

REPORT BY THE  
AUDITOR GENERAL  
OF CALIFORNIA

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**THE STATE OF CALIFORNIA  
SHOULD IMPROVE ITS  
INTERNAL AUDIT CAPABILITIES**

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REPORT BY THE  
OFFICE OF THE AUDITOR GENERAL

F-499

THE STATE OF CALIFORNIA SHOULD IMPROVE  
ITS INTERNAL AUDIT CAPABILITIES

JULY 1986



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Thomas W. Hayes  
Auditor General

July 25, 1986

F-499

Honorable Art Agnos, Chairman  
Members, Joint Legislative  
Audit Committee  
State Capitol, Room 3151  
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning a need to have departmental internal auditors fully comply with professional standards for internal auditing.

Respectfully submitted,

  
THOMAS W. HAYES  
Auditor General

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## SUMMARY

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### RESULTS IN BRIEF

The State of California should improve its internal audit capability. Many of the departmental internal audit units need to report to higher organizational levels and need to adhere closely to "Standards for Professional Practice of Internal Auditing" (professional standards) so that the departmental internal audit units can be more effectively used as an early detection system for financial and management problems in California State Government.

The internal audit units of at least 15 departments are not fully complying with legal requirements to utilize the professional standards as published by the Institute of Internal Auditors, Inc. (institute). Internal audits not done in accordance with professional standards reduce the assurance that internal control weaknesses in fiscal operations or in electronic data processing (EDP) operations are detected and corrected.

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### BACKGROUND

We identified 31 departments that currently have internal audit units that review and evaluate the departments' internal accounting controls and fiscal compliance in using public funds and other assets. According to the California Government Code Section 1236, state departments that have their own internal audit units must comply with the institute's professional standards. State Administrative Manual Section 20010 requires that reviews of internal controls and fiscal compliance be performed in accordance with these professional standards. Internal audits are part of the basic controls that can prevent misuse of public funds and other assets. Compliance with the institute's professional standards improves the efficiency and effectiveness of the internal audit units.

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## PRINCIPAL FINDINGS

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### Internal Audit Units Are Not Independent

Six of the 31 internal audit units that we reviewed are not organizationally independent of the activities they audit. Therefore, the internal audit units may have difficulty being objective. For example, the internal audit unit of the Department of Food and Agriculture reports to the Department of Food and Agriculture's assistant director, who also has direct authority over a variety of financial functions that the internal audit unit is asked to audit. Consequently, the internal audit unit may not be able to render the impartial and unbiased judgments essential to the proper conduct of audits.

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### The Internal Audit Units' Scope of Work Is Insufficient, and Their Work Is Inadequate or Improperly Managed

We reviewed the type and quality of work performed by 20 of the 31 internal audit units. Seven internal audit units did not always comply with the scope of work standards. For instance, 4 internal audit units did not include in their audit plans reviews of the EDP operations as required. In addition, 13 internal audit units did not always comply with performance of audit work standards. For example, 4 internal audit units do not always prepare an audit plan or audit program to guide them in conducting audits. Lastly, 12 internal audit units are not properly managed; 3 of these internal audit units do not have approved audit charters outlining the purpose, authority and responsibility of the internal audit unit. Because of these deficiencies, the reliability of the internal audit units' work is questionable. Moreover, improper management of an internal audit unit results in inefficient and ineffective use of resources.

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Internal Auditors Do Not Always  
Possess the Proficiency to  
Perform Audit Work

In seven internal audit units, the internal auditors did not always possess the appropriate skills or receive adequate training to perform audits. The Department of Finance in its 1986 EDP audit plan reported that the departmental internal auditors' knowledge of EDP quality control is not yet sufficient and needs to be increased. Specifically, three departments requested the Department of Finance's assistance to conduct such reviews because they were unable to do the work themselves.

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**RECOMMENDATIONS**

To improve the performance of the internal audit units, the following actions should be taken:

- The department directors should have their internal audit units report to a member of management who is not responsible for the operations that the internal audit units may audit;
- Each internal audit unit manager should clearly define the scope of the internal audit unit's work and provide continuing guidance and training;
- The State should standardize the technical and training requirements for internal auditors; and
- The Department of Finance should ensure that internal audit units comply with the professional standards of the Institute of Internal Auditors, Inc.



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## AGENCY COMMENTS

### Department of Finance

The Department of Finance generally agreed with our findings and acknowledged that improvements regarding internal control operations can be made. However, the Department of Finance responded that our review emphasized absolute compliance rather than reasonable compliance with the professional standards. However, we believe that our review emphasized reasonable compliance.

While the Department of Finance agreed that the internal audit units should be independent, it pointed out that the individual state agencies are responsible for placing the internal audit units within their organizations so that the units are independent.

### Other Agencies

The agencies responding generally agreed with the findings we reported and will be implementing changes to comply with the appropriate professional standards. However, the Health and Welfare Agency, responding for the Department of Developmental Services, believed that the Department of Developmental Services' workpapers that we reviewed were not representative of the Department of Developmental Services' audit work. Additionally, the Department of Food and Agriculture agreed that it has not prepared a formal training plan for fiscal year 1985-86 but claims that seven of its nine auditors have taken specialized outside training, including accounting and auditing courses.

We did not receive responses from the California State University Trustees and the Department of Justice.

## INTRODUCTION

Thirty-one departments have internal audit units to provide management with reliable and independent appraisals of the departments' internal controls and the departments' fiscal compliance requirements. According to the Department of Finance's latest data, which is dated March 1985, these units have approximately 185 professional staff conducting internal audits, and they have a total operating budget of approximately \$9 million.

In 1981, the Legislature enacted Sections 10534 and 12430 of the Government Code to coordinate the audit activities of the internal audit units, the Department of Finance, the State Controller, and the Office of the Auditor General. These sections also require the Department of Finance to coordinate and provide technical assistance to the internal audit units. In 1982, the Legislature enacted Sections 1236 and 10529 of the Government Code to require the State Controller, the Department of Finance, and the internal audit units to comply with the standards of internal auditing as specified in the "Standards for the Professional Practice of Internal Auditing" (professional standards) as published by the Institute of Internal Auditors, Inc. (institute). Moreover, Section 10529 requires the Department of Finance to ensure that the internal audit units use these professional standards. Finally, in 1982, the Legislature enacted Sections 13400 through 13407 of the Government Code, known as the Financial Integrity and State Managers' Accountability Act of 1983,

which requires the heads of the state agencies to report on the adequacy of their agencies' internal control systems. Sections 20010 and 20013 of the State Administrative Manual require that the departments review their systems and that the units use the institute's professional standards to conduct these reviews.

In addition, the Department of Finance has developed long-range plans and an audit program to review and evaluate the internal control systems in major state departments and institutions. Each internal audit unit uses the Department of Finance's audit program to review its department's internal controls. Every two years, the Department of Finance reviews the internal audit units' work on internal controls and, to minimize the duplication of audit work, uses the work of the internal audit units in its evaluation of all of the departments' controls statewide.

#### SCOPE AND METHODOLOGY

The objective of our review was to determine whether the internal audit units are complying with the institute's professional standards for independence, scope of work, performance of audit work, management of the internal audit unit, and proficiency. These standards require that internal audit units be independent of the activities they audit; that the scope of audit work encompass the examination and evaluation of the departments' internal control systems; that audit work include planning the audit, examining and

evaluating information, communicating results and following up; that the director of internal auditing properly manage the internal audit unit; and that audits be performed proficiently.

To analyze and evaluate the internal audit units' compliance with the institute's professional standards, we used the guidelines presented in the publication, "A Framework for Evaluating an Internal Audit Function," a publication of the Foundation for Auditability Research and Education, Inc. This publication presents guidelines and questionnaires for evaluating internal auditors' compliance with the institute's professional standards. Using these guidelines, we reviewed policies and procedures, and interviewed managers and staff of the internal audit units.

To evaluate departmental compliance with the independence standards, we analyzed the organizational structure of all 31 state departments that we identified as having internal audit units. To evaluate selected departments' compliance with the scope of work, performance of audit work, and management of the internal audit unit standards, we reviewed in depth 17 internal audit units' management plans; the units' individual audit planning documents, reports and related workpapers; the internal audit units' policies and procedures; and evidence showing that the internal audit units were properly supervised.

In reviewing the internal audit units' scope of work and performance of audit work, we determined that State Administrative Manual Section 20011 requires 24 of the 31 internal audit units to report the results of these reviews to the Department of Finance. To evaluate compliance with the reporting requirement, we analyzed the Department of Finance's records showing which departments had submitted the reports. To evaluate departmental compliance with professional proficiency standards, we analyzed the education and experience requirements that internal audit units use to select staff, and we reviewed the personnel files and the training programs of 17 of the 31 internal audit units' staff.

We performed these evaluations during fiscal years 1984-85 and 1985-86, and the results of our evaluations are summarized in Appendices B and C, respectively. The results of our evaluation for fiscal year 1984-85 were also previously reported in our report "State of California, Financial and Compliance Single Audit Report, Year Ended June 30, 1985," dated April 1986.

## AUDIT RESULTS

### STATE INTERNAL AUDIT UNITS ARE NOT USING PROFESSIONAL INTERNAL AUDITING STANDARDS

Fifteen of the 31 departments with internal audit units are not fully complying with statutory requirements to use the "Standards for the Professional Practice of Internal Auditing" (professional standards) published by the Institute of Internal Auditors, Inc. (institute). The 15 departments violated the criteria in the professional standards for independence, scope of work, performance of audit work, management of the internal audit unit, and professional proficiency. The organizational placement of 6 internal audit units within their departments does not allow the internal audit units to be independent of the activities they audit. Also, 13 internal audit units either do not have a comprehensive scope of work, do not adequately perform audit work, or are not always properly managed. Finally, 7 internal audit units do not always possess the proficiency to perform their work.

If the internal audit units are inefficient, departmental management cannot always be assured that internal controls are in place, that departmental policies are being carried out, and that internal control weaknesses are detected and corrective action taken. For example, in April 1986, in our report "State of California, Financial and Compliance Single Audit Report, Year Ended

June 30, 1985," we reported that the State lost \$10 million in revenues, did not collect over \$4 million in funds owed to it, and spent \$58 million in nonfunctional items because of undetected weaknesses in internal controls. Also, external auditors may be reluctant to rely on the work of the internal audit units; the external auditors may, therefore, be duplicating the work of the internal auditors. For example, during its annual financial audit of the State, the Office of the Auditor General cannot rely on much of the work done by internal audit units because the work is not always done in accordance with the institute's professional standards.

Government Code Section 10529 requires that the internal audit units conduct audits in accordance with the institute's professional standards, which contain criteria for independence, scope of work, performance of audit work, management of the internal auditing unit, and professional proficiency.

#### Internal Audit Units Are Not Independent

The organizational placement of six departmental internal audit units impairs their independence in conducting audits and objectively reporting audit findings. Each internal audit unit reports to a different management level, but some internal audit units report to a level that is not independent of the activities that they are asked to audit. As a result, these internal audit units are not always

able to render the impartial and unbiased judgements essential to properly conducted audits as required under the institute's professional standards.

Professional standards require that internal audit units be independent of the activities they audit. That is, the internal audit unit should report to an individual with sufficient authority to consider all of the department's operations, to consider all findings and recommendations, and to ensure that appropriate action is taken on all audit recommendations.

Twenty-four of the 31 internal audit units we reviewed report to individuals whose organizational placement is from one to four levels below the department director.\* Therefore, these internal audit units may not have the independence to audit all operations and to report and follow up on all findings. Moreover, 6 of the 24 internal audit units report to individuals who have responsibilities such as accounting, budgeting, personnel, or data processing. We found that the organizational placement of these 6 internal audit units affects their independence in planning and conducting audits and reporting all results.

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\*Director is used to indicate the head of the department. However, departments may use different titles.



For instance, the Department of Food and Agriculture's internal audit unit reports to an assistant director of the Division of Administrative Services, who has direct authority over the financial services, personnel services, and other departmental services that are subject to internal audit reviews. Also, the Department of Justice's internal audit unit reports to the deputy director of the Division of Administrative Services, who also has direct authority over accounting, budgeting, and personnel, which are subject to internal audit reviews. Because these internal audit units report to a level of management that has authority over other activities that may be subject to internal audits, the internal auditors may not have the independence necessary to plan and conduct audits and to report and follow up on audit findings and recommendations.

Internal Audit Units' Scope  
of Work, Quality of Work, and  
Management Are Not Always Adequate

The scope and quality of work performed by internal audit units often does not adequately provide their departments with assurance that internal control and administrative systems are in place and working properly. For example, four of the internal audit units did not include in their audit plans reviews of electronic data processing (EDP) operations, as required. Moreover, the internal audit units do not always comply with the standards for the performance of audit work, such as planning audits, adequately examining and evaluating information, and reporting audit findings. Finally,

managers of internal audit units do not always clearly define the objectives or activities of the internal audit units, implement quality control procedures to assure that work performed is properly conducted, or control available staff and time resources.

The institute's professional standards require that the scope of the internal audits define all areas of potential audits; that the audit work include planning, adequate examination and evaluation, and reporting results; and that management provide adequate guidance. As a result of the deficiencies noted, the internal audit function of certain departments is not operating in the most efficient and effective manner.

#### Audit Scopes Are Too Narrow

State departments do not always include in their audit plans the operations that they may be required to audit. Specifically, departments that have EDP operations are required to review a portion of their EDP systems annually and complete these reviews every three years. Further, the departments are required to report the results of the reviews to the Department of Finance by October 31 of each year. However, for the three-year cycle ending June 30, 1985, we found that 4 departments did not include this review as part of their scope and, as a result, were among the 12 departments that had not reported their results to the Department of Finance. For example, the Department of General Services, which should have reported on its EDP system by

October 31, 1985, had not performed the audit as of the end of our field work, approximately seven months later. Moreover, the Department of Food and Agriculture did not include a review of its EDP system in its schedule of audit assignments for fiscal year 1985-86. Because accounting and management information for these agencies is generated through EDP systems, users of this information cannot be assured that it is prompt, accurate, and reliable. Professional standards require that the scope of the internal audits include an examination and evaluation of the adequacy and effectiveness of the department's systems of internal controls. Further, State Administrative Manual Section 20013 requires internal audit units to review and evaluate the EDP control systems within their departments.

#### Audit Work Is Not Always Correctly Done

The work of the internal audit units is not always correctly done. In 13 of the 20 internal audit units that we reviewed, the internal audit units did not always adequately plan audits, sufficiently examine and evaluate information, correctly communicate results, and appropriately follow up on audit recommendations. (See Appendices B and C for a summary of variances from the institute's professional standards.)

Four of the internal audit units did not always adequately plan their audits. For instance, the Department of Parks and Recreation's internal auditors did not prepare audit plans or programs

to guide them in performing audits. As a result, the manager of the internal audit unit could not be sure that sufficient work had been done to meet the audit objectives or that his resources had been used efficiently.

Twelve of the internal audit units did not always document the extent or results of their examinations or evaluate sufficient information. For example, the Board of Equalization's internal audit unit did not always document the audit procedures it performed or explain why certain procedures were not performed. Also, the Department of Justice's internal audit unit did not document audit procedures, audit results, or supervisory reviews. When the internal audit units do not document the results of their examination, departmental management cannot be assured that the audit reports are supported by sufficient, competent, and relevant work.

Three of the internal audit units did not always correctly report the scope, purpose, or results of their audits. For example, the Department of Food and Agriculture's (DFA) internal audit unit did not always properly report the scope of their audits. In one instance, the DFA issued an opinion stating that the financial statements of the department had been prepared in accordance with generally accepted accounting principles. However, the financial statements were not prepared in accordance with generally accepted accounting principles. Further, generally accepted auditing standards do not allow an internal audit unit to issue an opinion on its department's financial

statements. As a result, the information from the internal audit units may be misleading the department.

Three of the internal audit units did not follow up on the results of their audits. For instance, the Department of Rehabilitation's internal audit unit did not follow up to ensure that its recommendations to two of its district offices were being implemented. As a result, the department has no assurance that internal controls and operations are improving.

The Internal Audit Units Are  
Not Always Adequately Managed

Internal audit units are not always adequately managed. At 12 of the 17 departmental internal audit units we reviewed, we found a variety of managerial problems. For instance, the Department of Consumer Affairs was one of three departments that did not provide its staff with a statement of the purpose, authority, or responsibility for conducting audits. Further, the Department of Justice and the California State Universities' Trustees were two of six departments that did not provide proper guidance and supervision, including prompt reviews of work performed. Also, the Department of Rehabilitation's internal audit unit was one of four internal audit units that did not analyze the operations that management may wish to audit. Finally, the Department of Finance was one of seven departments that did not always analyze variances between budgeted audit time and actual time spent on an audit. As a result of these weaknesses, departments do not have

assurance that audit responsibilities conform with departmental directives, that the work performed is of the desired quality, or that all potential audits have been considered and all resources efficiently used.

The institute's professional standards require that directors of internal audit units develop guidelines to identify the purpose, authority, and responsibilities of the internal audit units. Moreover, good management techniques require sufficient documentation, effective communication of policies and procedures, and prompt managerial reviews to keep the audit staff in consistent compliance with the institute's professional standards. In addition, analyzing differences between budgeted and actual audit time is important for evaluating the efficiency and performance of the audit staff.

Internal Auditors Do Not  
Always Possess Work Proficiency

Not all auditors in the internal audit units possess the proper qualifications or receive appropriate training to proficiently perform reviews of all internal controls and operations of their departments. Specifically, internal auditors have not developed and maintained the necessary technical abilities to perform audits of EDP systems. Consequently, there is limited assurance that the audits of EDP systems are done proficiently.

The institute's professional standards require that departments ensure that internal audit staff collectively possess the educational and technical background appropriate to perform audits. This educational background should include electronic data processing.

#### Internal Auditors Lack EDP Audit Capabilities

Several departments' internal audit units do not have staff with the skills necessary to meet EDP audit responsibilities. At least 3 of the 12 departments that failed to report on EDP system controls to the Department of Finance did not do so because their internal auditors lacked the capabilities to perform the necessary review. Further, 2 departments that were able to report on EDP system controls also lacked the computer expertise and required outside assistance to conduct the reviews. For example, the Board of Equalization contracted with a private consultant to review the board's EDP controls because the manager of the internal auditing unit believed that the internal auditors did not have the necessary expertise.

#### Inadequate Training Programs

In addition to having internal auditors with inadequate backgrounds, departments do not always provide their internal auditors with training to improve their ability to conduct audits. Seven of the 12 departments we reviewed did not have adequate training programs or training courses to improve the internal auditors' knowledge of the

institute's professional standards and technical skills. For example, the Department of Parks and Recreation's internal auditors have not had a training program for the last two fiscal years. Also, the Board of Equalization's internal audit unit's training program had no courses related to EDP systems despite the department's extensive EDP operations.

Those departments that are unable to have their EDP systems reviewed lack assurance that the computer systems and controls are operating properly to safeguard the State's assets, prevent misuse, and provide prompt, accurate, and reliable information. The institute's professional standards require that internal auditors possess appropriate knowledge and skills to fulfill their audit responsibilities.

#### Reasons For Deficiencies In Internal Audit Units

Government Code Section 1236 requires all departments with internal audit units to use the institute's professional standards, and Government Code Section 10534(c) requires the Department of Finance to coordinate the work of internal audit units and ensure compliance. However, some departments with internal audit units do not comply with the institute's professional standards. Individual departments are often unaware or unconcerned with the institute's professional standards. Further, although the Department of Finance consistently



performs quality assurance reviews of audit work standards, it is not ensuring that departments use all of the institute's professional standards.

Furthermore, some departments do not consider it necessary for the internal audit unit to be independent of the units it audits. Others believe it is not efficient for the internal audit unit to report to someone that might not be familiar with the operations.

Some internal audit units reported that they did not have the necessary staffing to have comprehensive audit scopes or did not have the expertise to conduct audits such as those of EDP systems. Others were careless in their work performance and stated that completing the audit was more important than performing all the planning and program procedures necessary. Some internal audit units have not developed the necessary policies and procedures to clearly guide their staffs in determining audit scope or in performing audits proficiently. Moreover, the State has not adequately developed requirements for education, experience, or training for internal auditors.

Finally, while the Department of Finance does ensure that departments comply with performance of work standards, it does not always ensure that departments are complying with all of the institute's professional standards. For example, the Financial and Performance Accountability Unit (FPAU) has not adequately monitored any of the internal auditors' reviews of EDP systems. Further, the FPAU

does not enforce the requirement that internal audit units report the results of their reviews biennially, as required by the Fiscal Integrity and State Managers' Accountability Act of 1983. Finally, the FPAU does not always provide sufficient technical assistance to the departments' internal audit units. However, the FPAU is in the process of revising its EDP Audit Guide and will be using the guide to provide training to all internal auditors.

### CONCLUSION

Even though Government Code Section 1236 requires department directors to use the "Standards for the Professional Practice of Internal Auditing," as published by the Institute of Internal Auditors, Inc., many departments do not. For example, 6 did not have their internal audit units reporting to independent managers. Also, 4 had not properly included audits of electronic data processing systems in their audit scope; 13 had deficiencies in the performance of work such as planning, workpaper techniques, and reporting; and 12 did not properly manage their units. Finally, 7 did not perform their work proficiently because of deficiencies in the education and training of the internal auditors. When the internal audit units fail to comply with the institute's required professional standards, the departments' management cannot be assured that their internal controls are adequate. In addition, external auditors may not be able to rely on the

work of the internal audit units and may, therefore, duplicate the work of these units.

### RECOMMENDATIONS

To enhance the independence of the internal audit units, the head of the internal audit unit at each department should be responsible to a manager who has the authority to ensure a broad range of audit coverage, a thorough consideration of findings, and effective action on findings.

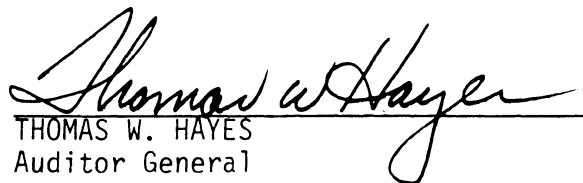
To better define their scope of work, internal audit units should be aware of their requirements to audit all controls, including electronic data processing systems. To improve the performance of audit work, the managers of internal audit units should standardize policies and procedures for their audits and provide the training necessary to ensure that internal auditors have the technical skills to perform audits. Finally, the managers should develop written guidelines to define their internal audit units' scope, duties, and responsibilities.

To improve auditors' proficiency, the State should standardize hiring and training requirements for the position of internal auditor. Individual departments should provide training to improve the internal auditors' knowledge of technical skills

necessary to allow them to perform audits. Finally, the Department of Finance should improve coordinating the work of internal audit units and should ensure that they use the institute's professional standards while conducting audits. The Department of Finance also needs to follow up on all instances of noncompliance with the institute's professional standards. Finally, the Department of Finance needs to assist the internal audit units in implementing the guidelines for audits of internal controls.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

  
THOMAS W. HAYES  
Auditor General

Date: July 21, 1986

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**REVIEWS OF INTERNAL AUDIT UNITS  
BY THE OFFICE OF THE AUDITOR GENERAL  
FISCAL YEARS 1984-85 AND 1985-86**

In fiscal years 1984-85 and 1985-86, the Office of the Auditor General conducted either limited-scope or full-scope reviews of the internal audit units in 32 state agencies. For fiscal year 1984-85, the limited-scope reviews focused on determining the internal audit units' compliance with standards for independence and work performance. For fiscal year 1985-86, the limited-scope reviews focused on determining the audit units' compliance with standards for independence and on reviewing the Department of Finance's evaluation of the units' audits of their departments' internal controls. For both fiscal years, the full-scope reviews focused on determining the internal audit units' compliance with all standards.

In 1984-85, the Office of the Auditor General conducted 8 limited-scope reviews and 5 full-scope reviews, a total of 13. In 1985-86, the Office of the Auditor General conducted 13 limited-scope reviews and 12 full-scope reviews, a total of 25.

Agencies	Reviews Conducted	
	1984-85	1985-86
1. Alcohol and Drug, Department of	Limited	Limited
2. Boating and Waterways, Department of		Limited
3. California Highway Patrol, Department of		Limited
4. California State University, Trustees		Full
5. California State University, Chico		Limited
6. California State University, San Diego		Limited
7. California Student Aid Commission		Limited
8. Consumer Affairs, Department of		Full
9. Corrections, Department of		Limited
10. Developmental Services, Department of		Full
11. Education, State Department of	Limited	Full
12. Employment Development Department	Limited	Full
13. Equalization, Board of	Limited	Full
14. Finance, Department of		Full
15. Food and Agriculture, Department of		Full
16. Franchise Tax Board	Full	
17. General Services, Department of	Limited	Full
18. Health Services, Department of	Full	
19. Industrial Relations, Department of		Limited
20. Justice, Department of		Full
21. Mental Health, Department of*	Limited	
22. Motor Vehicles, Department of	Limited	
23. Office of Criminal Justice Planning		Limited
24. Parks and Recreation, Department of		Full
25. Public Employees' Retirement System		Limited
26. Rehabilitation, Department of	Limited	Full
27. State Compensation Insurance Fund		Limited
28. State Controller's Office	Full	
29. State Teachers' Retirement System		Limited
30. Transportation, Department of	Full	
31. Water Resources, Department of	Full	
32. Youth Authority, Department of		Limited

\*The department's audit unit no longer performs internal audit activities.

**SUMMARY OF VARIANCES FROM THE PROFESSIONAL  
STANDARDS OF THE INSTITUTE OF INTERNAL AUDITORS, INC.  
DISTRIBUTION BY STATE DEPARTMENT  
FISCAL YEAR 1984-85**

Agency	Performance of Audit Work						Professional Proficiency		
	Independence	Scope Of Work	Planning	Examining and Evaluating	Communicating Results	Following Up	Management	Training	EDP Capabilities
<u>Limited-Scope Reviews*</u>									
Alcohol and Drug Programs, Department of	X								
Education, Department of	X			X					
Employment Development Department									
Equalization, Board of									
General Services, Department of	X								
Mental Health, Department of									
Motor Vehicles, Department of									
Rehabilitation, Department of	X								
<u>Full-Scope Reviews</u>									
Franchise Tax Board									
Health Services, Department of									
State Controller				X					
Transportation, Department of									
Water Resources, Department of				X			X		
Total Deficiencies	4	0	0	3	0	0	1	0	0

\*Limited-Scope Reviews conducted only for the "Independence" and "Performance of Work" standards.

**SUMMARY OF VARIANCES FROM THE PROFESSIONAL  
STANDARDS OF THE INSTITUTE OF INTERNAL AUDITORS, INC.  
DISTRIBUTION BY STATE DEPARTMENT  
FISCAL YEAR 1985-86**

Agency	Independence	Performance of Audit Work					Professional Proficiency		
		Scope of Work	Planning	Examining and Evaluating	Communicating Results	Following Up	Management	Training	EDP Capabilities
<u>Limited-Scope Reviews*</u>									
Alcohol and Drug Programs, Department of									
Boating and Waterways, Department of	X								
California Highway Patrol, Department of									
California State University, Chico									
California State University, San Diego									
California Student Aid Commission									
Corrections, Department of									
Industrial Relations, Department of									
Office of Criminal Justice Planning									
Public Employees' Retirement System									
State Compensation Insurance Fund									
State Teachers' Retirement System									
Youth Authority, Department of	X								

\*Limited-scope reviews conducted only for the "Independence" standard.

Agency	Performance of Audit Work					Professional Proficiency			
	Independence	Scope of Work	Planning	Examining and Evaluating	Communicating Results	Following Up	Management	Training	EDP Capabilities
<u>Full-Scope Reviews</u>									
California State University, Trustees		X		X			X	X	
Consumer Affairs, Department of		X	X	X	X	X	X	X	X
Developmental Services, Department of		X		X			X	X	X
Education, State Department of				X			X		
Employment Development Department								X	X
Equalization, Board of				X			X	X	
Finance, Department of						X	X		
Food and Agriculture, Department of	X	X		X	X		X	X	X
General Services, Department of	X	X		X			X		
Justice, Department of	X	X	X	X			X		
Parks and Recreation, Department of		X	X	X	X		X	X	X
Rehabilitation, Department of	X		X	X		X	X	X	
Total Deficiencies	<u>6</u>	<u>7</u>	<u>4</u>	<u>10</u>	<u>3</u>	<u>3</u>	<u>11</u>	<u>7</u>	<u>5</u>



## DEPARTMENT OF FINANCE

OFFICE OF THE DIRECTOR

SACRAMENTO, CA 95814-4998

JUL 11 1986



Thomas W. Hayes  
Auditor General  
660 J Street, Suite 300  
Sacramento, CA 95814

Report F-499 - The State of California Should Improve Its Internal Audit Capabilities

Dear Mr. Hayes:

I appreciate the opportunity to respond to the draft copy of the subject report which discusses the internal audit activities of a number of state departments, including the Department of Finance, and within the appendixes, summarizes the conduct of audit work performed. We acknowledge that improvements can be made to existing operations and positive recommendations for changes directed toward this end are welcome.

The scope of the report was to examine a representative number of State Internal Audit units to determine if they were complying with the Standards for Professional Practice of Internal Auditing (SPPIA). However, from the tone of the report, it is apparent that the review accented absolute compliance with the standards whereas, we believe, Standard 500 envisions that the review should provide reasonable assurance regarding compliance.\* The report cites a few incidents which were observed and finishes with appendixes in which departments are listed and columns filled in to show unidentified deficiencies. In our judgment, the report should place emphasis on improvement rather than criticism, and give some consideration to the circumstances faced by operating officials.

I will now comment specifically upon the recommendations. While your letter requested that we comment only upon issues relating specifically to the Department of Finance (DOF), my comments are on each recommendation since, by law, DOF is responsible for coordinating all internal auditing units.

Recommendation 1. Enhance independence of internal audit units.

We agree that internal auditors should be independent (Standard 100) and DOF has so commented in its quality control reviews. However, the organization of a specific state agency is the responsibility of the agency head and while we recommend that changes be considered, the final decision rests with the agency head.

FPA:385/1

\* Auditor General's Comment: We disagree that our review emphasized absolute rather than reasonable compliance with the professional standards. We focused our review on instances of non-compliance that were prevalent throughout the state's internal audit units' operations. These instances of non-compliance violated the professional standards that the Legislature requires state internal audit units to adhere to.

Recommendation 2. Internal audit units should better define their scope of work and audit all controls including EDP systems. Further, standard policies and procedures and written guidelines should be developed by managers.

While we agree in principle with this recommendation, the report does not acknowledge the transition the state internal audit units are undergoing. Many of these units were developed for the purpose of auditing specific federal grant programs and had little or no responsibility for evaluating their agencies system of internal control and the quality of performance by the agency staff in carrying out these assigned responsibilities (Standard 300). The entire scope of auditing at the state and local governmental level has been changed enormously by the introduction of the Single Audit Concept by the Federal Government (P.L. 98-502); the Federal Block Grants and the changes in technology brought on by the expansion of the use of computers.

DOF addressed its responsibility to coordinate the internal auditors by issuing State Administrative Manual (SAM) Section 20000 et seq. which defines standards and procedures to be used in performing the departmental internal control reviews. We have chosen to concentrate our efforts initially on the review of the systems of internal control. While Standard 300 calls for a more extended scope of work, we believe this standard allows us to make this type of decision and conform to the standards. Specifically, the standard recognizes that management provides general direction as to the scope of work and activities to be audited.

The report in the recommendations and in various sections refers to the failure of DOF to provide EDP training to department staff. In our written EDP Plan for 1986, we state that the current EDP Audit Guide will be revised to reflect the requirements of the California Information Technology Security Manual which will be replacing the State Administrative Manual security sections. This manual is expected to be published in Fall of 1986, and we will then provide training to all state agency audit staff on the new audit guide.

Because the audit requirements will be changing, we made the decision that it would not be fruitful to pursue a concerted course of training and monitoring of audit results in respect to the present audit guide.

Recommendation 3. - State should standardize hiring and training requirements for the position of internal auditor.

This subject of hiring internal auditors has been included in previous reports issued by the Auditor General. The minimum qualifications and the class requirements for an internal auditor in State service are subject to the rules of Civil Service established by Statute, the State Personnel Board and contract agreements. DOF has worked with the Personnel Board to move toward this goal. However, this cannot be done unilaterally nor can these rules be overruled without changes in existing laws.

DOF has worked with the other state agencies to develop and present training to auditors under the State Auditor Training Program. These programs must be carried out within the constraints of agency budgets and person-year allocations. Standard 200 relates to knowledge, skills and disciplines which the internal audit unit should possess, however, this standard also must be met within existing budget constraints and department priorities.

Recommendation 4. - DOF Should:


- a. Coordinate the work of internal audit units.
- b. Ensure they use standards while conducting audits.
- c. Follow up on all instances of non-compliance with these standards.
- d. Assist internal audit units in implementing the guidelines for audits of internal control.

The first responsibility of DOF is to give priority to those areas within the annual plan as directed by its management. The DOF charter calls for its audit unit to review systems of internal control within state departments on a two year cycle. The unit also conducts its statutory audits, comments upon Federal financial reports, and performs special audits as directed by management.

DOF is also conducting "Quality Control" reviews of agencies having internal audit units (Exhibit A) regarding their compliance with SAM 20000 et seq. which includes adherence to the standards. The recommendation requires that DOF perform "Peer" reviews. While these might be beneficial, the staffing of the unit and the present work priorities will not accommodate this expanded review. However, as shown in Exhibit A, DOF is working with the internal audit units to improve their execution of the DOF audit guide covering internal control reviews. We expect that as these units become more familiar with the audit guide that improvements will be forthcoming.

In conclusion, we believe a review of the activities of the various internal audit units is beneficial. However, we also feel that these reviews and the resulting report should be balanced; reflect all of the general standards on reporting; present sufficient detail to allow the reader to understand what is being recommended; and take into account the constraints which are present within State Government.

Very truly yours,

  
JESSE R. HUFF  
Director of Finance

DEPARTMENT OF FINANCE  
FINANCIAL AND PERFORMANCE ACCOUNTABILITY  
STATE AGENCIES REQUIRED TO REPORT ON INTERNAL CONTROL SYSTEMS  
(STATE ADMINISTRATION MANUAL, SECTIONS 20010, 200011, AND 20012)  
RESULTS OF QUALITY CONTROL REVIEWS OF INTERNAL AUDIT UNITS  
AGENCY REPORTS DUE OCTOBER 31, 1985 AND DECEMBER 31, 1985

Agency	Quality Control Review Opinion	Use of Department of Finance Audit Guide	Areas for Improvement					
			Independence Org.	Professional Proficiency	Internal Audit Standards	Performance of Audit Work		
			Obj.	Supvr.	Plan.	Exam. & Eval.	Comm. Res.	Follow-up
<u>Legislative, Judicial and Executive</u>								
State Controller's Office	1/ Qualified	x						
Board of Equalization					x			
<u>State and Consumer Services</u>								
Department of Consumer Affairs	Adverse	x		x				x
Franchise Tax Board	Adverse	x						x
Department of General Services	Adverse	x	x					x
<u>Business Transportation and Housing</u>								
Department of Housing and Community Development	2/ Unqualified							
Department of Transportation								
Department of the California Highway Patrol	Adverse	x						x
Department of Motor Vehicles	Adverse	x						x
<u>Resources</u>								
Department of Boating and Waterways	Qualified	x						
Department of Parks and Recreation	Qualified	x						
Department of Water Resources	Adverse	x	x					x
<u>Health and Welfare</u>								
Department of Aging	2/ Adverse							
Department of Alcohol and Drug Programs	Qualified	x						
Department of Health Services	Qualified	x						
Department of Developmental Services	Unqualified							
Employment Development Department	Unqualified							
Department of Rehabilitation	Qualified							
<u>Education</u>								
Department of Education	Adverse	x						
Student Aid Commission	Unqualified							
Department of Education								x
<u>Youth and Adult Correctional</u>								

DEPARTMENT OF FINANCE  
FINANCIAL AND PERFORMANCE ACCOUNTABILITY  
STATE AGENCIES REQUIRED TO REPORT ON INTERNAL CONTROL SYSTEMS  
(STATE ADMINISTRATION MANUAL, SECTIONS 20010, 20011, AND 20012)  
RESULTS OF QUALITY CONTROL REVIEWS OF INTERNAL AUDIT UNITS  
AGENCY REPORTS DUE OCTOBER 31, 1985 AND DECEMBER 31, 1985

Agency	Quality Control Review Opinion	Use of Department Of Finance Audit Guide	Independence			Areas for Improvement Internal Audit Standards		Performance of Audit Work Exam. & Eval. Comm. Res. Follow-up
			Org.	Obj.	Supvr.	Due Prof. Care	Plan.	
General Government								
Department of Food and Agriculture	Qualified							x
Office of Criminal Justice Planning	Unqualified							
Totals		13	2	1	10	2	2	9
								1

Note: A Quality Control Review of an internal audit unit is to determine that their study and evaluation of their department's system of internal control and fiscal compliance was made in accordance with the Audit Guide for Examination of Internal Control and Fiscal Compliance developed by the Department of Finance and in accordance with the Standards for the Professional Practice of Internal Auditing as required by Section 1236 of the Government Code. It is not, nor is it intended to be, a peer review of the overall operation of an internal audit unit.

- 1/ A quality control review could not be made as the State Controller's Office refused to provide the Department of Finance with a copy of the internal audit units report on their study and evaluation of the office's system of internal control and fiscal compliance.
- 2/ Department no longer has an internal audit unit.
- 3/ Department of Finance providing on-the-job training to the staff of the internal audit unit.



HEALTH and WELFARE AGENCY  
OFFICE OF THE SECRETARY  
1600 NINTH STREET, ROOM 450  
Sacramento, California 95814  
(916) 445-6951

July 11, 1986

Mr. Thomas W. Hayes, Auditor General  
Office of the Auditor General  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Hayes:

Thank you for the opportunity to review and comment upon the draft of your report entitled "The State of California Should Improve Its Internal Audit Capabilities." It was unusually difficult to respond to this report due to the rather general focus and lack of specific findings on individual departments. Considerable reliance was placed upon the information provided by your staff to the individual departments during the course of the audit and the exit interviews. Our comments are organized by department as follows:

Department of Developmental Services  
Performance of Audit Work

Finding:

The Department should perform audits/reviews of the developmental centers.

Response:

The Department of Developmental Services (DDS) is discussing this issue with the Department of Finance (DOF) regarding DOF assistance in auditing internal controls and fiscal compliance of the developmental centers.

Finding:

Auditor General staff indicate, based on the two audit work paper packages reviewed, that report findings were not adequately supported.

Response:

We do not dispute the fact that the particular work papers reviewed were lacking in certain respects. However, we do not believe the sample selected was representative of the Department's audit work. In fact, DOF recently completed a quality control review relative to DDS's internal control and fiscal compliance review. DOF's report gave DDS an

unqualified opinion that the Standards for the Professional Practice of Internal Auditing had been complied with fully.

Finding:

Auditor General staff indicated that DDS was deficient in the following:

- A. The lack of a statement of the purpose, authority, or responsibility for conducting audits, and
- B. The lack of proper guidance, including prompt reviews of work performed.

Response:

DDS agrees with the first point, with the exception of the existence of a statement of authority and annual Audit Branch objectives formalized and tracked as part of DDS's management by objectives system. Additionally, an organization chart for the Branch is included in DDS's Administrative Manual. Statements of purpose and responsibility for conducting audits will be incorporated into an audit manual.

With regard to the lack of adequate supervision, the audit work papers reviewed by the Auditor General staff, once again, may not be truly representative of DDS's audit function. However, it is true that workload problems resulting from special assignments, administrative tasks, and the necessity of allocating time between internal and external audit functions, have occurred at the supervisory level. The result has been an inability to perform sufficient and timely reviews of audit work.

Professional Proficiency

Finding:

The DDS audit staff have not received appropriate training to proficiently perform EDP controls reviews.

Response:

It is true that the staff who most recently performed the review received no prior in-service training for that purpose. This was a result of staff turnover. DDS has provided and will continue to provide in-service training in EDP auditing and controls. Additionally, the Audit Branch has historically been allocated more than its proportionate share of the Program Assessment Division's training budget. We recognize, however, due to the complexity of the field, that it will take time and experience for auditors to gain sufficient expertise in this area.

Finding:

The report appears to indicate that DDS audit staff lacked the computer expertise to perform EDP controls review, and therefore, required outside assistance to perform the review.

## Response:

While the auditors' EDP expertise is not yet at an optimal level, it is improving with time, experience and training. However, the reason for requesting assistance from DOF was one of our not having adequate resources to meet the S.A.M. 20013 October 31, 1985 deadline. Three auditors were hired August 1, 1985, and were immediately put to work on internal audit work, with assistance from two DOF staff.

Employment Development Department

Since there were no findings relating to the Employment Development Department, no response has been prepared.

Department of Rehabilitation  
Independence

## Finding:

Internal Audit Units of the Department of Rehabilitation are not adequately independent.

## Response:

The organization of the Audit Section reporting to the Deputy Director of Administrative Services Division was intended to offer adequate compliance with the Standards of Professional Practices of Internal Auditing (SPPIA) standards on independence for the bulk of the Audit Section's work which is rehabilitation program related. Rehabilitation programs are not supervised by the Deputy Director of Administrative Services.

However, to further promote independence, the Chief Deputy Director has assumed complete authority over internal audits and reports. The remainder of the Audit Section will continue reporting to the Deputy Director of Administrative Services Division for all other audit functions.

Performance of Audit Work

## Finding:

The draft report indicates that the Internal Audit Units' scope of work, quality of work, and management are not always adequate.

## Response:

The Audit Section is currently analyzing Departmental operations in order to develop a comprehensive audit plan. The plan will be monitored and updated as priorities change.

All audit work will be reviewed prior to the related reports being issued to assure the quality of the work.



The Audit Section has follow-up procedures established for all audits. These procedures will be closely supervised to assure all follow-up is done on a timely basis.

Professional Proficiency

Finding:

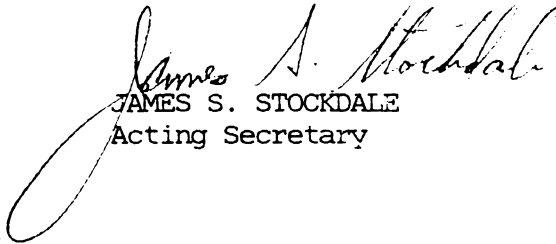
The draft report appears to conclude that the Department of Rehabilitation does not always provide its internal auditors with training to improve their ability to conduct audits.

Response:

The Audit Section is developing a training plan to provide the training necessary to improve the internal auditors' knowledge of the institute's professional standards and technical skill.

As indicated above, it was difficult to respond to this report. If we have misunderstood any of the findings, please let me know.

Sincerely,

  
JAMES S. STOCKDALE  
Acting Secretary

cc: P. C. Fontanoza, Director  
Department of Rehabilitation

K. R. Kiddoo, Director  
Employment Development Department

Gary D. Macomber, Director  
Department of Developmental Services

## DEPARTMENT OF FOOD AND AGRICULTURE

1220 N Street  
Sacramento, CA 95814



July 15, 1986

Mr. Thomas W. Hayes, Auditor General  
Office of the Auditor General  
660 J Street, Suite 300  
Sacramento, California 95814

Dear Mr. Hayes:

I appreciate the opportunity to respond to the draft copy of your report "The State of California Should Improve Its Internal Audit Capabilities" (F-499).

I would like to respond to several areas targeted as deficient in your report.

#### Training

Although a formalized training plan for the Internal Audit Unit was not prepared for Fiscal Year 1985-86 as had been done in prior years, seven of the nine auditors took specialized outside training. Four auditors took computer science courses; one auditor an accounting class; one auditor attended the "Becker" course in preparation for sitting for the Certified Public Accountant (CPA) examination; and one auditor who is a CPA attended continued-education seminars which included updates on standards of accounting and auditing, and auditing California governmental units.

#### EDP Capabilities

During Fiscal Year 1984-85 no EDP audit was performed. However, during Fiscal Year 1983-84 an EDP audit (84-240) was performed of the NCR computer system used by the Financial Services Branch of the Department of Food and Agriculture (CDFA). Five EDP audits were completed during Fiscal Year 1982-83.

In addition, the audit staff has maintained their professional proficiency by taking refresher courses, and through their programming and use of the four personal computers in their offices.

The staff have further demonstrated their EDP capabilities during the external audits of industry which can involve complex EDP systems.

#### Independence of Internal Audit Staff

The executive staff including the Director, Chief Deputy Director, Deputy Directors, and Associate Deputy Director have always been accessible, for any reason, to the internal auditor and they will continue to be accessible. The Department of Food and Agriculture recognizes that the internal

Mr. Thomas W. Hayes  
Page 2  
July 15, 1986

auditor should be organizationally independent of the activities to be reviewed. At this time, no change is planned in the administrative reporting relationship of the internal auditor. However, I have made a change in functional reporting with regard to internal audits (see enclosed memo dated July 10, 1986.) All future audit reports involving financial functions administered by the Assistant Director of Administrative Services will be addressed to the Director of the Department of Food and Agriculture.

It is our intention to continue our efforts to achieve 100 percent compliance with the "Standards for Professional Practice of Internal Auditing" (professional standards) as published by the Institute of Internal Auditors, Inc. Our deadline for achieving this is June 30, 1987. The items indicated below under Performance of Audit Work and Management should assist us in achieving our goal:

#### Performance of Audit Work

- Procedures have been implemented to assure that workpapers indicate the audit procedures performed, the analysis of audit results, the evidence of supervisory review, appropriate cross references to the audit program, and documentation of entrance and exit conferences.
- It is the Department of Food and Agriculture's intention to submit reports by established deadlines.
- In the future, the phrase "generally accepted accounting principles" will only be used if appropriate.

#### Management

To further strengthen the management of internal audits the Department of Food and Agriculture will take the following actions:


- Audit plans and work schedules will be established for short range (one year) and long range (five years) time periods.
- The Director will approve and issue both a charter and a policy letter regarding internal audits.
- The performance and training needs of the audit staff will be evaluated on an annual basis.

Your report has been helpful to the Department of Food and Agriculture in recognizing the importance of compliance with published professional standards. I feel your report is somewhat misleading in that it does not provide me with sufficient information to judge whether my Internal Audit

Mr. Thomas W. Hayes  
Page 3  
July 15, 1986

Unit has acknowledged the existence of the standards and the percent of compliance attained.

Sincerely,

  
for Clare Berryhill  
Director  
(916) 445-7126

Enclosure


# Memorandum

To : Clare Berryhill, Director

Date : July 10, 1986

Place : Sacramento

Telephone : 2-6332

From : Department of Food and Agriculture -  Gloria Harmon, Assistance Director  
Administrative Services

Subject : Independence of Internal Audits

It is recommended that the organizational independence of the internal audit function be documented to assist in attaining compliance with the "Standards for Professional Practice of Internal Auditing".

All audit reports that concern the Division of Administrative Services or areas under the direction of the Assistant Director of Administrative Services will be addressed to the Director of Food and Agriculture.

In the past, the internal auditor has had the independence to contact the Director's Office whenever necessary. No change is suggested to that practice other than the addressee on specific reports.

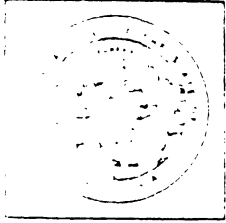
Approval

  
Clare Berryhill  
Director

7/10/86  
Date

  
George Gomes  
Chief Deputy Director

7/10/86  
Date



## State and Consumer Services Agency

OFFICE OF THE SECRETARY  
 915 Capitol Mall, Suite 210  
 Sacramento, CA 95814

July 14, 1986

Thomas W. Hayes  
 Auditor General  
 660 J Street, Suite 300  
 Sacramento, CA 95814

Dear Mr. Hayes:

RESPONSE TO REPORT F-499  
 The State of California Should Improve Its Internal Audit Activities

### DEPARTMENT OF GENERAL SERVICES

I appreciate the opportunity to respond to your draft copy of the subject report which was prepared in connection with your examination of 31 internal audit units throughout the State. The Department of General Services is mentioned only once in the narrative on Page 10 with reference to the scope of audits of data processing systems, but is included on Page 25 Appendix C with regard to four professional standards which include the above comment on audit scope. We have the following comments relative to the four marked items in Appendix C.

#### Independence

We share your concerns that auditors should remain objectively independent when they perform internal audit work. As circumstances have changed over past years, the Department has made several adjustments to the audit organization when necessary to facilitate the effective use of audit resources. I have requested that the Director of General Services again review the audit organization to consider available alternatives. We are confident that the Department can develop a solution which meets the program needs of the Department while alleviating your concerns in this area.

#### Scope

We concur with the comment on Page 10 that the audits of data processing systems were not conducted under SAM 20013.

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DEPARTMENTS AND PROGRAMS OF THE AGENCY

Building Standards Commission • Consumer Affairs • Fair Employment & Housing • Fire Marshal  
 Franchise Tax Board • General Services • Museum of Science & Industry • Personnel Board  
 Public Employees Retirement System • Teachers Retirement System • Veterans Affairs

At the present time, most audit work is performed at the special request of program managers to address specific problems. We will, however, enhance evaluation of automated systems and system controls in the audit workload as part of these requests.

#### Examining and Evaluation

We concur with your suggestion that some procedures utilized are at variance with internal auditing standards.

We are in process of developing more uniform procedures and have included additional technical instruction in the internal audit annual training and development plan which will address these areas.

#### Management

We concur that documentation of management practices is at variance with internal auditing standards; however, current methods of management and supervision result in timely, accurate reports which are relied upon by users. We will review our supervisory documentation methods for appropriate modification.

In summary, we have a number of projects currently underway which will strengthen the internal audit process.

Your review has assisted us to identify areas where we can continue to improve the process. We appreciate the courtesy and professionalism of your staff and the helpful suggestions offered during the onsite review.

#### DEPARTMENT OF CONSUMER AFFAIRS

The Director of Consumer Affairs and her staff have reviewed your draft report and the Director has informed me that the contents are consistent with the briefings previously provided by your staff. The Director has also assured me that she is committed to connecting the deficiencies noted in the report as they relate to the management and operations of the Department's Internal Audits Unit. A work schedule is currently being worked on which will establish specific target dates for accomplishing the needed improvements.

Please feel free to call me if you need additional information or your staff may wish to contact Director Tony Anthony or Director Marie Shibuya-Snell direct.

Sincerely,



SHIRLEY R. CHILTON  
Secretary of the Agency



STATE BOARD OF EQUALIZATION

1020 N STREET, SACRAMENTO, CALIFORNIA  
(P.O. BOX 1799, SACRAMENTO, CALIFORNIA 95808)  
(916) 445-3956

CONWAY H. COLLIS  
First District, Los Angeles  
ERNEST J. DRONENBURG, JR.  
Second District, San Diego  
WILLIAM M. BENNETT  
Third District, Kentfield  
RICHARD NEVINS  
Fourth District, Pasadena  
KENNETH CORY  
Controller, Sacramento

DOUGLAS D BELL  
Executive Secretary

July 10, 1986

Mr. Thomas W. Hayes  
Auditor General  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Hayes:

As a result of the your staff's quality assurance review, our Internal Audit Section has taken the following corrective actions:

1. Training:

As the Board's internal training program does not offer training specifically directed at increasing the competency of internal auditors, the unit has been budgeted an additional \$2000 for out-service training. We have also located audit training aides (videotapes) available from other state agencies which will be made available to our internal audit staff.

2. Examining and Evaluating:

The internal audit district audit program is being amended to document the objectives and scope of each section of review.

The internal audit review function is being strengthened in two ways; first, on district audits and all other major audits the supervising auditor will continuously review all work as it is completed, with particular attention paid to borrowed personnel. Secondly, the section has modified its workpaper index form to document the review of each individual workpaper.

3. EDP Capabilities:

Our current EDP audit needs are being met on a contractual basis with outside consultants. All our efforts to exchange personnel on a temporary basis with other state agencies to obtain expertise in this area have failed. Unless a position is made available to hire a trained auditor in this discipline, we will remain deficient in this area. We will continue to seek a resolution of this problem.

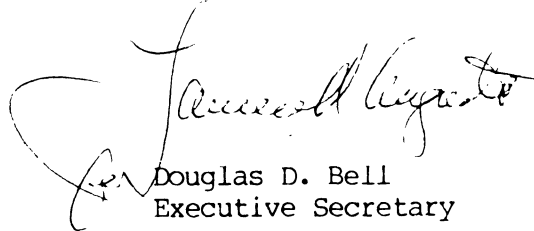


4. Management of the Internal Auditing Department:

Because of the small size of the unit (4 and 1/2 employees) and the principal auditor's personal involvement in all of the unit's work, there appeared little reason to supplement staff meetings and personal first hand observation with formally documented time and work performance reviews. However, in the future differences between budgeted and actual audit time will be analyzed in writing. Likewise, the unit's time budgeting process has been upgraded to include quarterly reviews directed at producing revised budgeted hours, reflecting more obtainable short term objectives.

Our Principal Internal Auditor related to me the professional manner in which your staff conducted its quality assurance review, and your department's emphasis on positive constructive feedback. My personal experience with your staff reinforces this position, and I wish to thank you for your assistance in improving the Board's internal audit function.

Sincerely,



Douglas D. Bell  
Executive Secretary

DDB:jlh



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**CALIFORNIA STATE DEPARTMENT OF EDUCATION**

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721 Capitol Mall; P.O. Box 944272

Sacramento, CA 94244-2720

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**Bill Honig**

Superintendent

of Public Instruction

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July 11, 1986

Thomas W. Hayes  
Auditor General  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Hayes:

My staff and I have reviewed the draft copy of your report entitled "The State of California Should Improve Its Internal Audit Capabilities," and in particular, those findings pertaining to the Department of Education. This Department recognized the need to improve its internal audit capabilities more than two years ago and has taken many actions to achieve this improvement.

In order to increase the effectiveness and independence of Internal Management Audits (IMA), the function was moved to the Executive Planning and Review Office in July, 1984. The number of staff was increased, and the level of the audit supervisor was elevated. An aggressive hiring effort was undertaken to fill IMA's vacant positions with well qualified staff. Development of more effective audit policies and procedures was begun and is continuing today. An audit manual has been drafted and is being finalized. On recommendation of, and in consultation with, the staff of the Financial and Performance Accountability Unit of the Department of Finance and your office, we have made changes to the IMA report preparation and distribution process. A three-year training program to increase and maintain the staff's knowledge of auditing was implemented. With these actions and those planned for the near future, we are confident we can meet all the professional standards by next year.

As to the specific issues raised in your report pertaining to "Examining and Evaluating" and to "Management," we believe the actions described in the previous paragraph will correct the underlying reasons for these issues. At the time of the review

Thomas W. Hayes  
July 11, 1986  
Page 2

of Internal Management Audits, your staff acknowledged that the improvements we have made and plan to make address their particular concerns.

If you wish to discuss our comments, please contact Diane Kirkham at 324-9071.

Sincerely,



William D. Dawson  
Executive Deputy Superintendent

SM/DD:jjm

cc: Diane Kirkham  
Bart Aspling  
Sandra McHaney

## DEPARTMENT OF PARKS AND RECREATION

P.O. BOX 2390  
SACRAMENTO 95811

(916) 324-9067

JUL 15 1986



Mr. Thomas W. Hayes  
Auditor General  
Office of the Auditor General  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Hayes:

This letter responds to your letter of July 7, 1986 regarding your audit report draft entitled, "The State of California Should Improve Its Internal Audit Capabilities."

Historically, the audit responsibilities of the Audits Office of this Department were limited to the "external" audits of the grant programs and the concession agreements administered by this Department. However, as problems arose internally within the Department that required the expertise of the Audits Office, particularly to examine fiscal records, assignments were made to the Audits Office to help resolve these special problems on a high priority, case by case basis.

While this Department has formally adopted an internal audit policy in December of 1983, our internal audit activities have been limited to the resolution of special problem cases and to the preparation of the biennial internal audit reports required by law. These audits were conducted in substantial compliance with the Standards for Professional Practice of Internal Auditing.

Recruitment and retention of qualified audit staff has been a critical problem for the Department. The Audits Office has nine authorized positions, eight professional and one clerical. Currently, efforts are being made to fill two vacant audit positions. In essence, the Audits Office, on the average for the last three years, has had an equivalent of less than one full-time "internal audit position," effectively limiting our capability to conduct extensive internal audits and to meet all of the Standards for Professional Practice of Internal Auditing. To address this recruitment problem, I have asked our Personnel Office to provide special assistance to the Audits Office.


With respect to the audit findings, the narrative portion of the report states that the Department auditors did not prepare audit plans or programs. It is true that for special problem cases, audit plans or programs were not prepared. It is not always feasible to prepare audit plans or programs in advance for these problem cases as each case has been somewhat unique requiring changes in audit process during the audit. However, for common problem areas, such as the park unit operations, audit plans or programs were available.

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The Department agrees that a formal internal audit training program has not been established by the Audits Office. While the Department recognizes the value of such training, unavailability of suitable courses has been a problem. We are hopeful that efforts to establish a training program for internal auditing will be made at the statewide level to meet our needs.

We appreciate the opportunity to comment on this draft report. If you have any questions regarding this letter, please contact Mr. Tom Okubo, Chief, Audits Office, at 445-5568.

Sincerely,

  
Wm. S. Briner  
Director

cc: Mr. Gordon K. Van Vleck  
Secretary for Resources

cc: Members of the Legislature  
Office of the Governor  
Office of the Lieutenant Governor  
State Controller  
Legislative Analyst  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
Capitol Press Corps