planning the Detailed Audit

Materiality and risk must be considered in performing the audit. The due professional care standards do not imply unlimited responsibility for disclosure of irregularities and other deficiencies. The IAD's principal effort should be in those areas where significant potential

for improvement may exist, rather than in areas that are relatively unimportant. Time should not be spent examining or developing evidence beyond what is necessary to afford a sound basis for a professional opinion.

Evaluating Internal Controls

1. Evaluating the system of internal controls will provide reasonable, but not absolute, assurance that the fundamental elements of the system are sufficient to mitigate the related risks and contribute to the attainment of management's objectives. The review and evaluation should be adequately documented and properly supported by results of tests, observations, and inquiries.

2. Examination of internal controls identified throughout the audit examination can be described as:

   a) evaluating the adequacy of control designs in relation to the identified risks in order to develop tests that confirm the adequacy of design and continued effective operation;

   b) identifying weaknesses in controls or missing controls in order to design tests that evaluate the potential or actual effects of the weakness; and

   c) identifying areas where additional information is necessary to carry out either of the above.

3. Discussing the adopted control procedures, methods, and plan of organization with the auditee is critical to understanding internal controls. The IAD may use internal control questionnaires or checklists as well as written narrative memoranda, flowcharts, transaction walkthroughs, and other applicable techniques in determining the adopted control procedures and the method and plan of organization (see preliminary survey techniques). These methods and techniques are preferred because they are useful for documenting "sufficient, reliable, relevant, and useful information necessary to support the engagement results and conclusion."[114]

4. The IAD should consider the following when evaluating the system of internal controls:

   a) types of errors and irregularities that could occur;

   b) potential to degrade likelihood of attainment of management objectives;

   c) control procedures to prevent or detect such errors and irregularities have been adopted and are being followed satisfactorily; and

   d) weaknesses that would enable errors and irregularities to pass through existing control and the effect these weaknesses have on the nature, timing, and extent of auditing procedures to be applied.

5. Documentation supports the IAD's understanding of internal controls. Audit working papers provide the documented support for the conclusions reached by IAD regarding

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[114] IPPF Standard #2330 – Documenting Information

the review and evaluation of internal controls. Only internal control activities that are deemed critical or important related to management's objectives and related control risks should be tested and evaluated. Working papers should be prepared to highlight the internal control attributes within the processes evaluated. Audit personnel should also be vigilant for opportunities to improve the efficiency of processes through the elimination of controls where duplication exists or risk levels do not justify control.

6. Tests of controls are performed to obtain sufficient evidence that controls are operating as intended. Test are performed for those control procedures or methods upon which the IAD has chosen to rely. Conversely, when the IAD determines that certain controls cannot be relied upon, tests of controls are not ordinarily performed. Rather, tests are carried out to evaluate the real or potential effect of the weakness.

7. The nature, timing, and extent of tests of controls must consider the availability of evidence and the audit effort required to test compliance. In considering the required audit effort, the IAD assesses whether precluding certain tests of compliance will reduce the reliance on the controls and procedures, and whether such reduced reliance significantly affects subsequent audit tests and procedures.

8. The timing of controls testing is applied to transaction cycles throughout the period under audit. With respect to control procedures and methods that depend primarily on segregation of duties and leave no audit trail, inquiries relate to the entire audit period with emphasis placed on the most recent processing methods.

9. Tests of controls may be applied either before or after the end of the period under examination. When tests are performed prior to the end of the period, the IAD determines whether control procedures are still in operation up to the end of the audit period. This may be accomplished by inquiry, observation, or further testing. Unless the IAD believes it is necessary, additional tests of controls are not required.

10. In summary, procedures for the study and evaluation of internal controls include:
    a) a preliminary survey to obtain internal familiarization with the audit customer's overall organization, operation, objectives, risks, and control systems;
    b) application analysis;
    c) determining facts - ascertain by analysis and inquiry what controls have been established;
    d) draft tentative organizational charts, flowcharts, and narrative procedural memoranda;
    e) walk through - trace selected transactions through the system to confirm whether it is functioning as described;
    f) document - complete the organizational charts, flowcharts, and procedural memoranda;
    g) evaluate - make a tentative evaluation of the effectiveness of internal control;

h) test and reevaluate - confirm, modify, or reject the tentative evaluation of internal control through test samples or data analysis techniques; and

i) document the results of the tests and the conclusions as to the effectiveness of internal control.

Documenting Audit Engagements

Preliminary Survey Techniques

The IAD "must identify, analyze, evaluate, and document sufficient, reliable, and useful information to achieve the engagement objectives."[115] [116] The information gathering techniques discussed in this section are not considered all-inclusive. The IAD should use only those techniques necessary for the specific program or activity to be surveyed. The IAD should constantly strive to develop new and more effective techniques. In selecting the best method for surveying a particular activity, the IAD should use techniques that will produce the desired result at the least cost. The most effective method may be a combination of several methods depending on the circumstance.

Interviewing

The preliminary survey includes the use of interviews in each major functional area. Interviews must be planned, keeping in mind that the purpose of the survey is to disclose areas with potential for improvement of risk management, control, governance, and operations.

Comparative Analysis

This technique involves comparing data, policies, processes and controls, sometimes from various sources, to identify unusual situations, deviations, or trends. Data can be compared to budget, prior periods, other departments, similar operations elsewhere in the organization, financial to statistical, and vice versa. Creativity and business knowledge will enhance the variety of options to consider. This is similar to Analytical Review discussed below.

Flowcharting

This technique involves charting steps that must be completed before a program or activity can be concluded successfully. This technique can be particularly useful to the IAD in documenting controls and in identifying bottlenecks and duplications in operations.

Narratives

This technique involves providing detail written discussion of the process under review. This can often be the simplest way to describe a situation or process.

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[115] IPPF Standard #2300 – Performing the Engagement
[116] IPPF Standard #2310 – Identifying Information

Analytical Review

Internal auditor "must base conclusions and engagement results on appropriate analysis and evaluations."[117] This technique involves comparing or examining financial and operational data such as income, expenses, or how many active contracts exist within and organization etc., for the same entity from period to period. It also can be used when evaluating changes in results that are dependent or affected by other factors. For example, if the number of employees increased from the last period, the payroll costs should also go up in addition to the normal increase due to raises, inflation cost etc. Both Analytical Review and Comparative Analysis above can be effective applications of Computer Assisted Audit Techniques (CAATs).

Visual Observations

A tour of the facilities of the entity to be audited may disclose material weaknesses in the operations in various areas, including supervision, housekeeping, safety, security, operational efficiency, and employee morale. Visual observations also include scanning records and reports for unusual items.

Risk and Control Matrices

This tool is an efficient way to document preliminary survey data in a visual way. It can match risks to controls, or lack thereof, and can further be customized or expanded to cross-reference to or show program steps or results of evaluation of the controls.

Audit Program

1. The IAD "must develop and document work programs that achieve the engagement objectives."[118] Work programs "must include the procedures for identifying, analyzing, evaluating, and documenting information during the assignment and must be reviewed and approved prior to its implementation and any adjustments approved promptly"[119] by the IAD Chief Deputy prior to its implementation.

2. The audit work program should be prepared after the completion of the preliminary survey and should contain a detailed plan for the work to be performed during the audit. A well-constructed program is essential to completing the audit project in an efficient manner. The audit program is intended to guide, among other actions, tests to:

   a) confirm the adequacy of the indicated design of controls;

   b) confirm the continued effectiveness of the operation of controls;

   c) evaluate the effects or potential effects of inadequately designed or missing controls in order to develop recommendations for improvement; and

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[117] IPPF Standard #2320 – Analysis and Evaluation
[118] IPPF Standard #2240 – Engagement Work Program
[119] IPPF Standard #2240.A1 – Engagement Work Program

d) gather missing information needed to evaluate risks and their related controls and the overall control environment.

3. "Work programs for consulting assignments may vary in form and content depending upon the nature of the assignment."[120]

Internal Audit Working Papers

1. Working papers serve as tools to assist the IAD in performing the audit work and to communicate with auditees. Working papers are also written evidence of work done to support the internal auditor's report.

2. Information included in working papers should be sufficient, reliable, relevant, and useful to achieve the engagement's objectives and to provide a sound basis for audit findings and recommendations. Sufficient information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the internal auditor. Reliable information is attainable through the use of appropriate audit techniques. Relevant information supports audit observations and recommendations and is consistent with the objectives for the audit. Useful information helps the organization meet its goals.

3. In addition to serving as a reference when reporting observations or answering questions, working papers can be useful to other parties, such as external auditors. Working papers are also used as a basis for the review of the quality of audit, and for the performance evaluation of audit staff.

4. The quality of working papers must adhere to the IIA *Standards* which requires internal auditors to "document reliable, relevant, and useful information to support the engagement results and conclusions."[121] These terms are defined as follows:

    a) **Reliable** – consistently good in quality or performance; able to be trusted; based on facts, supported with tangible and/or corroborating evidence;

    b) **Relevant** – closely connected or appropriate to what is being done or considered; are applicable and significant to the circumstances; and

    c) **Useful** – able to be used for a practical purpose or in several ways, adds value and is beneficial in determination of realities.

5. Working papers should also be complete, concise, uniform and neat as define below:

    a) **Complete** – Working papers must be able to "stand alone." This means that all questions must be answered, all points raised by the reviewer must be cleared, and a logical, well-thought-out conclusion must be reached for each audit segment.

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[120] IPPF Standard #2240.C1 – Engagement Work Program
[121] IPPF Standard #2330 – Documenting Information

b) **Concise** –Working papers must be confined to those that serve a useful purpose. Documentation of the facts should be focused on objectives, logical, and easily explained and interpreted.

c) **Uniform** - Electronic working papers should be created and saved in the common formats. They should be promptly filed and readily accessible within the standard filing structure, thereby also becoming subject to standard systems backup routines. Any manual working papers produced should be of uniform size and appearance. Smaller papers should be fastened to standard work papers, and larger papers should be folded to conform to size restrictions.

d) **Neat** - Working papers should not be crowded. Allow for enough space on each schedule so that all pertinent information can be included in an orderly manner. At the same time, keep work papers economical. Copies, forms, and procedures should be included only when relevant to the audit or to an audit recommendation. Unnecessary listings and/or schedules should be avoided. All schedules should have a purpose that relates to the audit procedures or recommendations.

Audit Observations

1. The IAD "must identify, analyze, evaluate, and document sufficient information to achieve the engagement objectives." [122] Sufficient information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions. Reliable information is the best attainable information using appropriate techniques. Relevant information supports observations and recommendations and is consistent with the objectives for the assignment.

2. Useful information helps the organization meet its goals. The IAD "must base conclusions and assignment results on appropriate analyses and evaluations."[123] The IAD must document relevant information to support the conclusions and assignment results. The audit findings should be based on the following attributes:

   a) Criteria (What should be!);

   b) Condition (What is!);

   c) Cause (Why did it happen?);

   d) Effect (So what?); and

   e) Recommendation (What should be done?).

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[122] IPPF Standard #2310 – Identifying Information
[123] IPPF Standard #2320 – Analysis and Evaluation

Criteria

This attribute establishes the legitimacy of the audit observation by identifying the evaluation criteria and answers the question: "By what standards was it judged?" In operational or management audits, criteria can relate to management objectives, plans, private sector standards, contracts, policies, procedures, guidelines, laws or regulations, and expectations for efficiency and effectiveness. In financial audits, criteria could be accuracy, completeness, materiality, consistency, or compliance with applicable accounting principles and legal or regulatory requirements. In audits of efficiency, economy, and program results (effectiveness), the related criteria might be defined in mission, operation, or function statements, performance, production, and cost standards, contractual agreements, program objectives, policies, procedures, and other command media, or other external sources of authoritative criteria.

Condition

The statement of condition identifies the nature and extent of the observation or unsatisfactory condition. It is the facts. It often answers the question: "What is wrong?" Normally, a clear and accurate statement of condition evolves from the internal auditor's comparison of results with appropriate evaluation criteria.

Cause

1. The fourth attribute identifies the underlying reasons for unsatisfactory conditions or observations, and answers the question: "Why did it happen?"

2. If the condition has persisted for a long period of time or is intensifying, the contributing causes for these characteristics of the condition should also be described.

3. Identifying the cause of an unsatisfactory condition or observation is a prerequisite to making meaningful recommendations for corrective action. The cause may be obvious or may be identified by deductive reasoning if the audit recommendation points out a specific and practical way to correct the condition. However, failure to identify the cause in a finding may also mean the cause was not determined because of limitation or defects in audit work, or was omitted to avoid direct confrontation with responsible officials.

4. An internal auditor's failure to thoroughly investigate "actual root causes" can contribute to less-than-adequate recommendations, possibly fixing the wrong thing or correcting the symptom rather than the real cause. Frequently, the "actual root cause" is a soft issue which otherwise would not be addressed.

Effect

1. This attribute identifies the real or potential impact of the condition and answers the question: "What effect did/could it have?"

2. The significance of a condition is usually judged by its effect. In operational audits, reduction in efficiency and economy, or not attaining program objectives (effectiveness), are appropriate measures of effect. These are frequently expressed in quantitative terms; e.g., dollars, number of personnel, units of production, quantities of material, number of transactions, or elapsed time. If the real effect cannot be determined, potential or intangible effects can sometimes be useful in showing the significance of the condition.

3. An accurate evaluation of the real, or potential, effect is crucial in determining the effort, resources, or control that should be applied to correct the situation, as well as in getting management's buy-in on the issue.

Recommendations

1. This final attribute identifies suggested corrective action and answers the question: "What should be done?" Recommendations in the audit report should state precisely what corrective action has been agreed upon. More generalized recommendations (e.g., greater attention be given, controls be reemphasized, a study be made, or consideration be given) should not be used in the audit report, although they are sometimes appropriate in summary reports to direct top management's attention to specific areas.

2. The relationship between the audit recommendation and the underlying cause of the condition should be clear and logical. If a relationship exists, the recommended action will most likely be feasible and appropriately directed.

3. Unless benefits of taking the recommended corrective action are obvious, they should be stated. Whenever possible, the benefits should be quantified in terms of additional revenue, lower costs, or enhanced effectiveness or efficiency. The cost of implementing and maintaining recommendations should always be compared to risk.

Management Responses

1. All audit observations must contain corrective action plans that cite the who, what, and when of remedial action. The quality and sustainability of the corrective action is significantly enhanced if the audit client is brought into the discussion and takes part in jointly developing the solution. Management responses to audit recommendations should directly acknowledge the observations and recommendations made and include plans of action with specific milestones and/or dates of completion. Where appropriate, corrective actions to be taken should be ascertained and included in the report. The individual responsible for corrective actions and dates for completion should also be included. Wherever possible, internal audit staff should work with auditees to seek the best improvement solutions.

2. To ensure that agreement is reached as to statements of facts, audit observations included in the report should be reviewed with the relevant auditees. The CAE and IAD Chief Deputy are responsible for evaluating the auditee's responses. Thereafter, the IAD will issue a final report to the relevant auditee and key stakeholders, including the Board and Budget Committee.[124]

3. Internal audit reports, whether draft reports or final reports, are confidential and have thus restricted distribution. Such reports, or any part thereof, should only be distributed to the relevant auditee, key stakeholders, the Board, Budget Committee, or any other person(s) authorized by the Board.

Rating Internal Audit Observations and Report

1. The IAD has developed a methodology for rating risk. The purpose of the risk rating methodology is to provide a framework by which individual audit observations can be classified and provide meaningful interpretation by all stakeholders. It helps to departmentalize the critical nature of the audit observations and creates a basis to ensure consistent application of opinions. Risk ratings reflect on the internal control environment of the audit area under review and help to assess the adequacy, effectiveness and efficiency of internal controls for the audit area under review. They also provide management a basis by which to understand the significance of related internal control deficiencies.

2. Audit observations will be rated individually based on the level of risk associated with the control environment under review, the likelihood that associated controls will not mitigate the risks, and the potential, or actual, impact of the observation to the County.

Rating Audit Observations

All audit observations will be rated High, Moderate, or Low based on analysis of the risk impact over the likelihood (probability) of a control or a process failure as follows:

a) **High Risk - *Risk has high impact and high likelihood***
This is a high-priority issue; immediate attention from senior management is required. This is a serious internal control or risk management issue that if not mitigated, may with a high degree of certainty, lead to:

    i. substantial losses, either imminent or apparent;

    ii. major disruption of County processes;

    iii. impairing the County's ability to accomplish its objectives;

    iv. material misstatement of the financial statements;

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[124] IPPF Standard #2440 – Disseminating Results

  v. non-compliance with established control policies and procedures;

  vi. substantial non-compliance with statutes and regulations; or

  vii. quantifiable negative financial impact over $1,000,000.

Audit observations receiving a "High" risk rating will be included in the audit report and will be reported quarterly to the Board and Budget Committee. The IAD will track and monitor "High" risk observations to ensure timely implementation of corrective action by management.

b) **Moderate Risk -** *Risk has high impact and low likelihood or low impact and high likelihood*

This is a medium-priority issue; timely attention from senior management is warranted. This is a significant internal control or risk management issue that can lead to:

  i. significant losses, either imminent or apparent;

  ii. significant disruption of County processes;

  iii. ineffective preventative, detective or mitigating controls;

  iv. potential financial statement impact;

  v. intermittent compliance with established control policies and procedures;

  vi. significant violation of statutes and regulations; or

  vii. quantifiable negative financial impact between $100,000, to $1,000,000.

Audit observations receiving a "Moderate" risk rating will be included in the audit report and will be reported quarterly to the Board and Budget Committee. The IAD will track and monitor "Moderate" risk observations to ensure timely implementation of corrective action by management.

c) **Low Risk -** *Risk has low impact and low likelihood*

This is a low-priority issue and generally involves minor internal control or risk management issues that may result from inefficient operations that can lead to:

  i. low probability of loss, either imminent or apparent;

  ii. minor disruption of County processes;

  iii. inefficient preventative, detective or mitigating controls;

  iv. limited or no financial statement impact;

  v. deviation from established control policies and procedures with limited impact;

  vi. isolated violation of statutes and regulations; or

vii. quantifiable negative financial impact of less than $100,000.

Audit observations receiving a "Low" risk rating will not be reported to the Board or Budget Committee, unless the finding remains open after one-year from the audit report date. These observations will be documented and shared with management as part of the exit conference. The audit report will reference the existence of low risk, low impact findings and will emphasize that such observations were discussed with management as part of the exit conference but explanations of low risk observations will not be included in the final audit report. The IAD will track and monitor "Low" risk observations to ensure timely resolution by management.

Rating the Audit Report

After individual audit observations have been rated, an overall rating will be assigned to the audit report. Audit report ratings are based on the criteria and analysis discussed above and considers the number of observations and the type of audit ratings in arriving at the overall rating. The audit report rating methodology is as follows:

a) ***"Effective"***
The control environment includes current written policies and procedures and evidence of regulatory compliance. Management information and monitoring systems are sufficiently established and general control objectives relative to authorization, recording, safeguarding, reconciliation, and valuation processes are effectively achieved. Additional criteria include:

    i. control environment is adequate;

    ii. no moderate or high risk observations;

    iii. all high risks are adequately controlled; and

    iv. no exposure to fraud or security violations.

b) ***Effective with Opportunity to Improve"***
The control environment includes written policies and procedures requiring minor updates. Evidence of regulatory compliance indicate minor violations. Management information and monitoring systems are adequate, however, general control objectives relative to authorization, recording, safeguarding, reconciliation, and valuation are not consistently applied to ensure effectiveness and to prevent inefficiencies and/or protect against loss. Timely management action is warranted. Additional criteria include:

    i. control environment is adequate with some exceptions;

    ii. some control weaknesses and/or opportunities for improvement;

    iii. 3 or less moderate risk observations;

    iv. all high risks are adequately controlled; and

    v. nominal exposure to fraud or security violations.

c) *"Insufficient and Requires Improvement"*

The control environment includes written policies and procedures that are outdated and need significant update. Regulatory compliance has been inconsistent resulting in significant losses. Management information and monitoring systems are inadequate and/or general control objectives relative to authorization, recording, safeguarding, reconciliation, and valuation are not effectively achieved to prevent inefficiencies and/or protect against loss. Timely management action is warranted. Additional criteria include:

    i.   control environment contains significant exceptions;

    ii.   some control weaknesses and/or opportunities for improvement;

    iii.   more than 3 observations with moderate risk ratings;

    iv.   at least one observation with a high-risk rating; or

    v.   notable or potential exposure to fraud or security violations.

d) *"Not Adequate"*

The control environment does not have written policies and procedures. Regulatory compliance has been ineffective resulting in substantial losses. Management information and monitoring systems are materially deficient and/or there is pervasive failure of general control objectives relative to authorization, recording, safeguarding, reconciliation, and valuation processes. Internal control deficiencies are prevalent and exposure to loss is high. Immediate senior/executive management action is required. Additional criteria include:

    i.   control environment is below standard;

    ii.   more than 3 observations with moderate risk ratings;

    iii.   at least two observations with high risk ratings;

    iv.   substantial losses, either imminent or apparent; and

    v.   significant exposure to fraud or security violations.

Communicating Results/Reporting

Exit Conference

1. The IAD "must communicate results to the appropriate parties" [125] and should conduct a proper exit conference with management. The objective of the exit conference is to inform management about the audit results, the reporting process, reaching final agreement on audit observations, and finalizing planned corrective actions.

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[125] IPPF Standard #2440 – Disseminating Results

Management can also provide updates on any action already taken. Most importantly, the exit conference provides the opportunity to confirm the accuracy of facts supporting the internal audit observations, enhance the quality of the proposed corrective actions, prevent any surprises and thereby contributes to the success and sustainability of corrective actions.

2. The IAD "is responsible for communicating the final results to parties who can ensure that the results are given due consideration."[126] During assigned engagements, the IAD will work with the Board, Budget Committee, and department heads to identify relevant stakeholders of activities being reviewed to ensure their participation in the exit conference.

3. The following events should take place prior to and during the exit conference. Prior to the exit conference, the IAD should:

   a) discuss all aspects of potential audit observations with the person[s] performing the function under review and seeking to ensure their input on potential solutions; fully developing all audit observations;

   b) work with management, where possible, to jointly develop corrective actions to address recommendations included in audit observations;

   c) discuss audit observations and developed recommendations with the responsible department head; and

   d) discuss any items requiring follow-up and document the auditee's response to the observation.

4. An Exit Conference Summary Sheet should be prepared by the IAD for each audit observation discussed during the exit conference.

Reporting Assignment Results

1. The IAD must communicate the assignment results. Communication must include "1) the objectives, scope, and methodology of the audit; 2) the audit results, including observations, conclusions, and recommendations, as appropriate; 3) a statement about the auditors' compliance with GAGAS; 4) a summary of the views of responsible officials; and 5) if applicable, the nature of any confidential or sensitive information omitted."[127] Management responses and action plans will also be included in communications.

2. Communications must be accurate, objective, clear, concise, constructive, complete, and timely as defined by the following:

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[126] IPPF Standard #2440.A1 – Disseminating Results
[127] GAGAS, paragraph 7.08 – Report Contents

a) **Accuracy —** Accurate communications are free from errors and distortions and should be supported with the underlying facts. It is paramount to the credibility of the internal audit activity that audit reports be factually based.

b) **Objective** — Objective communications are fair, impartial, and unbiased and result from a fair-minded and balanced assessment of all relevant facts and circumstances. Audit report observations, conclusions, and recommendations should be without prejudice.

c) **Clarity —** Clear communications are easily understood and logical, avoiding unnecessary technical language and providing all significant and relevant information. All reports must be understandable and clear. Clarity is improved by avoiding unnecessary technical language or audit terminology and providing sufficient supportive information. Use of customer terms is helpful.

d) **Quantification —** All audit observations should be quantified to the maximum extent possible to identify the significance and impact of the points made. Examples of quantification are monetary values, quantities, number of test exceptions, and scope of testing.

e) **Conciseness —** Concise communications are to the point and avoid unnecessary elaboration, superfluous detail, redundancy, and wordiness. All reports must be to the point. This does not necessarily mean short.

f) **Constructive —** Constructive communications are helpful to the client and the organization and lead to improvements where needed. Emphasis should be on improvement, not on criticism of processes, people, or the past.

g) **Complete —** Complete communications include what is essential to the target audience and all significant and relevant information and observations to support recommendations and conclusions. Audit reports should not require interpretation or oral comment to fill in the gaps. The report should stand by itself.

h) **Timeliness —** Timely communications are expedient, depending on the significance of the issue, allowing management to take appropriate corrective action before the issue becomes unmanageable or too costly. All reports must be issued in a timely manner upon completion of the assignment.

i) **Management action plan —** All reports must contain action plans — cite the who, what, and when of remedial action.

3. The IAD must release the results of audit and consulting work performed. "If not otherwise mandated by legal, statutory, or regulatory requirements, prior to releasing results to parties outside the organization the CAE or IAD Chief Deputy must:

a) assess the potential risk to the organization;

b) consult with senior management and/or legal counsel as appropriate; and

  c) control dissemination by restricting the use of the results."[128]

4. The IAD "is responsible for communicating the final results of consulting engagements to clients."[129] However, if significant governance, risk management, and control issues identified are significant to the organization, they must be communicated to the Board, Budget Committee and senior management.[130]

5. "If a final communication contains a significant error or omission, the IAD must communicate corrected information to all parties who receives the original communication."[131] Upon learning of any incorrect communications, the IAD will immediately notify the parties involved and generate appropriate corrections.

Monitoring and Follow-up Processes

1. The IAD Chief Deputy "must establish and maintain a system to monitor the disposition of results communicated to management."[132] Monitoring and follow-up are integral to the internal audit process. Corrective actions critical to issues identified during audits, special projects, analysis etc., require monitoring to ensure complete and timely implementation.

2. Senior management is responsible for the implementation of corrective actions identified on reported audit observations and in accordance with implementation time schedules agreed to with the IAD. The IAD will conduct follow up activities designed to verify the implementation of corrective actions. The IAD will issue regular follow-up reports to the Board and Budget Committee, to report on the progress of corrective actions. If there are implementation delays, the CAE and IAD Chief Deputy shall notify the Board and Budget Committee as to the reason for such delays. The Board or Budget Committee should thereafter consider discussing the matter with the division/unit in question.

3. The IAD is responsible for establishing a "follow-up process to monitor and ensure that management corrective actions including those observations and recommendations from previous engagements,[133] have been effectively implemented or that senior management has accepted the risk of not taking action."[134] The IAD will develop and maintain an "Audit Issues Tracking" database to track the implementation of corrective action. The IAD will prepare the "Audit Issues Tracking" report, quarterly. This report will include audit observations that contain outstanding corrective action items. The intent of this report is to track all findings so that they are appropriately resolved.

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[128] IPPF Standard #2440.A1 – Disseminating Results
[129] IPPF Standard #2440.C1 – Disseminating Results
[130] IPPF Standard #2440.C2 – Disseminating Results
[131] IPPF Standard #2421 – Errors and Omissions
[132] IPPF Standard #2500 – Monitoring Progress
[133] GAGAS, paragraph 6.36 Previous Audit Attestation Engagements
[134] IPPF Standard #2500.A1 – Monitoring Progress

4. There are two types of follow-up activities:

a) **Limited –** Limited follow-up may be satisfied by reviewing the auditee's procedures, or through a telephone conversation. Memo correspondence may also be used. This is usually applicable to less critical observations; and

b) **Detailed -** Detailed follow-up is usually more time-consuming and requires verifying and testing corrective procedures implemented as well as substantiating records. The more critical audit observations usually require detailed follow-up.

5. During follow-up and when assessing the adequacy and effectiveness of corrective action, it is also important to consider whether changes to circumstances have occurred since the original audit observation that may have affected the need for improvement.

6. When management elects to "accept the risk" of not implementing the corrective action to an improvement recommendation, the CAE and IAD Chief Deputy "must discuss the matter with senior management. If the CAE and IAD Chief Deputy determine that the matter has not been resolved, they must communicate the matter to the Board, or Budget Committee."[135] The CAE and IAD Chief Deputy will notify the Board, or Budget Committee, prior to the issuance of the final report. If the Board, or Budget Committee, agrees to accept the risk, the report will reflect their decision. If the Board, or Budget Committee, does not accept the risk, the CAE and IAD Chief Deputy will work with management to determine if there is an alternate solution to the previously recommended improvement or to resume with the previously recommended improvement. The IAD will include in its "Audit Issues Tracking" database and reporting, improvement recommendations for which management has elected to forego corrective action and has accepted the risk.

Quality Assurance Standards

Quality Assurance and Improvement Program

1. The IAD "must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity"[136] and continuously monitors its effectiveness. "The quality assurance program must include both internal and external assessments."[137] The program's design should help the internal audit activity add value and improve the County's operations and to provide assurance that the internal audit activity is in conformity with the *Standards* and Code of Conduct.

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[135] IPPF Standard #2600 – Communicating the Acceptance of Risk
[136] IPPF Standard #1300 – Quality Assurance and Improvement Program
[137] IPPF Standard #1310 – Requirements of the Quality Assurance and Improvement Program

2. "Each audit organization performing audits in accordance with GAGAS must establish and maintain a system of quality control that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements,[138] and have an external peer review performed…at least once every 3 years."[139]

3. The quality assurance program should evaluate and conclude on the quality of the internal audit activity and lead to recommendations for appropriate improvements. Assessments of quality programs should include evaluation of:

   a) compliance with the *Standards* and Code of Ethics;

   b) adequacy of the internal audit activity's charter, goals, objectives, policies, and procedures;

   c) contribution to the County's risk management, governance, and control processes;

   d) compliance with applicable laws, regulations, and government or industry standards;

   e) effectiveness of continuous improvement activities and adoption of best practices; and

   f) whether the auditing activity adds value, improves the County's operations, and contributes to the attainment of objectives.

4. The IAD "must communicate the results of the quality assurance and improvement program to the Board, Budget Committee and senior management. Disclosure should include:

   a) the scope and frequency of both the internal and external assessments;

   b) the qualification and independence of the assessor(s) or assessment team, including potential conflicts of interest;

   c) conclusion of the assessors; and

   d) corrective action plans."[140]

5. Both the IPPF and GAGAS discuss the need to establish a quality assurance system. However, GAGAS includes more detailed requirements for the audit organization's quality assurance system and the requirement to annually analyze and summarize the results of its monitoring procedures. The IAD will ensure to "analyze and summarize the results of its monitoring procedures at least annually, with identification of any

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[138] GAGAS, paragraph 3.82a. – Quality Control and Assurance
[139] GAGAS, paragraph 3.82b. – Quality Control and Assurance
[140] IPPF Standard #1320 – Reporting on the Quality Assurance and Improvement Program

systemic or repetitive issues needing improvement, along with recommendations for corrective action."[141]

Components of a Well-designed Quality Assurance Program

A well-designed Quality Assurance Program should contain the following four components to ensure effective quality:

a) engagement supervision that ensures objectives are achieved, quality is assured, and staff are developed;[142]

b) ongoing reviews or performance measurements;

c) periodic reviews performed through self-assessment or by an independent external or internal assessor with knowledge of internal auditing practices and the *Standards*; and

d) external assessments should be conducted by a qualified, independent reviewer or review team from outside the organization.

Supervision

1. Supervision is a process that begins with planning and continues throughout the examination, evaluation, communication, and follow-up phases of the engagement. Supervision includes:

    a) ensuring that the auditors assigned possess the requisite knowledge, skills, and other competencies to perform the engagement;

    b) providing appropriate instructions during the planning of the engagement and approving the engagement program;

    c) seeing that the approved engagement program is carried out unless changes are both justified and authorized;

    d) determining that engagement working papers adequately support the engagement observations, conclusions, and recommendations;

    e) ensuring that engagement communications are accurate, objective, clear, concise, constructive, and timely;

    f) ensuring that engagement objectives are met; and

    g) providing opportunities for developing internal auditors' knowledge, skills, and other competencies.

2. Appropriate evidence of supervision should be documented and retained. The IAD should make a written record of questions or notes arising from their review. When clearing notes, staff should amend work papers and notate/sign off on review notes.

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[141] GAGAS, paragraph 3.95. – Monitoring Quality
[142] IPPF Standard #2340 – Engagement Supervision

3. All engagement work papers should be reviewed. Evidence of supervisory review should include audit supervisors, managers or directors to initial and date each work paper after it has been reviewed.

Ongoing Monitoring and Performance Measurements

Internal Audit Quality and Improvement is assured through ongoing internal and external assessments of the internal audit activity. Ongoing monitoring must be a part of the system of quality control to evaluate whether the professional standards and legal and regulatory requirements have been followed, quality control system has been appropriately designed, and quality control policies and procedures are operating effectively and complied with in practice.[143]

Internal Assessments
"Internal audit assessment must include ongoing monitoring of the performance of the internal audit activity and periodic self-assessment or assessment by other persons within the organization having sufficient knowledge of internal audit practices."[144] Ongoing reviews should include performance measures and analysis. This may include:

   a) number of requests received and attained;

   b) % audit recommendations implemented;

   c) % audit recommendations with inaccurate conditions;

   d) % achievement of annual plan;

   e) external auditor assessment of internal audit competency;

   f) work environment surveys – suggested questions;

      i. To what extent have you received the training you need to perform your job?
      ii. How often do you meet with your manager to discuss performance?
      iii. To what extent are you recognized for your accomplishments?
      iv. To what extent do you have access to learning opportunities?
      v. How much opportunity do you have to pursue job and career interests?
      vi. To what extent do you receive the information you need to do your job?
      vii. To what extent does your job challenge you?
      viii. To what extent can you have open conversations with your manager on any work-related topic?
      ix. How useful are the resources provided (technology, guidance, reference data, work space…) for you to perform effectively?
      x. To what extent do you feel you (you and your team) add value to the organization?

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[143] GAGAS, paragraphs 3.93 through 3.95 – Monitoring Quality
[144] IPPF Standard #1311 – Internal Assessments

      xi. To what extent do you feel respected by client management?

      xii. Considering everything, how satisfied have you been with your employment in internal audit during the last six months?

g) retention (turnover);

h) professional development successes (certifications, active professional memberships etc.);

i) employee development plan completion; and

j) achieving staffing plans.

Level of Review

1. Quality Assurance (QA) reviews are to be performed on each audit. The IAD Chief Deputy will prescribe the level of review and reviewers. A QA review will be completed after the internal audit staff has completed their review of the work papers.

2. There are three levels of quality assurance review. For QA reviews initiated after the internal audit report has been issued, only Level Three will be assigned as follows:

    a) **Level One -** This is the most limited scope review. Its purpose is to ensure the final audit report is free of defects in grammar, punctuation, and usage of numbers. The QA reviewer will also ensure that the report is in an acceptable format in accordance with departmental policies and procedures.

    b) **Level Two -** This is a limited scope review which consists of a Level One review plus a detailed review of the audit comments and supporting working papers to ensure the accuracy of statements made and appropriateness of conclusions reached. The QA reviewer will also ensure that the report is in an acceptable format in accordance with departmental policies and procedures.

    c) **Level Three -** This is the most detailed level of QA review. It is to be performed by a team of reviewers and will include all steps contained in Levels One and Two. The review should also ensure that all conclusions are based on solid evidence and all appropriate signoffs are present. The QA reviewer will check to make sure that the entire report and working papers are compliant with the *Standards*. The reviewer is encouraged to make suggestions that will improve the quality of the audit report/work papers without significantly increasing time consumption.

Several checklists are to be used in evaluating the technical aspects of the project.

External Assessments

1. "External assessment, also known as "peer reviews" must be conducted at least once every five years by a qualified independent assessor or assessment team

from outside the organization."[145] GAGAS requires peer reviews to be performed more frequently requiring that "audit organizations performing work in accordance with GAGAS must have an external peer review performed by reviewers independent of the audit organization at least once every three years."[146] The CAE and IAD Chief Deputy "must discuss with the Board and Budget Committee:

    a) the form and frequency of external assessment; and

    b) the qualification and independence of the external assessor or assessment team including any potential conflict of interest."[147]

2. External assessments should appraise and express an opinion as to the internal audit activity's compliance with the *Standards* and GAGAS. It should evaluate the effectiveness of the activity in carrying out its mission as set out in its charter and expressed in the expectations of the Board, Budget Committee, and senior management. As appropriate, it should include recommendations for improvement to internal audit management and processes, and the value added to the organization.

3. The first external assessment performed on an internal audit activity should cover a "review period ending no later than 3 years from the date an audit organization begins its first audit in accordance with GAGAS. The period under review generally covers 1 year, although peer review programs may choose a longer review period. The deadlines for peer review reports are established by the entity that administers the peer review program. Extensions of the deadlines for submitting the peer review report exceeding 3 months beyond the due date are granted by the entity that administers the peer review program and GAO."[148]

4. To meet the stricter requirements of GAGAS, the IAD will have an external peer review conducted at least once every three years.

Use of Conformance Language

1. The IAD "should use the following language, which represents an unmodified GAGAS compliance statement, in the audit report to indicate that they performed the audit in accordance with GAGAS:"[149] The IAD will include the following unmodified compliance statement on all audit reports resulting from audit work performed in conformity with GAGAS.

"We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the

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[145] IPPF Standard #1312 – External Assessments
[146] GAGAS, paragraph 3.96 – External Peer Review
[147] IPPF Standard #1312 – External Assessments
[148] GAGAS, paragraph 3.97 – External Peer Review
[149] GAGAS, paragraph 7.30 – Reporting Auditors' Compliance with GAGAS

evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives."

2. If the IAD is unable to comply with GAGAS requirements, it "should include a modified GAGAS compliance statement in the audit report. For performance audits, auditors should use a statement that includes either 1) the above language modified to indicate the requirements that were not followed or 2) language that the auditor did not follow GAGAS."[150]

3. "Indicating that the internal audit activity conforms with the *International Standards for the Professional Practice of Internal Auditing* is appropriate only if supported by the results of the quality assurance and improvement program."[151] In addition, "Indicating that engagements are "conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*" is appropriate only if supported by the results of the quality assurance and improvement program."[152] The internal audit activity conforms with the Code of Ethics and the *Standards* when it achieves the outcomes described therein. The results of the quality assurance and improvement program include the results of both internal and external assessments. All internal audit activities will have the results of internal assessments.

4. "When nonconformance with the Code of Ethics or the *Standards* impacts the overall scope or operation of the internal audit activity, the CAE and IAD Chief Deputy must disclose the nonconformance and the impact to the Board, Budget Committee, and senior management."[153] "When nonconformance with the Code of Ethics or the *Standards* impacts a specific engagement, communication of the results must disclose the:

   a) principle(s) or rule(s) of conduct of the Code of Ethics or the Standard(s) with which full conformance was not achieved;

   b) reason(s) for nonconformance; and

   c) impact of nonconformance on the engagement and the communicated engagement results."[154]

Use of External Service Providers

Depending on the complexity, size, volume, and specialized or unique nature of assurance and consulting services identified on the annual audit plan, the CAE and IAD

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[150] GAGAS, paragraph 7.31 – Reporting Auditors' Compliance with GAGAS

[151] IPPF Standard #1321 – Use of "Conforms with the *International Standard for the Professional Practice of Internal Auditing"*

[152] IPPF Standard #2430 – Use of "Conducted in Conformance with the *International Standard for the Professional Practice of Internal Auditing"*

[153] IPPF Standard #1322 – Disclosure of Nonconformance

[154] IPPF Standard #2431 – Engagement Disclosure of Nonconformance

Chief Deputy may need to consider using external providers to assist in their completion. "When an external service provider serves as the internal audit activity, the provider must make the organization aware that the organization has the responsibility for maintaining an effective internal audit activity."[155]

Internal Audit Approach to Fraud

The IAD "must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk."[156] Though the primary objective of internal audit is not to discover fraud, internal audit staff should have sufficient knowledge to identify the indicators of fraud and maintain professional skepticism throughout the audit recognizing the possibility that a material misstatement due to fraud could exist.

What is Fraud?

1. Fraud is defined as an intentional illegal act characterized by deceit, concealment, or violation of trust to obtain an unjust or illegal advantage. Fraud can be perpetrated by one or more individuals among management, those charged with governance, employees, or third parties. Fraud acts are not dependent upon the threat of violence or physical force.

2. The *Standards* require that internal audit staff have sufficient knowledge to identify the indicators of fraud. Although audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected, internal audits should be planned in such a manner that control weaknesses having fraud potential are identified. Internal audit staff are not expected to have knowledge equivalent to that of a person whose primary responsibility is detecting and investigating fraud.

3. Internal audit activities should be designed in a manner that provides review of the control environment and the inherent potential for fraud. Internal audit risk analysis and audit selection should be based on the degree of change and pressure in operating units. Where appropriate, financial and operating systems should be tied to related accounting and reporting information to validate propriety.

4. Periodic audit training, distribution of audit publications, and other communication methods should be implemented to apprise internal audit staff of the changing nature of fraud and the control environment in which fraud may occur.

5. IAD staff should also receive periodic training around fraud indicators and related methods to ensure awareness of the potential for fraud in areas such as bribes, kickbacks, diversion, embezzlement, concealment, and misrepresentation. System reviews surrounding core business cycles (revenue, disbursement, conversion, inventory, cost, payroll/benefits, capital assets) should be carried out to evaluate the

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[155] IPPF Standard #2070 – External Service Provider and Organizational Responsibility of Internal Auditing
[156] IPPF Standard #2120.A2 – Risk Management

overall control environment and related potential for fraudulent actions to take place. When a specific concern is identified from the normal audit process or by an employee or management concern, IAD staff may become involved in audit or investigative work in these areas.

Deterrence of Fraud

1. Fraud deterrence includes those actions taken to discourage the perpetration of fraud or limit exposure if fraud does occur. The principal mechanism for deterring fraud is control. Control includes all aspect of hard and soft controls beginning with the tone at the top set by the Board, Budget Committee, and senior management - the overall control environment. Management is responsible for the maintenance of an effective control environment. The IAD is tasked with evaluating the control environment to determine the adequacy of internal controls.

2. Internal audit is responsible for assisting in the deterrence of fraud by examining and evaluating the adequacy and the effectiveness of controls, commensurate with the extent of potential exposure/risk in the various segments of the entity's operations. In carrying out this responsibility, the IAD should determine whether:

    a) the organizational environment fosters control consciousness;

    b) the organizational environment is considered along with other appropriate factors in the risk analysis process leading to audit selection and audit program development;

    c) realistic organizational goals and objectives are set;

    d) written county policies (e.g., code of conduct) exist that describe prohibited activities and the action required whenever violations are discovered;

    e) effective procedures exist for the proper handling of complaints regarding accounting and auditing, and other matters and for the anonymous submission of complaints, including the receipt, retention, and treatment of complaints received at all levels to include the Board, or Budget Committee;

    f) appropriate authorization policies for transactions are established;

    g) policies, practices, procedures, reports, and other mechanisms are developed to monitor activities and safeguard assets, particularly in high-risk areas; and

    h) communication channels provide management with adequate and reliable information.

Detection of Fraud

1. Detection consists of identifying indicators of fraud sufficient to warrant recommending an investigation. These indicators may arise because of controls established by management, tests conducted by the IAD, and other sources both within and outside the organization. The IAD should:

a) "ensure staff assigned to perform the audit collectively possess adequate professional competence needed to address the audit objectives and perform work in accordance with GAGAS."[157] Competence is implied relative to fraud detection;

b) have sufficient knowledge of fraud to be able to identify indicators that fraud might have been or could be committed. This knowledge includes the characteristics of fraud, the techniques used to commit fraud, and the types of frauds associated with the activities audited;

c) should assess risk of fraud occurring that is significant within the context of the audit objectives;[158] and

d) be alert to opportunities, such as control weaknesses, that could allow fraud. If significant control weaknesses are detected, additional tests conducted should include tests directed toward the identified fraud indicators.

2. The IAD should review potential fraud indicators derived from auditing procedures, discussions with employees and management, or through Whistle Blower informants. If significant control weaknesses are detected, additional tests may be performed to identify fraudulent activity. If fraud is detected, depending on the nature and extent of the fraud perpetrated, any additional audit or investigation activity will be carefully coordinated with the approval/involvement of the Board, Budget Committee, the ACO, the CAO, County Counsel, or District Attorney.

Investigation of Fraud

1. "When auditors identify factors or risks related to fraud that has occurred or is likely to have occurred that they believe are significant within the context of the audit objectives, they should design procedures to obtain reasonable assurance of detecting any such fraud. Assessing the risk of fraud is an ongoing process throughout the audit and relates not only to planning the audit but also to evaluating evidence obtained during the audit."[159]

2. Fraud investigation will consist of performing extended procedures necessary to determine whether fraud, as suggested by the indicators, has occurred. It includes gathering sufficient evidential matter about the specific details of a discovered fraud. Internal auditors, lawyers, investigators, security personnel, and other specialists from inside or outside the organization are the parties that usually conduct or participate in fraud investigations.

3. When a fraud investigation is deemed necessary, the CAE and IAD Chief Deputy will discuss with the Board and Budget Committee and the CAO as to the appropriate mix of internal or external resources to complete the investigation based on required

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[157] GAGAS, paragraph 3.69 – Competence
[158] GAGAS, paragraph 6.30 – Fraud
[159] GAGAS, paragraph 6.32 – Fraud

expertise or competency.[160] If any "report discloses fraud or gross negligence a copy will be filed with the district attorney."[161]

4. Once a fraud investigation is concluded, the IAD should assess and analyze the facts to determine if controls need to be implemented or strengthened to reduce future vulnerability.

Reporting of Fraud

1. "When auditors detect instances of fraud, waste, and abuse that are not significant within the context of the audit objectives but warrant attention…, they should communicate those observations in writing to the audited entity officials. When auditors detect any instances of fraud, waste, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment."[162]

2. If the IAD concludes that fraud, waste or abuse occurred or is likely to have occurred, they should report the matter as an observation. Whether a particular act is, in fact, fraud, waste or abuse, may have to await final determination by a court of law or other adjudicative body.[163]

3. A report may be made after a preliminary assessment of facts relating to the alleged/suspected irregularity. The report should include the internal audit conclusion as to whether there are sufficient grounds for further investigation.

4. The form, nature, and timing of communicating a fraud investigation will be predetermined by the CAE and IAD Chief Deputy in collaboration with the Board, or Budget Committee, and the CAO.

5. A final report should be submitted to the Board, or Budget Committee, and the CAO to communicate the results of the fraud investigation. The report should include observations, conclusions, recommendations, and, where appropriate, corrective action to be taken.

6. Auditors should report known or likely fraud, waste or abuse directly to parties outside the audited entity when:

   a) management "fails to satisfy legal or regulatory requirements to report such information to external parties specified in law or regulation, auditors should first communicate the failure to report such information to those charged with

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[160] GAGAS, paragraph 6.31 – Fraud
[161] Government Code Chapter 3.5 Controller Section 26883
[162] GAGAS, paragraph 7.22 – Fraud, Noncompliance with Provision of Laws, Regulations, Contracts, and Grant Agreements, and Abuse.
[163] GAGAS, paragraph 7.21 – Fraud, Noncompliance with Provision of Laws, Regulations, Contracts, and Grant Agreements, and Abuse.

governance. If the audited entity still does not report this information to the specified external parties as soon as practicable after the auditors' communication with those charged with governance, then the auditors should report the information directly to the specified external parties;"[164]

b) management "fails to take timely and appropriate steps to respond to known or likely fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse that 1) is significant to the observations and conclusions and 2) involves funding received directly or indirectly from a government agency, auditors should first report management's failure to take timely and appropriate steps to those charged with governance. If the audited entity still does not take timely and appropriate steps as soon as practicable after the auditors' communication with those charged with governance, then the auditors should report the entity's failure to take timely and appropriate steps directly to the funding agency."[165]

Administrative Matters

Duties and Responsibilities of the Internal Audit Division

Chief Audit Executive (CAE)

Pursuant to Government Code[166] section 26883, the Board has the power to "enter into contracts for audits or require the County Auditor-Controller to audit the accounts and records of any department, office, Board, or institution under its control and of any district whose funds are kept in the County Treasury. Additionally, Government Code section 26884 gives the Board the option of electing to require the Auditor-Controller "perform the additional services authorized by this chapter." By code the Auditor-Controller is deemed the CAE and is responsible for:

a) overseeing the day-to-day operations of the IAD

b) ensuring the IAD is sufficiently staffed and resourced in accordance with Board authorizations;

c) ensuring the IAD retains the appropriate skills, knowledge, and expertise expected in a professional internal audit activity;

d) ensuring the IAD has the appropriate mix of skills to effectively support the needs of the County:

e) ensuring the IAD is performing its duties effectively and efficiently and in a manner that supports the Board's strategic initiatives;

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[164] GAGAS, paragraph 7.24a – Fraud, Noncompliance with Provision of Laws, Regulations, Contracts, and Grant Agreements, and Abuse.
[165] GAGAS, paragraph 7.24b – Fraud, Noncompliance with Provision of Laws, Regulations, Contracts, and Grant Agreements, and Abuse.
[166] Government Code; Title 3; Division 2; Part 3; Chapter 3.5

f) ensuring the IAD adheres to GAGAS and IIA *Standards*, federal, state, and local laws, and County policies and procedures;

g) reviewing and approving the county-wide risks assessment and annual Internal Audit Plan;

h) ensuring engagement results are reported to the Board, Budget Committee and senior management timely; and

i) ensuring systems, tools and processes are in place to enable effective management resourcing of IAD staff, documentation of engagement results, monitoring those results, and reviewing results for quality and adherence to GAGAS and the IIA *Standards.*

Chief Deputy (Director)

1. The IAD Chief Deputy "must effectively manage the internal audit activity to ensure it adds value to the organization."[167] The IAD Chief Deputy is responsible for directing IAD activities and supporting the CAE in providing advice and guidance to the Board, Budget Committee, and senior management on risk management, internal control and governance issues.

2. The IAD Chief Deputy is also responsible for:

      j) assessing and monitoring county-wide risks;

      k) preparing and monitoring the Annual Internal Audit Plan;

      l) managing internal audit staff including:

         i. assessing staff requirements;

         ii. posting and transfer of staff;

         iii. implementing a management information system to help manage division;

         iv. designing and organizing division training;

         v. making recommendations for posts, promotions and disciplinary matters; and

         vi. maintaining a database of staff and preparing rotational plans.

      m) examining proposals for improving the financial management system;

      n) dealing with cases on the failure of internal control systems, departures from instructions and provisions, errors, irregularities and fraud;

      o) promptly alerting the CAE and the Board, or Budget Committee, whenever a major weakness in the system is identified or an irregularity or a fraud is detected;

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[167] IPPF Standard #2000 – Managing the Internal Audit Activity

    p) ensuring there is sufficient supervision at all levels of the internal audit process and uniformity in the application of internal audit procedures through:

        i. quality review assessment; and

        ii. monthly meetings with staff auditors;

    q) ensuring audit quality meets the *Standards* by:

        i. establishing and reviewing policies and procedures to guide the audit team in carrying out their work; supervising the audit team's work;

        ii. developing and supporting the implementation of standard internal auditing methodology and procedures to be used across the County;

        iii. reviewing the Internal Audit Charter as and when required; and

        iv. conducting periodic quality assurance reviews to ensure that audit work is being carried out according to the *Standards* and GAGAS;

    r) reviewing and finalizing the Internal Audit Plan;

    s) approving the Audit Engagement Plan for each audit prior to commencement;

    t) ensuring follow-up exercise is carried out on internal audit recommendations;

    u) discussing with the CAE and the Board, or Budget Committee, non-implementation of internal audit recommendations;

    v) preparing and submitting to the Board, or Budget Committee, an Annual Internal Audit Report highlighting major internal audit observations and recommendations together with auditee responses to be submitted to the Board; and

    w) conducting special investigations or inquiries at the request of the CAE and the Board, or Budget Committee.

3. The CAE or IAD Chief Deputy may be asked to assume additional roles and responsibilities in addition to internal auditing, such as responsibility for compliance or risk management activities. These roles and responsibilities may impair, or appear to impair, the organizational independence of the IAD. Safeguards are required by oversight activities, often undertaken by the Board, or Budget Committee, to address these potential impairments, and may include such activities as periodically evaluating reporting lines and responsibilities and developing alternative processes to obtain assurance related to the areas of additional responsibility.

4. "Where the CAE has, or is expected to have roles and/or responsibilities that fall outside of internal auditing, safeguards must be in place to limit impairments to independence or objectivity."[168] The CAE and IAD Chief Deputy will evaluate all

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[168] IPPF Standard #1112 – Chief Audit Executive Roles Beyond Internal Auditing

activities for which duties have been assigned and determine whether assigned activities impair objectivity and require safeguards to ensure independence and objectivity.

Internal Audit Analyst (Audit Manager)

The Internal Audit Analyst is a manager role designated by the IAD Chief Deputy to help lead the internal audit division and is responsible for:

a) assisting in identifying and assessing county-wide risk and controls;

b) assisting in the preparation of the Annual Internal Audit Plan;

c) maintaining a data base in respect of audit status and any other information needed for the smooth operation of the unit as requested by the IAD Chief Deputy;

d) assisting in the identification and assessment of emerging and/or critical issues;

e) maintaining the departments policies and procedures;

f) supervising audits by providing staff instructions and approving audit programs;

g) reviewing audit work to ensure the adequacy of audit scope and tests performed as well as the accuracy of conclusions reached;

h) assessing the quality of the audit by ensuring adherence to audit policies, standards and procedures;

i) documenting and maintaining evidence of supervision, such as review notes, to-do lists, and work paper review checklist;

j) performing audit work, where necessary;

k) reviewing and issuing audit reports; and

l) training and providing guidance to internal audit staff.

Internal Auditor III (Audit Supervisor)

Internal Auditor III is a supervisory role. Audit supervisors are designated by the CAE to lead audits, or conduct special investigations. Audit supervisors are responsible for:

a) reviewing audit work to ensure the adequacy of audit scope and tests performed as well as the accuracy of conclusions reached;

b) assessing the quality of audit by ensuring adherence to audit policies, standards and procedures;

c) documenting and maintaining evidence of supervision, such as review notes, to-do lists, and work paper review checklist;

d) conducting preliminary audit surveys and analytics of audit clients;

e) developing risk-based audit programs;

f) executing audits in accordance with the audit program and procedures;

g) reviewing audit observations and, where necessary, conducting further investigations;

h) reporting on internal audit observations and proposing corrective measures;

i) follow-up on audit observations reported to ensure recommendations made are satisfactorily implemented; and

j) training and providing guidance to internal audit staff.

Internal Auditors I and II (Staff Auditors)

Internal Auditors I and II are staff auditors. Staff auditors are designated by the CAE to carry out audits, either alone or as head of a team. Staff auditors are responsible for:

a) conducting preliminary survey of audit assignments;

b) carrying out the audit in accordance with the audit program and procedures;

c) maintaining adequate documentations of audit work performed;

d) documenting observations and, where necessary, conducting further investigations;

e) reporting on internal audit observations and proposing corrective measures; and

f) follow- up on internal audit reports to ensure that recommendations made on prior audit observations are satisfactorily implemented.

Training and Certification Opportunities

1. To ensure IAD competencies are sufficient to meet the County's needs, the IAD's policy is to obtain the most skilled and qualified internal auditors. The CAE and internal audit members reporting to CAE will have appropriate professional certifications and qualifications.[169] Internal audit staff holding the ranks of Internal Auditor III and above will be required to obtain and hold an active professional certification in at least one of the following disciplines:[170]

a) Certified Public Accountant (CPA);

b) Qualification in Internal Audit Leadership (QIAL)

c) Certified Internal Auditor (CIA);

d) Certified Information Systems Auditor (CISA);

e) Certification in Risk Manager Assurance (CRMA);

f) Certified Financial Services Auditor (CFSA);

g) Certified Government Auditing Professional (CGAP);

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[169] Government Code Title 3, Division 2, Part 3, Chapter 4, Article 4, Section 1236(a)(4)
[170] IPPF Standard #1200 – Proficiency

    h) Certified Professional Forensic Accountant (CPFA);

    i) Certified Professional Environmental Auditor (CPEA);

    j) Certified Professional Safety Auditor (CPSA); or

    k) Certification in Control Self-Assessment (CCSA)

2. Staff holding the rank of Internal Audit I or Internal Auditor II will be encouraged to seek a professional designation. The IAD fully supports all internal audit staff in their efforts to maintain and/or obtain professional certifications.

Continuing Education Requirements

1. The IAD "must enhance their knowledge, skills, and other competencies through continuing professional development."[171] To enhance the competencies of the IAD, internal audit staff are required to establish a professional development plan and attend at least 24 hours of continuing professional education (CPE) for every two-year period covering governmental accounting, auditing, or related subjects in the achievement to that plan. Auditors involved in planning, directing, or reporting GAGAS audits and/or auditors performing 20% or more time on GAGAS, should take an additional 56 hours of CPE for a total of 80 hours." [172] GAGAS CPE requirements are more stringent than CPE required of County's code.[173] When deciding on what type of CPE to attend, internal audit staff should reflect on their job requirements,[174] including, training policies and professional education requirements of their profession, organization, industry, and any certifications or areas of specialization.

2. Internal auditors can use self-assessment tools, such as the Competency Framework, as a basis for creating a professional development plan. The development plan may encompass on-the-job training, coaching, mentoring, and other internal and external training, volunteer, or certification opportunities.

3. Internal auditors should discuss their professional development plan with the CAE or IAD Chief Deputy. The professional development plan may be used as the basis for developing measures of the internal auditor's performance (i.e., key performance indicators), which could be incorporated into supervisory reviews, client surveys, and annual performance reviews.

4. Individual internal auditors are responsible for conforming with CPE standards and may demonstrate conformance by retaining documentation or other evidence of any of the following:

    a) self-assessments against a competency framework or benchmark;

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[171] IPPF Standard #1230 – Continuing Professional Development
[172] GAGAS, paragraph 3.76 – Continuing Professional Development
[173] Government Code Title 3, Division 2, Part 3, Chapter 4, Article 4, Section 26945.1(a)
[174] Government Code Title 3, Division 2, Part 3, Chapter 4, Article 4, Section 26945.1(b)

    b) professional development and training plans;

    c) memberships and participation in professional organizations;

    d) subscriptions to sources of professional information; and

    e) completed training (e.g., CPE credits or certifications).

Performance Evaluations

1. Each internal auditor working for Monterey County should be notified, regularly, of the extent to which their performance is satisfying the standards of their position. Performance evaluations will be conducted on all IAD staff continuously. Internal audit members will be commended, coached, advised or instructed after each engagement for which they participate. Quarterly, staff members will have a "progress evaluation" with the IAD Chief Deputy. The purpose of the quarterly evaluation is to:

    a) identify strengths and weaknesses;

    b) revise or reestablish goals to ensure achievement of performance standards;

    c) provide constructive feedback and action plans on areas of improvement; and

    d) ensure tracking and achievement of professional development and training plans.

2. Annually, the IAD will conduct a formal evaluation in compliance with Monterey County's Employee Performance Evaluation Policy. The IAD will document performance evaluations using the Auditor-Controller's Performance Appraisal Form. The key performance evaluation factors for which internal audit staff will be evaluated include:

    a) job competencies, knowledge, and skills;

    b) details of the quality and quantity of work performance;

    c) employee work habits, reliability, and manor of conduct;

    d) working relationships;

    e) communication skills; and

    f) supervisory skills.

3. Internal audit staff performance evaluations will be rated based on the following criteria:

Performance Rating Scale Definitions	
Outstanding	Work performance/results are extraordinary, or consistently exceed job expectations and/or standards; contributes significantly to objectives of the department/division.

Exceeds Job Standard	Work performance/results frequently exceeded job expectations and/or standards; above average contributions to objectives of the department/division.
Meets Job Standard	Work performance/results fully meet, and on occasion exceed, job expectations and/or standards; average contributions to objectives of the department/division.
Improvement Needed	Work performance/results do not consistently meet job expectations and/or standards; improvement is required.
Unsatisfactory	Work performance/results are inadequate and well below minimum job expectations and/or standards; significant improvement required.

Record Retention

1. "The CAE must develop retention requirements for engagement records, regardless of the medium in which each record is stored. These retention requirements must be consistent with the organization's guidelines and any pertinent regulatory or other requirements."[175]

2. "The CAE must develop policies governing the custody and retention of consulting engagement records, as well as their release to internal and external parties. These policies must be consistent with the organization's guidelines and any pertinent regulatory or other requirements."[176]

3. The IAD will conform to the Auditor-Controller's Records Retention and Disposition Schedule unanimously approved by the Board on December 1, 2004. This schedule requires audit records be retained for five years after the fiscal year they are produced.

4. An "audit record" is any type of document created or received while performing the internal audit activity, including, but not limited to, paper, email, any type of electronic file or data, still photographs, motion pictures, drawings, plans/blueprints, and audio/video recordings, etc. IAD records are defined as follows:

   a) **Active Record** - any record that is currently actively used by an office or function;

   b) **Inactive Record** - is a record that is no longer an Active record but still must be maintained pursuant to the Auditor-Controller's Records Retention and Disposition Schedule. Inactive records are typically maintained in the Auditor-Controller's Office or at an off-site storage facility.

   c) **Electronic Record** - is a record kept in an electronic format, such as a word processing document, a spreadsheet, a database, a scanned or imaged

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[175] IPPF Standard #2330.A2 – Documenting information
[176] IPPF Standard #2330.C1 – Documenting information

document, and any other type of file stored on a computer, server or mainframe storage device or medium, or on any external or off-site storage medium, or with a third party acting as an agent. Electronic records have the same retention periods as paper and other tangible records;

d) **Archived Record -** is an Inactive record that has permanent or historical value.

Protecting Confidential Information

1. Confidential information is any information with restrictions placed on the communication or dissemination of that information. Confidential information must be treated with care ensuring to follow all applicable laws and county policies and procedures.

2. The IAD is committed to protecting confidential information received or reviewed while performing the internal audit activity. Confidential information will only be reviewed if required to reach conclusions about the propriety of transactions, processes, and adequacy of controls. If confidential information is not required to perform an internal audit engagement, it may be specifically omitted from documentation and data request made by the IAD. The IAD bifurcates confidential information into 1) government information and 2) personal information as follows:

   a) **Confidential government information** includes any information held by an agency which is not yet or may never be made public. How such information is collected, stored, shared and used affects the public trust. Examples include the information people provide when they apply for services, information contained in official documents such as legal papers or papers evidencing sensitive information discussed during closed sessions with the Board or Budget Committee. The IAD will ensure confidential government information, is handled with the greatest of care and in accordance with county, state, and federal law.

   b) **Confidential personal information** or Personally Identifiable Information (PII) records include an individual's name or personal mark together with that individual's social security number; driver's license number or other government identification card number; financial account number, credit or debit card number, or any number or code which may be used alone or in conjunction with another piece of information to assume the identity of another person, access financial resources, or obtain credit information. PII is highly sensitive and must be safeguarded and secured always. The IAD will conform to the Information Technology Division's Data Privacy Policy, dated May 13, 2014, which seeks to protect the privacy of PII.

Glossary

Add Value: The internal audit activity adds value to the organization (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes.

Adequate Control: Present if management has planned and organized (designed) in a manner that provides reasonable assurance that the organization's risks have been managed effectively and that the organization's goals and objectives will be achieved efficiently and economically.

Assurance Services: An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements.

Board: The highest level governing body (e.g., a board of directors, a supervisory board, or a board of governors or trustees) charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable. Although governance arrangements vary among jurisdictions and sectors, typically the board includes members who are not part of management. If a board does not exist, the word "board" in the *Standards* refers to a group or person charged with governance of the organization. Furthermore, "board" in the *Standards* may refer to a committee or another body to which the governing body has delegated certain functions (e.g., an audit committee).

Charter: The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities.

Chief Audit Executive: Chief audit executive describes the role of a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the mandatory elements of the International Professional Practices Framework. The chief audit executive or others reporting to the chief audit executive will have appropriate professional certifications and qualifications. The specific job title and/or responsibilities of the chief audit executive may vary across organizations.

Code of Ethics: The Code of Ethics of The Institute of Internal Auditors (IIA) are Principles relevant to the profession and practice of internal auditing, and Rules of Conduct that describe behavior expected of internal auditors. The Code of Ethics applies to both parties and entities that provide internal audit services. The purpose of the Code of Ethics is to promote an ethical culture in the global profession of internal auditing.

Compliance: Adherence to policies, plans, procedures, laws, regulations, contracts, or other requirements.

Conflict of Interest: Any relationship that is, or appears to be, not in the best interest of the organization. A conflict of interest would prejudice an individual's ability to perform his or her duties and responsibilities objectively.

Consulting Services: Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation, and training.

Control: Any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organizes, and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved.

Control Environment: The attitude and actions of the board and management regarding the importance of control within the organization. The control environment provides the discipline and structure for the achievement of the primary objectives of the system of internal control. The control environment includes the following elements:

- Integrity and ethical values.
- Management's philosophy and operating style.
- Organizational structure.
- Assignment of authority and responsibility.
- Human resource policies and practices.
- Competence of personnel.

Control Processes: The policies, procedures (both manual and automated), and activities that are part of a control framework, designed and operated to ensure that risks are contained within the level that an organization is willing to accept.

Core Principles for the Professional Practice of Internal Auditing: The Core Principles for the Professional Practice of Internal Auditing are the foundation for the International Professional Practices Framework and support internal audit effectiveness.

Engagement: A specific internal audit assignment, task, or review activity, such as an internal audit, control self-assessment review, fraud examination, or consultancy. An engagement may include multiple tasks or activities designed to accomplish a specific set of related objectives.

Engagement Objectives: Broad statements developed by internal auditors that define intended engagement accomplishments.

Engagement Opinion: The rating, conclusion, and/or other description of results of an individual internal audit engagement, relating to those aspects within the objectives and scope of the engagement.

Engagement Work Program: A document that lists the procedures to be followed during an engagement, designed to achieve the engagement plan.

External Service Provider: A person or firm outside of the organization that has special knowledge, skill, and experience in a particular discipline.

Fraud: Any illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage.

Governance: The combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives.

Impairment: Impairment to organizational independence and individual objectivity may include personal conflict of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations (funding).

Independence: The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.

Information Technology Controls: Controls that support business management and governance as well as provide general and technical controls over information technology infrastructures such as applications, information, infrastructure, and people.

Information Technology Governance: Consists of the leadership, organizational structures, and processes that ensure that the enterprise's information technology supports the organization's strategies and objectives.

Internal Audit Activity: A department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes.

International Professional Practices Framework: The conceptual framework that organizes the authoritative guidance promulgated by The IIA. Authoritative guidance is composed of two categories; 1) mandatory and 2) recommended.

Must: The *Standards* use the word "must" to specify an unconditional requirement.

Objectivity: An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.

Overall Opinion: The rating, conclusion, and/or other description of results provided by the chief audit executive addressing, at a broad level, governance, risk management, and/or control processes of the organization. An overall opinion is the professional judgment of the chief audit executive based on the results of a number of individual engagements and other activities for a specific time interval.

Risk: The possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood.

Risk Appetite: The level of risk that an organization is willing to accept.

Risk Management: A process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's objectives.

Should: The *Standards* use the word "should" where conformance is expected unless, when applying professional judgment, circumstances justify deviation.

Significance: The relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors, such as magnitude, nature, effect, relevance, and impact. Professional judgment assists internal auditors when evaluating the significance of matters within the context of the relevant objectives.

Standard: A professional pronouncement promulgated by the International Internal Audit Standards Board that delineates the requirements for performing a broad range of internal audit activities and for evaluating internal audit performance.

Technology-based Audit Techniques: Any automated audit tool, such as generalized audit software, test data generators, computerized audit programs, specialized audit utilities, and computer-assisted audit techniques (CAATs).