

SELF-ASSESSMENT WITH EXTERNAL INDEPENDENT VALIDATION

Lexington-Fayette Urban County Government Office of Internal Audit November 2012

EXECUTIVE SUMMARY

The LFUCG Office of Internal Audit (IA) conducted a self-assessment of its internal audit services. The principal objectives of the assessment were to assess IA's conformity to The Institute of Internal Auditors (IIA) *Standards for the Professional Practice of Internal Auditing (Standards)*, evaluate IA's effectiveness in carrying out its mission (as set forth in its charter and expressed in the expectations of management), and identify opportunities to enhance management and work processes, as well as IA's value to the Lexington-Fayette Urban County Government (LFUCG).

OPINION AS TO CONFORMITY TO THE *STANDARDS*

It is our overall opinion that the IA activity generally conforms to the *Standards* and Code of Ethics. For a detailed list of conformance to individual standards, please see Attachment A. The QA team identified opportunities for further improvement, details of which are provided in this report.

The IIA *Quality Assessment Manual* suggests a scale of three ratings, "generally conforms," "partially conforms," and "does not conform." "Generally Conforms" is the top rating and means that an IA activity has a charter, policies, and processes that are judged to be in conformance with the *Standards*. "Partially Conforms" means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies did not preclude the IA activity from performing its responsibilities in an acceptable manner. "Does Not Conform" means deficiencies in practice are judged to be so significant as to seriously impair or preclude the IA activity from performing adequately in all or in significant areas of its responsibilities.

SCOPE AND METHODOLOGY

As part of the preparation for the self assessment, we prepared a self-study, with detailed documentation, and sent out surveys to staff and to a representative sample of LFUCG's executives. A summary of the survey results and accompanying comments (without identifying the individual survey respondents) have been furnished to the Director of Internal Audit. Extensive interviews were conducted with LFUCG Council Members, Administration, and Internal Audit Board Members.

Also reviewed were the IA's risk assessment and audit planning processes, audit tools and methodologies, engagement and staff management processes, and a representative sample of IA's working papers and reports.

POSITIVE ATTRIBUTES

The IA environment is well-structured and progressive, where the IIA *Standards* are understood and management is endeavoring to provide useful audit tools and implement appropriate practices. Among these tools and practices are; frequent professional training for IA staff (including training directed toward obtaining the Certified Internal Auditor qualification) resulting in a highly qualified staff, efficient scheduling and reporting, concise reports with a focus on risk, and a good reputation and credibility with customers. Consequently, the comments and recommendations are intended to build on this foundation already in place at the LFUCG.

OBSERVATIONS AND RECOMMENDATIONS to improve compliance with the Standards

1. Consider using the IIA's Practice Guides to enhance the QA&IP.

- *Standard 1300 (QA&IP) The CAE must develop and maintain a quality assurance and improvement program (QA&IP) that covers all aspects of the internal audit activity.*
- *Standard 1310 (Requirements of the QA&IP) The QA&IP must include both internal and external assessments.*
- *Standard 1311 (Internal Assessments) Periodic reviews performed through self-assessment or by other persons within the organization with sufficient knowledge of internal audit practices.*

IA meets the requirements as they relate to external assessments, and meets some of the requirements relating to internal assessments. The IIA has issued two Practice Guides to assist CAEs who are developing QA&IPs:

- "Measuring Internal Audit Effectiveness" and,
- "Quality Assurance and Improvement Program"

The Practice Guides provide a framework that includes general concepts such as stakeholder satisfaction, key audit processes, audit staff capabilities, and technological innovation to create a robust, right-sized QA&IP program, including follow through reporting, to meet the specific needs of an internal audit activity.

Recommendation

IA should enhance the QA&IP by considering the techniques outlined in the IIA Practice Guides. The resulting program should be tailored to fit the situation, involve all members of IA, and help provide assurance that IA is following its own policies and procedures, while meeting the expectations of senior management and the Audit Board as it maintains general conformity with the IIA Standards and Code of Ethics.

Components of the QA&IP should consider stakeholder satisfaction, key audit processes, staff capabilities, and technological innovation, while bringing focus on managing and improving all IA processes.

One of the possible steps to enhance a QA&IP is to create an IA Quality Assurance Review team. The team's documented objectives may be to evaluate IA compliance with IIA Quality Standards, to initiate an appropriate internal quality assurance review, ensure compliance with IIA Standards 1300, 1310 & 1311 and to ensure ongoing improvement in all audit processes. The team's most important goal is to make certain that IA remains an independent, objective assurance and consulting activity that adds value

to and improves the company's operations. Team oversight should be provided by the CAE or his designee.

Management's Action Plan

The Director of Internal Audit agrees with the recommendation and will implement use of the IIA's Practice Guides to enhance the QA&IP. The Director of Internal Audit will also consider the development of a Quality Assurance Review team as a possible method for enhancing the IA QA&IP.

2. Establish a process to periodically report internal QA&IP results to senior management and the IA Board.

- *Standard 1320 (Reporting on the QA&IP) The CAE must communicate the results of the QA&IP to senior management and the board.*

IA has created procedures establishing some internal assessment processes that moved it towards conformity with IIA Standard 1311. IA has not, however, established a formal approach to report the results of its QA&IP to senior management and the board as required by Standard 1320.

Recommendation

IA should formalize a process to report the results of its QA&IP efforts, both internal and external, necessary action plans, and their successful implementation at least annually to senior management and the Internal Audit Board.

Management's Action Plan

The Director of Internal Audit agrees with the recommendation and will implement a process to communicate the results of its QA&IP and the implementation of related action plans to senior management and the Internal Audit Board.

3. Expand the IT audit universe included in the annual risk based planning

- *Standard 2010 (Planning): The chief audit executive must establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.*

The current audit universe has limited auditable units in the IT area, and IA does not have the resources to effectively review IT risk exposures.

Recommendation

IA should expand the IT Audit Universe to contain IT risks identified in the Protiviti PeopleSoft Audit which should be final in the third quarter of fiscal year 2013. Once the IT audit universe is established and risk assessment completed, consideration should be given how best to perform these reviews (most likely retaining outside expertise on an annual basis).

Management's Action Plan

The Director of Internal Audit agrees with the recommendation to expand the Audit Universe when Protiviti completes the PeopleSoft Audit. IA will seek funding on an annual basis to perform additional IT audits/reviews.

4. Monitoring Progress of recommendations to management

- *Standard 2500 – (Monitoring Progress) The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.*

2500.A1– The chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

2500.C1– The internal audit activity must monitor the disposition of results of consulting engagements to the extent agreed upon with the client.

IA has a tracking process for audit recommendations to management; however, there is no formal or systematic reporting on the disposition and current status of the recommendations to the Internal Audit Board.

Recommendation

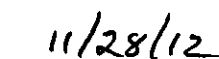
Review the current status and disposition of audit recommendations with the Internal Audit Board at least annually (note see IPPF Practice Advisory 2500-1).

Management's Action Plan

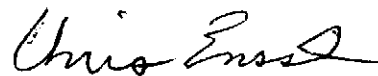
The Director of Internal Audit agrees with the recommendation and will review the current status and disposition of audit recommendations with the Board at least annually.



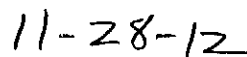
Bruce B. Sahli, CIA
Director
LFUCG Office of Internal Audit



Date



Chris Ensslin, CFE, CIA
Quality Assurance Self-Assessor
LFUCG Office of Internal Audit



Date

ATTACHMENT A

STANDARDS CONFORMANCE

EVALUATION SUMMARY

LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT

		("X" Evaluator's Decision)		
		GC	PC	DNC
OVERALL EVALUATION		X		
ATTRIBUTE STANDARDS		X		
1000	Purpose, Authority, and Responsibility	X		
1010	Recognition of the Definition of Internal Auditing	X		
1100	Independence and Objectivity	X		
1110	Organizational Independence	X		
1111	Direct Interaction with the Board	X		
1120	Individual Objectivity	X		
1130	Impairments to Independence or Objectivity	X		
1200	Proficiency and Due Professional Care	X		
1210	Proficiency	X		
1220	Due Professional Care	X		
1230	Continuing Professional Development	X		
1300	Quality Assurance and Improvement Program	X		

		("X" Evaluator's Decision)		
		GC	PC	DNC
1310	Requirements of the Quality Assurance and Improvement Program	X		
1311	Internal Assessments		X	
1312	External Assessments	X		
1320	Reporting on the Quality Assurance and Improvement Program		X	
1321	Use of "Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	X		
1322	Disclosure of Nonconformance	X		
PERFORMANCE STANDARDS		X		
2000	Managing the Internal Audit Activity	X		
2010	Planning		X	
2020	Communication and Approval	X		
2030	Resource Management	X		
2040	Policies and Procedures	X		
2050	Coordination	X		
2060	Reporting to Senior Management and the Board	X		
2100	Nature of Work	X		
2110	Governance	X		
2120	Risk Management	X		
2130	Control	X		
2200	Engagement Planning	X		

		("X" Evaluator's Decision)		
		GC	PC	DNC
2201	Planning Considerations	X		
2210	Engagement Objectives	X		
2220	Engagement Scope	X		
2230	Engagement Resource Allocation	X		
2240	Engagement Work Program	X		
2300	Performing the Engagement	X		
2310	Identifying Information	X		
2320	Analysis and Evaluation	X		
2330	Documenting Information	X		
2340	Engagement Supervision	X		
2400	Communicating Results	X		
2410	Criteria for Communicating	X		
2420	Quality of Communications	X		
2421	Errors and Omissions	X		
2430	Use of "Conducted in conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	X		
2431	Engagement Disclosure of Nonconformance	X		
2440	Disseminating Results	X		
2500	Monitoring Progress		X	
2600	Management's Acceptance of Risks	X		

	("X" Evaluator's Decision)		
	GC	PC	DNC
IIA Code of Ethics	X		
Definition of Internal Auditing	X		

ATTACHMENT B

INDEPENDENT VALIDATOR

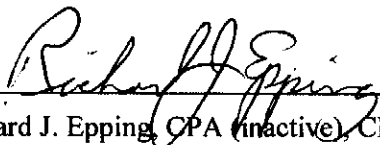
STATEMENT

Richard J. Epping, CPA (inactive), CIA, CCA was engaged to conduct an independent validation of the Lexington-Fayette Urban County Government Office of Internal Audit (IA) self-assessment. The primary objective of the validation was to verify the assertions made in the attached quality self-assessment report concerning adequate fulfillment of the organization's basic expectations of the IA activity and its conformity to The Institute of Internal Auditors' (The IIA's) *International Standards for the Professional Practice of Internal Auditing (Standards)*.

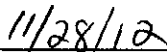
In acting as validator, I am fully independent of the organization and have the necessary knowledge and skills to undertake this engagement. The validation, conducted during the period November 19-28, 2012 consisted primarily of a review and testing of the procedures and results of the self-assessment. In addition, interviews were conducted with the Mayor, CAO, and Internal Audit Board Chairperson.

I concur fully with the IA Office's conclusions in the self-assessment report attached. Recommendation for the IT Audit Universe has been reported and accepted by the Internal Audit Director for inclusion in the final report. Recommendations to enhance the QA&IP program and monitoring progress of recommendations to management were added as a result of the validation process. In addition, Attachments C and D have been added to provide additional innovative practice suggestions for Internal Audit, the Internal Audit Board and Management.

Implementation of all the recommendations contained in the self-assessment report will improve the effectiveness and enhance the value of the IA activity and ensure its full conformity to the *Standards*.



Richard J. Epping, CPA (inactive), CIA, CCA
Independent Validator



November 28, 2012

ATTACHMENT C

Innovative Practice Suggestions for the Office of Internal Audit

1. The CAE should perform a staffing analysis based on the risk assessment of the audit universe and present the results to senior management and the Audit Board to help validate the current level of staffing resources. The analysis can clearly demonstrate audit areas (risks) that are intentionally excluded from or delayed in the proposed audit plans because of resource limitations. Such data will afford both senior management and the Audit Board the opportunity to enhance their oversight of IA.
2. The CAE should consider developing a departmental level Competency Model to clearly articulate the skill-sets and professional knowledge required to adequately carry out the group's mission and satisfy the expectations of its stakeholders.
3. Audit recommendation tracking could be improved by:
 - a. Including the date management agreed to implement
 - b. Remove from list when completed
4. Revise presentation of audit universe to Audit Board by including columns for last year audited, included in current audit plan, and maybe a 3 to 4 year projected audit plan
5. Planning meeting notes should include date and participants. This was not consistently provided in workpapers.
6. Include positive comment in audit reports.
7. Audit work paper review notes should indicate who reviewed and when or who cleared the notes.

ATTACHMENT D

Innovative Practice Suggestions for Internal Audit Board and Management

1. Audit Board By-laws should be revised to require annual review and approval of Internal Audit Charter.
2. Consideration should be given to having the Mayor's appointee to the IAB being someone other than major client of IA.
3. Mayor Gray requested suggestions on what his role with the CAE should include. Some items to consider would be:
 - a. CAE meet with Mayor periodically and/or the Mayor could attend IA Board Meetings as desired.
 - b. CAE discuss audit universe and audit plan in one of these meetings.
 - c. Mayor show continued support for (including funding for) outsourcing of IT audits in the annual budget request.