Escambia County School District

Report on Quality Assurance Assessment of Internal Audit

February 28, 2007

Report on Quality Assurance Assessment

Escambia County School District
Office of Internal Auditing

Executive Summary

The Escambia County School District's internal audit activity is required every five years by the **Institute of Internal Auditors** *International Standards for Professional Practice of Internal Auditing (Standards)* to have an assessment to ascertain compliance with these *Standards* and appraise the quality of operations. Periodic assessments by professionals with a working knowledge of the *Standards* are integral to the quality assurance program. This report reflects the results of this assessment conducted January 26, 2007, through February 8, 2007.

There are three levels of assurance for expressing an opinion on this self-assessment. "Generally Conforms" means an internal audit activity has a charter, policies, and processes that are judged to be in accordance with the *Standards*, with some opportunities for improvement. "Partially Conforms" means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies do not preclude the Internal Audit 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 internal audit activity from performing adequately in all or in significant areas of its responsibilities.

> *Based upon the information received and evaluated during this self-assessment, the Escambia County School District's Office of Internal Auditing GENERALLY CONFORMS to the IIA Standards.*

The Escambia County School District Internal Auditing function has been in a state of transition recently because of turnover of the Chief Audit Executive (Director) position occurring twice within the past five years. Along with this turnover, staffing of the auditors has had high turnover. Accordingly, these circumstances have affected the effectiveness of the Internal Auditing function, as well as its image.

Prior to this peer review, the Office of Internal Auditing conducted its own self-assessment. In my opinion, that review was conducted in a professional manner, resulting in conclusions with which I agree. I also concur with the opportunities for improvement identified in that assessment. Internal Audit is in the process of addressing those opportunities.

Additionally, during the external validation, the following areas were identified that could be improved to enhance compliance with professional requirements and improve efficiency/effectiveness:

1. Internal Audit should be included in the major enterprise resource planning [ERP] system software being considered for the District.

2. The Internal Audit Director should interact more with District upper administration.

3. A risk-based audit plan needs to be developed.

4. A formal follow-up system needs to be developed.

5. The CAE and auditors should enhance their knowledge base related to the K-12 environment.

6. Increased focus is needed regarding Information Technology auditing.

7. The School Board and Audit Committee should review the Audit Committee charter and update as necessary.

Finally, with the relatively new internal audit staffing, it is recommended that the next Quality Assurance review be conducted within *three* years rather than five years.

Detailed Results

Background

The IIA *Standards* require that the Internal Audit function conduct internal quality assurance reviews every five years to assess compliance with *Standards* and to appraise the quality of operations. A self-assessment was performed to lay the foundation for this external peer (Validation Team) review and provided key information. This report is the result of the external peer assessment, which was performed January 26, 2007, through February 8, 2007.

Escambia County School District [ECSD] Office of Internal Auditing (IA) has a charter, policies and procedures that are judged to be in accordance with the *Standards*.

Objectives, Scope, and Methodology

The primary objective of the self-assessment was to evaluate the District IA's compliance with IIA *Standards*. An additional objective included identifying opportunities for enhancement. The work performed during the review included:

- Review of the self assessment work papers (including surveys);
- Interviews with ECSD Board chair and district's key management;
- Interviews with the ECSD Audit Committee chair and members;
- Interviews with IA staff;
- Review of a sample of work papers and reports produced by IA; and
- Review of IA's Charter (Charter), policies and procedures, annual work plan, and other relevant documents.

Report Distribution

Chairman, Escambia County School District Audit Committee
Members, Escambia County School District Audit Committee
Chairman, Escambia County School Board
Members, Escambia County School Board
Superintendent, Escambia County School District
Director & Staff of Escambia County School District Office of Internal Auditing

ECSD Internal Audit History

Internal Auditing at the District began in 1982, when the position of Director of Internal Auditing was established. Prior to 1982, all functions related to auditing, the majority of which was the auditing of internal accounts, were incorporated into the Finance Department. The Director of Internal Auditing reported to the Assistant Superintendent of Finance and Business Affairs. By 1995 the Office of Internal Auditing had grown to the Director, four internal auditors, a senior accounting clerk, a data entry clerk, two property records technicians, and two secretaries. In 1995 the Director of Internal Auditing position began reporting directly to the Superintendent. In 1996 one internal auditor position was cut and moved to the Finance Department as Analyst for Risk Management and Employee Benefits Trust Funds; the next year the Property Secretary position was cut. In 1998 a cooperative education auditor position was created. In 1999 the Board removed the functional reporting of the

Director of Internal Auditing from the Superintendent of Schools to the School Board. The School Board also established the Audit Committee, and subsequently approved its charter. Shortly thereafter, one auditor position was moved to the Finance Department to assist with internal accounts operations. In 2000 Property Accounting moved back to the Finance Department. In 2006 the School Board approved the Audit Committee's recommendation to move the entire staff of the Office of Internal Auditing under the School Board.

An Internal Audit charter was created for the Department in 1999 and has been amended three times, with the most recent being June 2005.

Opportunities for Enhancement

1. Internal Audit should be included in the major ERP system software being considered for the District.

The District is exploring new ERP (enterprise resource planning) system software; this system would integrate the data and processes of key District functions: accounting, budgeting, human resources, payroll, etc. Traditionally managers notify the head of IA of all major systems development projects. Usually, managers/project leaders invite the IA activity to participate in all major systems development activities (including participation in systems development teams, systems development steering committees, etc.). To date, IA's participation in the ERP exploration has been limited, at best.

Although it is desirable that auditors have a background in the subject-matter area of the proposed system (e.g. finance, personnel, specific program/activity) and in the technology expected to be used in the design of the delivery vehicle (e.g. electronic data processing [EDP], micrographics), it should be kept in mind that the internal auditor's *role* is that of <u>control</u> expert, not <u>subject-matter</u> expert.

Several factors which have the effect of increasing pressure on IA to participate in systems development projects:
- systems development projects are notorious for cost/time overruns;
- implemented systems are equally notorious for not meeting all user requirements;
- systems, particularly EDP systems, often have under-designed control frameworks; and,
- improved efficiency sometimes means ineffective controls which can lead to a myriad of problems.

Recommendation
- *Internal Auditing should be included in the ERP process. Their involvement could help to identify potential control problems and present opportunities to correct these during the development stage rather than after implementation.*

2. The Internal Audit Director should interact more with District upper administration.

IIA *Standard* **2000** states that the Chief Audit Executive [CAE] should manage the internal audit activity to ensure it *adds value* to the organization. The District Internal Audit [IA] function appears to be starting to add value to the District operations; prior to 2006/07 the IA focus has been on the school internal accounts (cash counts and internal control reviews). The District has not had an opportunity to recognize their expertise and potential for value added. Prior to being appointed as the IA Director, this CAE had been 'loaned' to the District to coordinate the Hurricane Ivan financial recovery. Additionally, four managers within the District are former internal auditors for the District. This evidences the District's viewing IA as a resource and evidences the District's trust in the competency of the IA staff.

More value can be added with an ongoing dialogue with senior management regarding issues and concerns facing the District. Additionally, performing some consulting activities as well as audits that are not school internal accounts engagements, will evidence adding value to the District. With changes in IIA *Standards* and the Government Auditing Standards (Yellow Book), internal audit departments have greater flexibility in their involvement in risk management and governance issues. Accordingly, IA has an opportunity to promote its services and increase its visibility across campus. Further, these actions will show the District/Board the value added by having the IA function. This is a pivotal time in the history of the IA Department and it can be used to enhance their image.

Recommendations

- *The Internal Audit Director [CAE] should begin routinely meeting with upper administration of the District. These meetings should be used to ensure that ECSD IA resources are being focused on the major issues and risks facing the District. Brief one-on-one meetings with District leadership, as well as inclusion periodically in senior staff meetings and agenda review meetings, establishes an ongoing rapport/dialogue with District management.*

- *The Internal Audit Director [CAE] should develop ways to promote the services and visibility of the department across the District. This can be done several ways such as articles/tips in District publications on issues such as compliance and internal controls or conducting training sessions on these and similar topics. Such sessions can also allow the staff to develop through their participation in the events.*

- *Consideration should be given to including in the work plan time for consulting projects (management advisory services). Some internal audit functions budget anywhere from 5-20% of the available work time for such services.*

3. A risk-based audit plan needs to be developed.

IIA *Standard* **2010** states that a risk-based audit plan should be developed and undertaken annually to ensure the District IA activities are aligned with the organization. School districts are mandated by Florida State School Board of Education Rule 6A-1.087 to have the school internal accounts audited annually, which has been the primary focus of IA audits. Recently, these audits were streamlined to be performed earlier in the school year and giving IA an opportunity to expand its audit focus.

Further**,** *Standard* **2010** requires the CAE "*to establish risk-based plans to determine priorities of the internal audit activity, consistent with the organization's goals.*" All organizations face a number of uncertainties and risks which can both negatively or positively affect the organization. Risk can be managed in a number of different ways, including acceptance, avoidance, transfer, or control. Ultimately, the key audit objectives are to provide management with the information to mitigate the negative consequences associated with accomplishing the District's objectives, as well as an assessment of the effectiveness of management's risk management activities. The audit universe includes components from the District's strategic plan and reflects the District's objectives. Audit work schedules should be based upon, among other factors, an assessment of risk priority and exposure. Prioritizing is needed to make decisions for applying relative resources based on the significance of risk and exposure. Most risk models use risk factors to establish the priority of engagements such as: financial impact, asset liquidity, management competence, quality of internal controls, degree of change or stability, time of last audit engagement, complexity, employee and government relations, etc. Accordingly, the CAE has begun to work with the audit staff, the Audit Committee and District management to develop a risk assessment model that will have an enterprise wide focus.

Recommendations
- *Research various risk analysis models used by IA colleagues/peers. Identify a model that will work within the District's environment.*

- *Develop a formalized risk assessment process adopting an enterprise wide focus. This process should incorporate interviews/surveys with a substantial number of managers throughout all areas of the District. These results should be factored into the audit plan development along with other emerging issues.*

- *Meet with senior leadership at the District to begin discussion of the strategic and technology plans as well as ascertain their feedback regarding prevalent risks.*

- *Identify comprehensive and critical/key areas of risk for the Escambia County School District.*

4. A <u>formal</u> follow-up system needs to be developed.

Since the primary audits performed by the IA function have been school internal accounts, follow-up has been traditionally performed during the next cycle of the engagement. However, as IA moves into broader audit areas, the need for a formalized follow-up system is imperative. IIA *Standard* **2500** addresses follow-up and monitoring of IA recommendations. This standard states: "*The chief audit executive (CAE) should 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.*"

The CAE is responsible for scheduling follow-up activities as part of developing engagement work schedules. This includes performing follow-up of all external auditors' recommendations. Scheduling of follow-up should be based on the risk and exposure involved, as well as the degree of difficulty and the significance of timing in implementing corrective action. Factors that should be considered in determining appropriate follow-up procedures are the:
- significance of the reported observation or recommendation;
- degree of effort and cost needed to correct the reported condition;
- impact that may result should the corrective action fail;
- complexity of the corrective action; and
- time period involved.

Recommendation
- *Consider establishing a database of audit follow-up recommendations and schedule periodic follow-up/monitoring. Periodically report the results to the District management and to the Audit Committee.*

5. The CAE and auditors should enhance their knowledge base related to the K-12 environment.

IIA *Standard* **1230** relates to the continuing education/professional competencies of the audit staff. As noted in the self-evaluation, IA staff receives continuing professional education on accounting/internal auditing/auditing/fraud. Additionally, the staff credentials evidence experience and expertise. However, District management has been critical of the IA function and the need for IA staff to better understand the K-12 operating and accounting environment.

Recommendations
- *Obtain industry-specific training for the IA staff.*

- *Consider becoming active in Florida Association of School Business Officers [FASBO], Southeastern Association of School Business Officers [SASBO] and Florida School Finance Officers Association, Inc.[FSFOA]. Seek and network with other K-12 internal auditors; consider expanding this networking beyond*

Florida into other states. This will enhance the competencies of the staff, as well as raise the credibility of the staff with District management.

- *Continue training within the internal auditing/accounting/fraud arenas.*

- *Document, by individual, the number of hours of continuing professional education [CPE] earned each year.*

6. Increased focus is needed regarding Information Technology auditing.

The staff credentials are impressive; however, there is an absence of an Information Technology audit position/focus. For all audits/reviews, the use of technology is always considered to make sure that the computer-related data is retrieved and analyzed where possible, to present to management comprehensive assessments. IIA **Standard 1210 addresses** the professional competencies of the audit staff. Due to the vast risks associated with information systems of a school district, additional staff with IT skills should be added or current staff should seek IT audit certifications to help address these unique risks. Various computer assisted audit techniques [CAATS] are available to auditors and range from simple spreadsheets (e.g. Excel, Lotus, Quattro Pro) to flowcharting (Visio) to custom audit software (e.g. SAS, ACL, IDEA, etc.).

CAATS help auditors extract data needed for audits; match the data from multiple files; test balances and details of transactions; determine the reliability of computer-processed transactions and information; test the adequacy of controls to prevent unauthorized access; and test the general and application controls. The ability to test inside systems is becoming critical as more and more computer systems become "paperless" and external corroborative support is less available. CAATS include generalized audit software, utility software, test data, application software tracing and mapping and audit expert systems.

Recommendations
- *Allocate resources for the IA function to provide adequate staffing and/or training to deal with information technology audit areas.*

- *Provide resources for the IA to purchase/implement CAATS, including data mining techniques.*

- *Obtain IT training for the current staff.*

7. The School Board and Audit Committee should review the Audit Committee charter and update it as necessary.

The Audit Committee's role has continued to evolve since its inception in 1999. Consequently, the Audit Committee's Charter has been occasionally updated. One additional area that needs to be addressed in the Charter relates to the Audit Committee's role in dealing with the external auditors. Section 218.391(2) of the Florida Statutes requires District school boards to establish an audit committee, whose "*primary purpose is to assist the governing body in **selecting an auditor** to conduct the annual financial audit…[and]…serve other audit oversight purposes as determined by the entity's governing body*."

The District has used an "auditor selection committee," which has been comprised of various senior and executive District staff, the CAE, and one member of the Audit Committee. This selection committee develops a Request for Proposal, evaluates the proposals and ranks and recommends firms.

The IIA's model Audit Committee Charter lists the following among the responsibilities of the Audit Committee, as they relate to external auditors:
- Review the external auditors' proposed audit scope and approach, including coordination of audit effort with internal audit.
- Review the performance of the external auditors, and exercise final approval on the appointment or discharge of the auditors.
- Review and confirm the independence of the external auditors by obtaining statements from the auditors on relationships between the auditors and the company, including nonaudit services, and discussing the relationships with the auditors.
- On a regular basis, meet separately with the external auditors to discuss any matters that the Committee or auditors believe should be discussed privately.

In dealing with external auditors, the District staff perform the above-listed responsibilities, without the involvement of the Audit Committee or CAE. The Audit Committee's involvement after the selection process has been traditionally limited to participating in the audit exit interview.

Recommendation:
District administration, the School Board and the CAE should determine the amount of involvement the Audit Committee should have with external auditors, and that level of responsibility should be documented in the Audit Committee's Charter.

Observation

With the relatively new internal audit staffing, it is recommended that the next Quality Assurance review be conducted within *three* years rather than five years.

Conclusion

The above report explains, in detail, observations and suggested opportunities for enhancement, which will increase the effectiveness and efficiency of the Escambia County School District Office of Internal Auditing. Based upon the information reviewed and evaluated during this self-assessment, it is my opinion that the Escambia County School District Office of Internal Auditing **GENERALLY CONFORMS** to the IIA Standards.
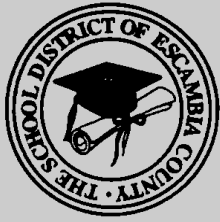
Respectfully submitted,

Betsy Bowers
CIA-Certified Internal Auditor
CFE- Certified Fraud Examiner
CGFM-Certified Government Financial Manager

IIA STANDARDS COMFORMANCE EVALUATION SUMMARY

STANDARD TYPE AND DESCRIPTION	VALIDATION OPINION
Attribute Standards:	
- Purpose, Authority, and Responsibility	Generally Conforms
- Independence and Objectivity	Generally Conforms
- Proficiency and Due Professional Care	Generally Conforms
- Quality Assurance and Improvement Program	Generally Conforms
Performance Standards:	
- Managing the Internal Audit Activity	Partially Conforms
- Nature of Work	Partially Conforms
- Engagement Planning	Generally Conforms
- Performing the Engagement	Generally Conforms
- Communicating Results	Generally Conforms
- Monitoring Progress	Partially Conforms
- Management's Acceptance of Risks	Generally Conforms
The Institute of Internal Auditors' *Code of Ethics*	Generally Conforms

OVERALL EVALUATION   **GENERALLY CONFORMS**

March 23, 2007

Ms. Betsy Bowers, CIA, CFE, CGFM
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Pensacola, Florida 32514

RE: Escambia County School District – Quality Assurance Assessment of Internal Audit

Dear Ms. Bowers:

Enclosed is our response to the Report on Quality Assurance Assessment of Internal Audit dated February 28, 2007.

Thank you for conducting the assessment on such short notice. We appreciate the opportunity to respond to the report and the proposed enhancements contained therein. After reviewing the responses, please advise me if you require further clarification or action on our part.

We look forward to working with you in the future in our shared professional organizations.

Sincerely,

David J. Bryant, CPA
Director
Office of Internal Auditing

C: Audit Committee

Comment No. 1: Inclusion in ERP Evaluation Team

We are in full agreement that our involvement in the development stage of the ERP process would be beneficial to the District. We have expressed our desire to the Superintendent to be included in the process, and hopefully we will be able to participate.

Comment No. 2: IA Director Should Interact More with District Upper Administration

I have recently met with the Deputy Superintendent to provide him with an update with the activities of Internal Auditing. I plan to continue these meetings every few months, or more frequently if required. In addition, I plan to meet with Directors of various departments throughout the District to begin establishing a rapport with leaders throughout the District.

We have begun the initial phases of updating our website to promote our services and increase the visibility of our office. Staff has attended website development classes hosted by the District webmaster, and we are in the initial phases of discussing updated content.

I am in agreement that an allotment of time should be included in our annual work plan for management consulting activities. These activities have traditionally been grouped under "Other Activities" in the annual work plan. I plan to delineate approximately 5% of available time for such activities in the 2007-2008 annual work plan.

Comment No. 3: Development of a Risk-based Audit Plan

I have obtained several examples of risk-based methodologies for audit planning purposes. For the 2007-2008 annual work plan, and years thereafter, work plans will be developed using formal risk analysis. The process will include meetings with managers throughout the District, during which critical areas will be identified. The goal of the process will be to perform reviews that address risks to the District achieving its objectives and to ensure the IA's activities are aligned with the District.

Comment No. 4: Development of a *Formal* Follow-up System

We have created a detailed database which includes all audits, reviews and other activities performed during the year. The database records various completion points and other pertinent information. Once a project has been approved by the School Board, the approval date will be recorded and a follow-up date will be determined. The administrative secretary will then send me an appointment (via my electronic calendar) to schedule the follow-up activities ninety (90) days from the Board approval date, or a reduced period if required.

In addition, a report will be presented to the Audit Committee at each meeting as to the activities for which follow-up activities are outstanding. A report on the results of follow-up activities will be provided to the Superintendent's office as well as the School Board members' office.

Comment No. 5: CAE and Staff Should Enhance Their Knowledge Related to the K-12 Environment
The current year budget has been amended to allow for myself to attend the Internal Auditor's Roundtable at the annual conference of the Florida Association of School Business Officials. The 2007-2008 office budget, as approved by the Audit Committee, includes an allowance for attendance at the full conference in 2008. We will continue to research and attend training specific to the K-12 educational environment, as well as training for government auditing, internal auditing and fraud.

Comment No. 6: Increased Focus on Information Technology
Although I do not feel the District is in a position to add additional staff to the Office of Internal Auditing for the purpose of IT auditing, the current staff is eager to pursue certifications, including perhaps the Certified Information Systems Auditor certification. In the future, we will obtain training and reference materials related to information technology auditing.

The District is currently researching new ERP software to handle all Finance and Human Resources functions. Upon selection of a software, we will explore various computer assisted auditing techniques that we feel will work best with the software chosen.