

External Quality Control Review

2003-05-27 09:11:33

of the
CITY AND COUNTY OF DENVER
CITY AUDITOR'S OFFICE
DIVISION OF INTERNAL AUDIT

Conducted in accordance with guidelines of the
**National Association of Local
Government Auditors**

for the period

JANUARY 1, 2002 THROUGH APRIL 30, 2003



National Association of Local Government Auditors

June 6, 2003

Mike Clark, CPA
Director of Internal Audit
City and County of Denver
Office of the Auditor
201 West Colfax Ave., Dept. 705
Denver, Colorado 80202

Dear Mr. Clark,

We have completed an external quality control review of the Division of Internal Audit of the City and County of Denver Office of the Auditor for financial-related and performance audits issued during the period January 1, 2002, through April 30, 2003. In conducting our review, we followed the standards and guidelines contained in the *N.A.L.G.A. Quality Control Review Guide* published in May, 1995, by the National Association of Local Government Auditors. Work of the Internal Audit Division that was excluded from the scope of our review was the separation audits and the activities of the Prevailing Wage Section. Accordingly, we did not express an opinion on the compliance of these functions with government auditing standards.

As prescribed by the N.A.L.G.A. Guide, we reviewed the internal quality control system of the Internal Audit Division and tested a sample of financial-related and performance audits for compliance with government auditing standards issued by the Comptroller General of the United States. Due to variance in individual performance and judgment, compliance does not imply adherence to standards in every case, but does imply adherence in most situations.

We have concluded from our review that your system of internal quality control is suitably designed and provided reasonable assurance that applicable government auditing standards were followed in the financial-related and performance audit work. We have also concluded from the sample of audits tested that your quality controls were working effectively and that audits were conducted in conformance with applicable standards during the period under review.

It is our opinion, therefore, that the Division of Internal Audit of the City and County of Denver Office of the Auditor was in compliance with government auditing standards during the period January 1, 2002, through April 30, 2003. We have prepared a separate letter to management which offers suggestions for further strengthening your internal quality controls.

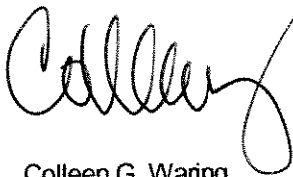
Although current contractual terms and working relationships appear to provide adequate support for the work of the Internal Audit Division, we identified a critical weakness in the lack of formal, authoritative enabling legislation. Currently, the key elements for an effective independent audit function (as identified in the N.A.L.G.A. Model Legislation) have been established for the most part on an informal basis. We strongly encourage the City and County Auditor to pursue formalizing these essential elements, through either modifications to the City Charter or additions to the City Code. Relevant essential elements are:

1. Requirement for a written report of audit results and recommendations.
2. Assurance of full, free, and unrestricted access to local government employees, officials, records, vendor contracts, and reports.
3. Existence of an audit committee for review of the auditor's work.

4. Compensating controls (such as employment under the CSA) that balance the influence of partisan politics on the selection and operation of the audit function.
5. Requirement for managers to respond in writing to audit recommendations.
6. Requirement for follow-up on significant findings and recommendations from previous audits.
7. Requirement for periodic quality assurance reviews of the audit function.

Most of these provisions have been implemented through other means. For instance, Internal Audit Division staff appear to be protected by the classified service. Moreover, requirements for a written report, follow-up on prior audits, and periodic external quality assurance reviews have been implemented as a result of the Internal Audit Division's adoption of generally accepted government auditing standards. However, we could not find authoritative legislation, either in the City Charter or City Code that formalizes these important protections. Moreover, government auditing standards and Internal Audit Division policies and procedures may not be sufficient to obligate the City and County of Denver and its agents to provide full and free access to staff, records, and other information, or to respond promptly to audit recommendations.

We appreciate the assistance and full cooperation of all the staff of the Internal Audit Division during the conduct of this Quality Assurance Review.



Colleen G. Waring
City of Austin, TX



Trudy J. Mattson
University Medical
Center of Southern Nevada



Denny L. Nester
City of Colorado Springs, CO



National Association of Local Government Auditors

June 6, 2003

Mike Clark, CPA
Director of Internal Audit
City and County of Denver
Office of the Auditor
201 West Colfax Ave., Dept. 705
Denver, Colorado 80202

Dear Mr. Clark,

We have completed an external quality control review of the Division of Internal Audit of the City and County of Denver Office of the Auditor for financial-related and performance audits issued during the period January 1, 2002, through April 30, 2003. We have issued a report stating our opinion concerning your organization's overall level of compliance with government auditing standards. We are issuing this companion letter to management to discuss details of internal control weaknesses identified during our review and offer suggestions for improvement. This letter should be read in conjunction with our opinion report.

During our review, we noted several procedures and methods for which we would like to commend the Division. These include:

- The Internal Audit Division employed a procedure for following up on audit recommendations that we found to be unique and value-added.
- The organization of work papers was commendable. The use of forms and check lists ensured the quality of the work performed by the Division.
- The Policies and Procedures Manual exhibited much forethought and planning. It was very well organized.
- The Performance Audit Survey Checklist is a good general guideline to cover the risks and management controls associated with performance.
- The Division utilizes risk assessment in the development of their annual audit plan. While this is not required by standards, it is recognized as a "best practice" in industry as well as government.
- Considering that the Internal Audit Division is not formally recognized under City Charter and City Code, the Division has played a significant role in providing accountability and improvements in City operations.

We found weaknesses in the following areas, none of which have a material effect on the overall compliance of the Division of Internal Audit with government auditing standards. These weaknesses include:

Description of audit objectives, scope and methodology can be more precisely delineated in some working papers and reports. Some audits' objectives, scope, and/or methodologies were not fully reflective of the nature of the work that was done. Specifically, use of standard language such as "Review of internal controls and financial-related information" was not congruent with scope periods described. (Financial-related information covers a range of time, while internal control opinions can only reflect the state of controls as of a specific point.) Objectives stated in the report and working papers were sometimes broader than documented tests would support.

[GAS 6.19; 7.10]

The connection between evaluation of internal controls and testing decisions could be better documented. We observed instances where ICQs were completed after the tests and sample sizes had been determined, (in one case after the report was drafted). It may be that some staff are not employing tests of controls to inform their testing and sampling decisions. Rather, they may be completing ICQ forms as a required document for the working papers without a full appreciation of their purpose and value to audit planning.

[GAS 6.5 a, d, e; 6.12; 6.13; 6.42]

Reliability of computer-processed data used for audits may need increased attention.

- Current policies and procedures do not contain provision for testing the reliability of computer-processed data when such data is significant to the audits.
- Internal Audit management has indicated that it relies on the annual external audit testing of the City's IT system(s).
- Several of the audits we reviewed employed (either as information or evidence) reports produced from programs and applications that are not part of the annually tested system. As use of technology proliferates in every aspect of the organization's operations, these "shadow systems" will play an increasing role as sources of information and audit evidence. Their reliability should be tested, or if used for information only, they should be sourced and labeled as "unaudited" both in working papers and reports.

[GAS 6.62]

Rationale for placing reliance on the work of others should be documented. For reasons similar to those discussed above in testing reliability of computer-processed data, Internal Audit Division policies and procedures may need to strengthen guidance related to relying on the work of others. Current policies neither provide direction on how to determine that the work of other auditors can be relied upon, nor do they require that such reliance be documented.

[GAS 6.14; 6.15; 6.16]

Evidence of review is missing on working papers prepared by Audit Supervisors. Working papers prepared by audit supervisors should be reviewed, even if by subordinate staff. In one case, working papers for an audit that was conducted entirely by a single individual—who was an audit supervisor—contained very limited evidence of review.

[GAS 6.63c; 6.23; 6.24; 6.25]

Timeliness of report issuance can be improved. Seven of the audits in our sample took more than 4 months from the date of the exit conference to the final issuance of the audit report. Two of these audits were issued 9 months after the exit conference.

[GAS 7.6; 7.7; 7.8]

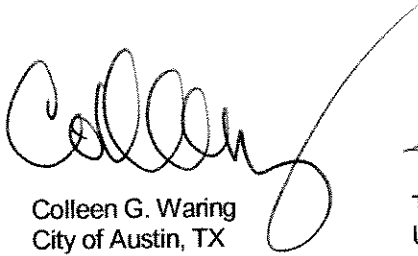
Future impact of Amendment 3

Although the period for this review was not affected by recent changes in government auditing standards, going forward the Internal Audit Division will need to consider the impact on its operations of *Amendment 3* to the government auditing standards. Two key issues to be addressed are the Internal Audit Division's independence to carry out work related to the City's financial accounting systems, and the need for additional or revised policies and procedures related to providing nonaudit services.


With respect to independence, *Amendment 3* establishes new requirements for audits covering periods from January 1, 2003, if audit organizations also provide nonaudit services. The standard has expanded the consequences of *personal* impairments to independence (resulting from performance of certain types of nonaudit services) to impair the independence of the audit organization as a whole. Examples of nonaudit services that are considered to impair independence include serving as members of an entity's management committee, developing programmatic policy, authorizing an entity's transactions, or maintaining custody of an entity's assets.

Considering that the Office of the City and County Auditor has responsibility for processing and recording the organization's accounting transactions, continued independence of the Internal Audit Division to carry out related audit work may be subject to question.

For audit organizations that also provide nonaudit services, *Amendment 3* requires implementation of new policies, procedures, and other internal controls as safeguards to ensure compliance with independence requirements.



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Donald J. Mares
Auditor

June 9, 2003

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Dear External Quality Control Peer Review Team Members:

I am in receipt of the external quality control report for the City and County of Denver Auditor's Office, Internal Audit Division citing your opinion of our operations being in full compliance with government auditing standards during the period January 1, 2002 through April 30, 2003. I am pleased with your opinion and conclusions of our quality controls working effectively and that audits conducted were in conformance with applicable standards during the period of review. Additionally, I appreciate the review team's efforts to recognize areas where our office excels and make suggestions in the management letter to strengthen our internal quality controls.

The quality control team handled themselves professionally and I commend them for the work performed. The review team's identification and recognition of our lack of formal authoritative enabling legislation will help us to facilitate future change in our City Charter and Denver's Revised Municipal Code to benefit the City. We concur with suggestions offered in the management letter to improve our quality control system and will take the appropriate action to reduce reoccurrences of the weaknesses identified.

Thank you for conducting the external quality control review of this office. We appreciate your professionalism and the time and effort you devoted to helping us improve our operations.

Sincerely,

Mike Clark, CPA
Director of Internal Audit