

Office of the County Executive

LOB #6:

INTERNAL AUDIT

Purpose

The Internal Audit LOB exists to provide independent, objective assurance over the adequacy of internal controls functioning in the County; and management advisory consulting that adds value to and improves County operations. Internal Audit reports to the County Executive and supports County agencies/departments in accomplishing their objectives by utilizing a systematic, disciplined approach to assess and improve the effectiveness of risk management, internal control, and governance processes.

Description

The Internal Audit Line of Business (LOB) consists of all major activities performed by the County's IAO except for the Business Process Audits which have been broken out into a separate LOB. This LOB includes the following functions:

- Operational Audits
- Information Technology Audits
- Fraud and Ethics Investigations
- Management Advisory Services
- Financial Reviews of organizations that provide services to the County
- Construction Contract Reviews
- Follow Up Activities
- Training for county staff on risk assessment, internal controls and fraud awareness

All work completed by IAO is performed in accordance to Government Auditing Standards which are issued by the U.S. Government Accountability Office (GAO). These standards dictate the evidence required to support our conclusions. To ensure compliance to these standards, IAO is subject to quality assurance peer reviews every 3 years by auditors from other local governments.

IAO performs a risk assessment each fiscal year to determine audits and management advisory projects for an Annual Audit Plan that will provide the most value for the resources spent. This includes obtaining information by sending out risk assessment questionnaires; and meetings with senior management discuss their current operational environment, risks and objectives. Other factors considered include how long it has been since an area has been audited and the materiality of issues found in prior year audits. Fraud and ethics investigations are performed throughout the year based on allegations that the IAO receives. Finally, Financial Reviews, Construction Contract Reviews and Management Advisory Services are performed as requested by County agencies/departments throughout the year.

Projects are performed by professional staff auditors with an average of 10 years of experience. Auditors performing this work are required to have active certification as a Certified Public Accountant (CPA), Certified Internal Auditor (CIA) or Certified Information Systems Auditor (CISA) and have at least a bachelor's degree with major course work in accounting, auditing, finance and/or information systems.

Internal Audit has been performing all of the functions listed above except for the Financial Reviews since it was established by the Board of Supervisors in 1982. The Financial Reviews started in 2008.

Office of the County Executive

A more detailed description of each function is as follows:

Operational Audits are performed to evaluate County program/process' efficiency and effectiveness. These audits are completed to determine the adequacy of controls over areas such as money coming into the county; purchases made; waste and ineffective use of county resources; compliance to contract/legal requirements and fraud.

Information Technology Audits are performed to ensure that data processed on information systems is secure, complete and accurate. In these audits, we examine the county's information technology infrastructure, policies and operations to ensure there are proper information system controls to protect company information assets and data; validate compliance with IT specific privacy laws; make sure information is correctly processed in the system; and ensure that system reports used in management decisions are accurate.

Fraud and Ethics Investigations are conducted to review allegations of fraud, waste, abuse and ethical violations. IAO is the owner of the County's Fraud Hotline which receives calls from County staff and external citizens. Additionally, allegations come from the IAO website Fraud Reporting Form, direct phone calls to our office, or in-person communication at our office. Internal Audit ensures that other county agencies are brought into the investigation as needed (i.e. Police, Human Resources, Office of Public Affairs, etc.). At the end of the investigation, IAO ensures that proper controls are implemented if the area being investigated has an increased risk for fraud. Finally, IAO also owns the Ethics Hotline where County employees can call to proactively call to report allegation of ethics violations and obtain advice on how to handle situations that arise involving ethical dilemmas.

Management Advisory Services are management requests for consultative projects that may involve the review of programs, goals, contracts, procedures, and controls within financial and operational areas.

Financial Reviews are financial analyses of organizations receiving funding from the county in which questions have arisen as to their financial viability. Most of these reviews are performed for Human Services divisions that have financial concerns regarding their not-for-profit organization partners receiving county funding to provide public services. These reviews are performed to ensure proper stewardship of these funds.

Construction Contract Reviews include reviews of proposed architect and engineer (A&E) overhead rates to ensure that only allowable costs are included so the County can negotiate the lowest rate; analyses to determine a construction firm's financial ability to complete required work prior to awarding the contract; and contractor claim reviews.

Follow-Up Activities are performed on all projects completed by IAO that have findings/recommendations. IAO performs procedures after the audit/project reports have been issued to verify that action plans stated in the management response during the audit/project have been implemented.

Training is conducted by IAO staff to educate staff throughout the county on risk assessment, internal controls and fraud awareness. IAO participates in County management training classes 4 times a year and works with the Office of Public Affairs to have regular fraud/ethics articles included in NewsLink and other newsletters circulating throughout the County. The goal is to train county staff on developing good internal controls and be able to detect the warning signs of fraud to promote continuous monitoring even when an auditor is not performing audit work in that area.

Office of the County Executive

Benefits

Internal Audits and Management Advisory Projects provide independent, objective assessments of risk, controls, and compliance, transparency of county operations and fraud deterrence. Audit/project report recommendations lead to enhanced controls over processes, programs, and functions; increased efficiency and effectiveness of county operations; cost savings and revenue enhancement; and more effective management decision making.

Follow Up Activities on recommendations hold County agencies/departments accountable for making the necessary changes to improve their operations.

Fraud and Ethics Investigations resolve these harmful threats to the organization before they can cause any additional damage. Our auditors are professionally trained in fraud investigation to avoid critical mistakes that can occur when county staff without expertise take it upon themselves to investigate. Additionally, recommendations are made to strengthen controls to prevent the schemes from happening in the future.

According to the *Association of Certified Fraud Examiners 2014 Report to the Nations on Occupational Fraud and Abuse*,

“...Passive detection methods (confession, notification by law enforcement, external audit and by accident) tend to take longer to bring fraud to management’s attention, which allows the related loss to grow. Consequently, proactive detection measures – such as hotlines, management review procedures, internal audits and employee monitoring mechanisms – are vital in catching fraud early and limiting their losses.”

“Organizations with hotlines were much more likely to catch fraud by a tip, which our data shows is the most effective way to detect fraud. These organizations also experienced frauds that were 41% less costly, and they detected frauds 50 percent more quickly.”

IAO is committed in our efforts to combat and prevent fraud in the county by monitoring the Fraud Hotline and Ethics Help Line. All of IAO’s audits include a fraud detection component; and provide guidance to county staff when ethical dilemmas arise. IAO has continued to work to raise awareness of fraud and ethics and the need for employees to contact our office when fraud is suspected or questions arise.

Financial Reviews provide management with a tool to assess the financial strength of a company doing business with or providing services to the County. This additional information leads to better management financial decision making, cost savings and corporate stewardship. These projects have saved the county from misappropriating funds to organizations that could not perform the agreed upon services because they were not financially stable.

Construction Contract Reviews ensure that only allowable costs are included for overhead rates, labor burdens and change orders in construction contracts. These projects have yielded the county recommended cost savings of hundreds of thousands of dollars in some years.

Training efforts lead to increased knowledge and awareness of county staff. Once staff is educated on risk assessment, internal controls and fraud detection they have to tools to perform risk assessments, develop solid internal controls and detect fraud in their agencies/departments. This contributes to more effective and efficiency operations.

Mandates

This Line of Business is not mandated.

Office of the County Executive

Trends and Challenges

Trends

Information Technology: Cybersecurity is a rapidly growing threat that needs to be addressed by all organizations that store confidential/sensitive financial, personal and organizational data. Data breaches are a common occurrence in headline news. The County electronically stores a significant amount of confidential/sensitive data from social security numbers to health records. Additionally, technology is rapidly changing and we live in a world of constant connectivity. IT controls must keep up to ensure County data is secure, complete and accurate.

Regulatory Compliance: New and changing regulations are placing increased burdens on County agencies/departments under tight budgets increasing the risk that compliance to certain requirements for federal, state and county regulations such as OMB Circular A-133, Health Care Reform, the Health Insurance Portability and Accountability Act (HIPAA), Payment Card Industry Data Security Standard (PCI DSS), the Virginia Records Act and the Fairfax County Information Technology Security Policy may be missed

Third Party Relationships: To more effectively serve its constituents, the County is increasing relying on third parties in its operations. From partnering with a not-for-profit organization to outsourcing computing services to the cloud, these relationships require solid oversight and contract governance to ensure they are not falling short of their responsibilities.

Challenges

Staff Development/Training: With the rapidly changing technology and ever changing regulatory environment in the County, it is imperative that our auditors have proper training to be able to effectively audit controls over new technology and compliance to new regulations. Most of the IAO staff require some type of professional certification (i.e. CPA, CIA, CISA) that has continuing education requirements of around 40 hours per year. Training for accounting/information technology technical classes has become increasingly expensive and IAO has been supplementing the training budget with some of the surplus funding from position vacancies over the last few years. The office is now fully staffed, so getting everyone all of their continuing professional education hours on topics required to keep up to date on technology and regulatory requirements will be challenging.

Talent Recruitment and Retention: The role of Internal Audit has been expanding to areas beyond the historical compliance based scope. Increasingly Internal Audit staff is required to have adequate subject matter expertise in new technology (i.e. Cloud Based Systems, Social Media, Mobile Devices, etc.) and regulatory areas (i.e. Health Care Reform, Medicaid/Medicare, Data Security Standards, etc.) in order to properly perform our audits. IAO needs to be able to recruit, retain and develop staff to ensure any gaps in needed skill sets are closed. Recruitment and retention is especially challenging to obtain and retain IT Auditors with strong, up to date technical skills as they are in high demand and are able to command higher salaries.

Levels of Audit Coverage: Given current staffing levels IAO is unable to perform, Operational, and IT audits at desired frequency or scope levels. Workload increases from additional responsibilities in the areas of fraud, ethics, and financial reviews result in delays in getting Annual Audit Plan projects completed and reports issued in as timely a manner as desired.

Office of the County Executive

Resources

Category	FY 2014 Actual	FY 2015 Actual	FY 2016 Adopted
LOB #6: Internal Audit			
FUNDING			
<u>Expenditures:</u>			
Compensation	\$821,973	\$796,020	\$980,602
Operating Expenses	44,914	48,306	35,674
Total Expenditures	\$866,887	\$844,326	\$1,016,276
General Fund Revenue	\$0	\$0	\$0
Net Cost/(Savings) to General Fund	\$866,887	\$844,326	\$1,016,276
POSITIONS			
Authorized Positions/Full-Time Equivalents (FTEs)			
<u>Positions:</u>			
Regular	10 / 10.4	10 / 10.4	10 / 10.4
Total Positions	10 / 10.4	10 / 10.4	10 / 10.4

Metrics

Metric Indicator	FY 2013 Actual	FY 2014 Actual	FY 2015 Actual	FY 2016 Estimate	FY 2017 Estimate
Audits and Contract Management Advisories Completed	26	21	21	25	25
Allegations & Questions on Fraud and Ethics Help Hotline	50	70	79	70	70
Revenue Covered by Audits/Projects	\$151,278,168	\$2,277,740,015	\$42,660,000	\$19,029,000	TBD
Expenditures Covered by Audits/Projects	\$2,614,795,465	\$42,074,015	\$2,425,636,000	\$134,800,000	TBD
Percent of Recommendations that Increased Efficiency/Effectiveness of Department Operations	70%	100%	100%	95%	95%
Percent of Recommendations that Strengthened Management Controls	70%	100%	100%	95%	95%
Percent of Recommendations Implemented	60%	88%	53%	80%	80%
Contract Cost Savings Identified from Architecture and Engineering (A&E) Desk Reviews	\$207,190	\$135,200	\$21,732	\$50,000	\$50,000

Office of the County Executive

Metric Type - Output

Audits and Contract Management Advisories Completed – This metric measures the volume of work produced by the department during a fiscal year. The metric is based upon the count of audit reports and memos issued for Operational Audits, IT Audits, Management Advisory Audits, Architecture and Engineering (A&E) Desk Reviews, and Pre-Award Desk Reviews. Data for this metric is retained in the department's Project Tracking Database. The downward trend over the last two years is largely due to the Deputy Director position that was vacant during half of fiscal years FY 2014 and all of FY 2015. This impacted the number of audits and reviews that could be properly managed during the year. Additionally, the number of fraud and ethics allegations that our office had to investigate increased which pulled some of our resources off of audits and management advisories. Finally, there was a slight decrease in requests to perform A&E and Pre-Award Desk Reviews; which are a function of procurement activities in other departments. Our estimate for FY 2016 and FY 2017 reflects an increase capacity to manage more engagements during the year with the filled Deputy Director position.

Allegations & Questions on Fraud and Ethics Help Hotline – This metric measures the volume of actions taken in response to submissions to the fraud and ethics hotline. The metric is based upon the count of fraud or ethic allegation reports received through the county's hotline. Data for this metric is retained in the department's Fraud and Ethics Tracking Database. The upward trend in reports received can be attributed to more awareness of the hotlines by employees and county residents. While the number of reports received has increase over last three years, the actual confirm instances of county fraud and/or ethic violations were 2 for FY 2013 and FY 2014 and 3 for FY 2015. Our estimate for FY 2016 and FY 2017 reflects our expectation that reports to the hotline will remain at the same level.

Revenue Covered by Audits/Projects – This metric measures the amount of revenue reviewed and affected by recommendations in our audits/projects during a fiscal year. The metric is based upon the value of specific revenue areas in departments/agencies that were reviewed through Operational Audits, Information Technology (IT) Audits, and/or Management Advisory Projects. The sources of data for this metric were the audit reports, audit work papers, county financial reports, and adopted county budget reports. The fluctuations over the past three years is based on the departments and transactions selected for audit. Our risk base audit approach results in the selection of key revenue areas for audit but also includes other factors such as expenditures, information system controls and fraud risks. In FY 2014, IAO audited real estate property taxes and land development fees and deposits, two high revenue areas for the county. Our estimate for FY 2016 reflects revenue audits included in our FY 2016 audit plan. FY 2017 reflects a figure to be determined as projections cannot be established until a risk assessment is performed to identify the relevant risks present in FY 2017 which will drive the audit program.

Expenditures Covered by Audits/Projects – This metric measures the amount of expenditures under audit during a fiscal year or expenditures affected by audit recommendations to strengthen controls. The metric is based upon the value of expenditure transactions in departments that were reviewed through our Operational Audits, Information Technology (IT) Audits, and/or Management Advisory Projects. The sources of data for this metric were the audit reports, audit work papers, county financial reports, and adopted county budget reports. The fluctuation over the past three years is based on the departments and transactions selected for audit. Our risk base audit approach resulted in the selection of key expenditure areas for audit but also includes other factors such as money coming into the county, information system controls and risk of fraud. A large portion of our expense testing is perform through our other line of business – Business Process Audits. In FY 2013, IAO performed a management advisory service to significantly improve the controls over department/agency monthly financial reconciliations, a key internal control over all county expenditures. In FY 2015, IAO performed an audit to review the internal controls over the county's electronic payments. Our estimate for FY 2016 reflects expenditure audits included in our FY 2016 audit plan. FY 2017 reflects a figure to be determined as projections cannot be established until a risk assessment is performed to identify the relevant risks present in FY 2017 which will drive the audit program.

Office of the County Executive

Metric Type – Service Quality

Percent of Recommendations that Increased Efficiency/Effectiveness of Department Operations – This metric measures the auditee’s assessment as to whether audit recommendations made improved efficiency and/or effectiveness of their department operations. The metric is based upon the percentage of auditees who responded on the Customer Satisfaction Questionnaire Agree or Strongly Agree to the question “did recommendations provide ways to improve efficiency and/or effectiveness in department operations”. Data for this metric is retained in files by the department. The two year trend of 100 percent reflects our understanding of county operations and ability to work with departments to provide internal controls recommendations that improve department operations. IAO estimates for FY 2016 and FY 2017 reflect our recognition that past history has shown that a small percentage of auditees may not always recognize recommendations as an improvement to operations.

Percent of Recommendations That Strengthened Management Controls – This metric measures the auditee’s assessment that recommendations made to improve or implement internal controls strengthened their control environment. The metric is based upon the percentage of auditees who responded on the Customer Satisfaction Questionnaire Agree or Strongly Agree to the question “did recommendations sufficiently address ways to strengthen management controls”. Data for this metric is retained in files by the department. The two year trend of 100% reflects our understanding of county operations and ability to work with departments to provide internal controls recommendations that strengthen management controls. Our estimates for FY 2016 and FY 2017 reflect our recognition that historically a small percentage of auditees will not always perceive audit recommendations as opportunities to strengthen management controls.

Metric Type – Outcome

Percent of Recommendations Implemented – This metric measures the audit recommendations implemented by auditees that have been verified by an Internal Audit follow up review. Data for this metric is retained in department’s Project Tracking Database. The FY 2015 total of 53 percent reflects that county agencies/departments have incurred challenges in fully implementing recommendations, particularly the larger, technically complex ones. Additionally, while Internal Audit does follow up on all recommendations made in audit reports, due to limited resources, staff may not always have time verify audit recommendation implementation as quickly as IAO would like. Our estimates for FY 2016 and FY 2017 reflect our plan to work with departments to set more realistic action plan deadlines.

Contract Cost Savings Identified from Architecture and Engineering (A&E) Desk Reviews
This metric measures the cost saving identified by an IAO recommendation of lower indirect overhead rate on A&E contracts. The metric is based upon IAO’s review of an A&E vendor’s submitted indirect overhead rates to ensure that only allowable costs are included in the calculations. Data for this metric is retained in Internal Audit’s Project Tracking Database. The downward trend is partially due to the decrease in the number of review requests from a high of 16 to a low of 11 during the three years. It should be noted that the majority of cost savings identified are identified on the initial review of a vendor indirect rate, of which there were 13 instances during the three year period. During the three year period, seven vendors have been reviewed more than once with only 3 having repeat finding of cost savings. Our estimates for FY 2016 and FY 2017 reflect our expectation that IAO will be performing first time review on new vendors.