



Transmitted via e-mail

January 29, 2015

Ms. Cynthia Bridges, Executive Director
California State Board of Equalization
450 N Street, MIC 73
Sacramento, CA 95814

Dear Ms. Bridges:

Final Report—California State Board of Equalization, External Quality Assessment

The Department of Finance, Office of State Audits and Evaluations, has completed its external quality assessment of the California State Board of Equalization's (BOE) Internal Audit Division for the period July 1, 2012 through June 30, 2014.

The enclosed report is for your information and use. BOE's response to the report observations is incorporated into this final report. BOE agreed with our observations and we appreciate its willingness to implement corrective actions. The observations in our report are intended to assist management in improving its internal audit activities. This report will be placed on our website.

We appreciate the assistance and cooperation of BOE. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Rick Cervantes, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Richard R. Sierra, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: Mr. Brock Wimberley, Chief, Internal Audit Division, California State Board of Equalization

An External Quality Assessment

California State Board of Equalization Internal Audit Division

Prepared By:
Office of State Audits and Evaluations
Department of Finance

MEMBERS OF THE TEAM

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Final reports are available on our website at <http://www.dof.ca.gov>

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BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

The California State Board of Equalization (BOE) oversees tax programs concentrated in four general areas: sales and use taxes, property taxes, special taxes, and the tax appellate program. BOE-administered revenues support hundreds of state and local government programs and services, including schools and colleges, hospitals and health care services, criminal justice, correctional, social welfare, law enforcement, consumer services, natural resource management, transportation, and housing programs.¹

The Internal Audit Division (IAD) provides independent, objective assurance and consulting services designed to add value and improve BOE's operations. In addition, IAD assists BOE in accomplishing its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of the organization's risk management, control, and governance processes.² The audit and consulting results are reported directly to BOE's Executive Director and Internal Audit Committee. Additionally, IAD coordinates all external audits, inquiries, and reviews of the organization's internal controls or processes. IAD consists of the Chief Auditor, a manager, and fourteen staff auditors.

SCOPE

The Department of Finance, Office of State Audits and Evaluations, performed an external quality assessment (Assessment) of IAD's internal audit operations for the period July 1, 2012 through June 30, 2014. The Assessment objective was to evaluate IAD's conformance with the Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing* (Standards) and *Code of Ethics*.

METHODOLOGY

We conducted our Assessment of IAD's compliance with the Standards and *Code of Ethics* in accordance with the IIA's *Quality Assessment Manual* (QAM). Specifically, we performed the following procedures:

- Reviewed and evaluated IAD's self-assessment, including the list of completed audits.
- Surveyed IAD staff and BOE management to evaluate the effectiveness and value added by the IAD.
- Interviewed management, those charged with governance, and audit staff to assess their understanding of and compliance with relevant quality control policies and procedures.
- Reviewed other documents to assess compliance with the Standards and *Code of Ethics*, including the IAD's Operations Manual, continuing professional education records, and IAD's annual risk assessment documentation.
- Selected a sample of completed audits and reviewed the audit reports and working papers for compliance with the Standards, *Code of Ethics*, and IAD's policies and procedures.

¹ BOE's website: http://www.boe.ca.gov/info/agency_history.htm

² BOE Internal Audit Division Operations Manual

We completed an external quality assessment of the California State Board of Equalization's Internal Audit Division's (IAD) compliance with the Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing* (Standards) and *Code of Ethics* for the period July 1, 2012 through June 30, 2014. We formed our opinion on IAD's compliance with the Standards and *Code of Ethics* based on the following compliance ratings delineated in IIA's *Quality Assessment Manual* (QAM).

Generally Conforms—The internal audit activity has a charter, policies, and processes that are judged to be in conformance with the Standards.

Partially Conforms—Deficiencies in practice are noted that are judged to deviate from the Standards, but these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner.

Does Not Conform—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.

It is our overall opinion that IAD partially conforms with the Standards and *Code of Ethics*. We also identified opportunities for IAD to further enhance its internal audit operations which are described in the Observations and Recommendations section of this report. See Appendix A for a detailed list of conformance with individual Standards and *Code of Ethics*.

Original signed by:

Richard R. Sierra, CPA
Chief, Office of State Audits and Evaluations

December 17, 2014

OBSERVATIONS and RECOMMENDATIONS

This section contains our observations of the California State Board of Equalization's (BOE) Internal Audit Division's (IAD) successful practices and opportunities to enhance its operations.

IAD's strengths include managing the internal audit activity and the nature of the work. Some examples of successful practices include the following:

- Leading BOE's risk assessment process with management involvement
- Assessing the adequacy and effectiveness of BOE's system of internal controls
- Developing a comprehensive audit plan based on identified departmental risks
- Developing a comprehensive IAD Operations Manual
- Proactively restructuring IAD into the following three specialties:
 - Internal Audit
 - Information Technology Audit
 - Enterprise Risk Management
- Actively recruiting staff with specialized skills

In addition to IAD's strengths, we identified the following opportunities for IAD to enhance its internal audit operations.

Observation 1: Quality Assurance and Improvement Program Implementation

Although IAD's Operations Manual includes the framework for a Quality Assurance and Improvement Program (QAIP) that complies with the *International Standards for the Professional Practice of Internal Auditing* (Standards), IAD has not fully implemented these procedures. The Standards, section 1300, define the QAIP requirements. Additionally, the Standards, sections 2400, 2430, and 2431 establish the related reporting requirements. The areas requiring improvement are as follows:

- IAD did not perform a formal self-assessment (i.e. internal peer review) and report the results to senior management and the Internal Audit Committee (Committee).
- IAD did not have an external quality assessment within the last five years. The most recent external assessment report was issued in December 2004, which also included an observation that the previous external quality assessment was not conducted timely.
- IAD issued reports during the assessment period stating the work was conducted in accordance with the Standards. IAD management identified this discrepancy and removed this statement from recent reports.

The Standards require that this statement be supported by internal and external assessment results documenting compliance with the QAIP before including it in reports. The Standards also require disclosing the nonconformance and impact to senior management, the board, and in any reports for which the engagement is impacted.

Recommendations:

To comply with the QAIP requirements, IAD should perform the following:

- A. Fully implement the QAIP procedures described in IAD's Operations Manual.
- B. Perform formal self-assessments on a periodic basis and report the results to senior management and the Committee.
- C. Ensure an external assessment is performed at least once every five years.
- D. Only include the statement that the work was conducted in accordance with the Standards when this statement is supported by both internal and external assessments.

Observation 2: Organizational Independence Risk

The Committee membership structure creates an organizational independence risk. The Committee consists of BOE's Executive Director, Chief Deputy Director, six division chiefs, and the IAD Chief (in a non-voting capacity). The IAD Chief reports functionally to the Committee and administratively to the Executive Director.

Because the Committee approves IAD's annual audit plan and IAD reports its results directly to the Committee, its structure creates the risk that the Committee could inappropriately restrict the scope of IAD's work or limit reporting for areas in which Committee members have direct operational responsibility. Standards section 1110.A1 requires that the internal audit activity be free from interference in determining the scope of internal auditing, performing work, and communicating results.

Recommendation:

To strengthen the organizational independence of IAD, the Committee membership should be expanded to include one or more BOE board members.

Observation 3: Audit Planning Documentation Enhancements

Two of the three audit engagements reviewed did not include documentation of the auditor's consideration of significant risks, or opportunities for making improvements to the audited activity's governance, risk management, or control processes. Further, the engagements reviewed did not include evidence that the audit program was formally approved prior to its implementation. Documenting the risk assessment, improvement opportunities, and prior approval of the audit program during the planning phase will enhance the effectiveness and efficiency of the audit and ensure the audit objectives are achieved.

Standards sections 2200, 2201, and 2240.A1 require internal auditors to develop and document a plan for each engagement that includes, among other requirements, assessing significant risks, considering opportunities for improvements, and prior approval of the audit program. Additionally, the IAD Operations Manual, section 2302.20, states that the auditors must present completed audit programs to the IAD Chief for approval as part of the planning phase. The work program must be approved prior to its implementation, and any adjustments approved promptly. Further, the IAD Operations Manual states that the IAD Chief's approval of the audit program should be documented either via e-mail, signature on audit program, and/or Chief's initials beside the changes.

Recommendation:

Enhance audit documentation to include the auditor's consideration of significant risks, improvement opportunities, and approval of the audit program during the planning phase of each engagement.

Observation 4: Disposition of Audit Results Were Not Adequately Monitored

IAD did not effectively monitor the disposition of audit results. Specifically, for two of three engagements reviewed, IAD follow-up evaluations did not occur in accordance with the Corrective Action Plans (CAP) as follows:

- One final report, issued March 2014, required a CAP follow-up evaluation in 90 days. However, a follow-up evaluation has not been documented as of August 2014.
- For one final report issued August 2012, several follow-up evaluations occurred at 60 and 90 day intervals through November 2013. While an informal decision was made to give the auditee more time to document corrective action, the extension was not specifically defined and further follow-up evaluations have not been conducted as of August 2014.

Ineffective monitoring of the disposition of audit results increases the risk that audit findings will not be fully remediated. The Standards, section 2500 A.1 require the chief audit executive to 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.

Recommendation:

Ensure that follow-up evaluations are performed timely to monitor the correction of audit findings or obtain documentation that management has accepted the risk of not taking action.

Observation 5: Internal Audit Charter Lacked Required Components

The IAD Audit Charter does not include definitions for the nature of assurance or consulting services as required by Standards, sections 1000.A1 and 1000.C1. A written audit charter that includes definitions for nature of assurance or consulting work is critical to managing the internal audit function because it defines the authority and responsibility of the internal audit activity.

Recommendation:

Amend the Audit Charter to include the definition of the nature of assurance and consulting work.

Observation 6: Written Engagement Access and Retention Policies

The IAD does not have documented policies related to access and retention of engagement documentation as required by Standards, sections 2330.A2 and 2330.C1. The lack of a documented policy increases the risk that engagement documentation may not be adequately safeguarded or disposed of prematurely.

Recommendation:

Document and implement policies to control access and retain engagement documentation.

Quality Assessment Evaluation Summary

Quality Assessment Evaluation Summary—Overall Evaluation	GC	PC	DNC
OVERALL EVALUATION		√	

Quality Assessment Evaluation Summary—Major/Supporting Standards		GC	PC	DNC
1000	Purpose, Authority, and Responsibility		√	
1010	Recognition of the Definition of Internal Auditing, the Code of Ethics, and the <i>Standards</i> in the Internal Audit Charter	√		
1100	Independence and Objectivity	√		
1110	Organizational Independence		√	
1111	Direct Interaction with the Board ¹	√		
1120	Individual Objectivity	√		
1130	Impairment to Independence or Objectivity	√		
1200	Proficiency and Due Professional Care	√		
1210	Proficiency	√		
1220	Due Professional Care	√		
1230	Continuing Professional Development	√		
1300	Quality Assurance and Improvement Program		√	
1310	Requirements of the Quality Assurance and Improvement Program		√	
1311	Internal Assessments		√	
1312	External Assessments			√

¹ For the external assessment, we considered reporting to the Audit Committee to substantially meet the requirement to interact with the Board.

Quality Assessment Evaluation Summary— Major/Supporting Standards		GC	PC	DNC
1320	Reporting on the Quality Assurance and Improvement Program		√	
1321	Use of “Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”		√	
1322	Disclosure of Nonconformance			√
2000	Managing the Internal Audit Activity	√		
2010	Planning	√		
2020	Communication and Approval	√		
2030	Resource Management	√		
2040	Policies and Procedures	√		
2050	Coordination	√		
2060	Reporting to Senior Management and the Board ¹	√		
2070	External Service Provider and Organizational Responsibility for Internal Auditing	N/A		
2100	Nature of Work	√		
2110	Governance	√		
2120	Risk Management	√		
2130	Control	√		
2200	Engagement Planning		√	
2201	Planning Considerations		√	
2210	Engagement Objectives	√		
2220	Engagement Scope	√		
2230	Engagement Resource Allocation	√		
2240	Engagement Work Program		√	
2300	Performing the Engagement	√		
2310	Identifying Information	√		

Quality Assessment Evaluation Summary— Major/Supporting Standards		GC	PC	DNC
2320	Analysis and Evaluation	√		
2330	Documenting Information		√	
2340	Engagement Supervision	√		
2400	Communicating Results		√	
2410	Criteria for Communicating	√		
2420	Quality of Communications	√		
2421	Errors and Omissions	N/A		
2430	Use of “Conducted in Conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”		√	
2431	Engagement Disclosure of Nonconformance			√
2440	Disseminating Results	√		
2450	Overall Opinions	√		
2500	Monitoring Progress		√	
2600	Communicating the Acceptance of Risks	√		
	The IIA’s Code of Ethics	√		

Rating Definitions

GC = Generally Conforms

PC = Partially Conforms

DNC = Does Not Conform

N/A = Not Applicable



STATE BOARD OF EQUALIZATION

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January 9, 2015

Mr. Richard R. Sierra, CPA
Chief, Department of Finance
Office of State Audits and Evaluations
915 L Street, 6th Floor
Sacramento, CA 95814

RE: *Draft Report – California State Board of Equalization, External Quality Assessment*

Dear Mr. Sierra,

The Board of Equalization (BOE), Internal Audit Committee (Committee) would like to thank the Department of Finance, Office of State Audits and Evaluations (Finance) for its recommendations contained in the *Draft Report - California State Board of Equalization, External Quality Assessment*.

The Internal Audit Division (IAD) agrees with the recommendations contained in this report. The IAD has either fully implemented or plans to implement all recommendations to ensure conformance with the Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing (Standards)*. For convenience, we have cited each finding and recommendation, followed by our response.

Observation 1- Quality Assurance and Improvement Program (QAIP) Implementation

To comply with the QAIP requirements, IAD should perform the following:

A. Recommendation:

Fully implement the QAIP procedures in the IAD's Operations Manual.

Response: The IAD fully implemented QAIP procedures contained in the Operations Manual. The IAD plans to address areas for improvement as they are identified through continuous monitoring and periodic internal reviews.

B. Recommendation:

Perform formal self-assessment on a periodic basis and report the results to senior management and the Committee.

Response:

A formal internal self-assessment will be performed at least annually with results reported to senior management and the Committee.

C. Recommendation:

Ensure an external assessment is performed at least once every five years.

Response:

The 2019 annual audit plan will include the required external quality assessment.

D. Recommendation:

Only include the statement that the work was conducted in accordance with the Standards when this statement is supported by both internal and external assessments.

Response:

The IAD removed the above statement from reports mid-2014 and will continue to exclude from reports until general conformance with the *Standards* has been determined.

Observation 2 – Organizational Independence Risk

Recommendation:

To strengthen the organizational independence of IAD, the Committee membership should be expanded to include one or more BOE board members.

Response:

The Committee plans to discuss membership composition to strengthen IAD organizational independence.

Observation 3 - Audit Planning Documentation Enhancements

Recommendation:

Enhance audit documentation to include the auditor's consideration of significant risks, improvement opportunities, and approval of the audit program during the planning phase of each engagement.

Response:

The IAD procedures and documentation have been enhanced to ensure:

1. completion of a Risk and Control Matrix to document risk consideration;
2. consideration of improvement opportunities; and
3. audit program approval is obtained for each engagement.

Observation 4 - Disposition of Audit Results Were Not Adequately Monitored

Recommendation:

Ensure that follow-up evaluations are performed timely to monitor the correction of audit findings or obtain documentation that management has accepted the risk of not taking action.

Response:

The IAD developed a dashboard to enhance follow-up evaluation timeliness, evaluate implemented actions' effectiveness, or obtain documentation that senior management has accepted the risk of not taking action.

Observation 5 - Internal Audit Charter Lacked Required Components

Recommendation:

Amend the Audit Charter to include the definition of the nature of assurance and consulting work.

Response:

The IAD amended its' charter to include the definition of the nature of assurance and consulting services for review and approval at the next Committee meeting.

Observation 6: Written Engagement Access and Retention Policies

Recommendation:

Document and implement policies to control access and retain engagement documentation.

Response:

The IAD defined access and engagement records retention in the Operations Manual.

If you have any questions, please contact me at (916) 327-4975 or Mr. Brock Wimberley at (916) 445-0360.

Sincerely,

Original Signed by Cynthia Bridges

Cynthia Bridges
Executive Director

CB:jb

cc: Mr. David Gau
Mr. Randy Ferris
Ms. Lynn Bartolo
Ms. Brenda Fleming
Mr. Dean Kinnee
Mr. Jeffrey L. McGuire
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Mr. Brock Wimberley