

# Internal Audit Department

O R A N G E C O U N T Y  
6<sup>th</sup> Largest County in the USA

## INDUSTRY STANDARDS/ BEST PRACTICES RESEARCH: INTERNAL AUDIT REPORTING MODELS FOR LARGE U.S. COUNTIES AND CITIES

Our research indicates that of the five reporting models identified, having the Director of Internal Audit report directly to the highest governing body (the elected Board of Supervisors or City Council) is the most widely used model (50%) throughout the U.S. for similar sized counties and cities.

This means that the Director of Internal Audit is an appointed position reporting directly to the elected Board of Supervisors/City Council while *not* performing management or accounting duties.

OC IAD's reporting model is the only model of the five reported that fully complies with all three professional auditing standards (U.S. GAO, AICPA, and IIA).

REPORT No: 1407-1  
REPORT DATE: AUGUST 29, 2014

**Director:** Dr. Peter Hughes, MBA, CPA, CIA  
Senior Audit Manager: Michael Goodwin, CPA, CIA  
Senior Auditor: Susan Nestor, CPA, CIA

### RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010, 2013



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors' Bronze Website Award



2005 Institute of Internal Auditors' Award for Recognition of Commitment to Professional Excellence, Quality, and Outreach



ORANGE COUNTY BOARD OF SUPERVISORS'  
**Internal Audit Department**

*GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010, 2013*

*Providing Facts and Perspectives Countywide*

**RISK BASED AUDITING**

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To access and view audit reports or obtain additional information about the OC Internal Audit Department, visit our website: [www.ocgov.com/audit](http://www.ocgov.com/audit)



**OC Fraud Hotline (714) 834-3608**

# Letter from Director Peter Hughes



## Transmittal Letter

Report No. 1407-1 August 29, 2014



**TO:** Members, Board of Supervisors  
Members, Audit Oversight Committee

**FROM:** Dr. Peter Hughes, CPA, Director  
Internal Audit Department

**SUBJECT:** Industry Standards/Best Practices  
Research: Internal Audit Reporting  
Models for Large U.S. Counties and  
Cities

We have completed our research on the industry standards/best practices of internal audit reporting models for large U.S. counties and cities. The final results are attached for your review.

Our research indicates that of the five reporting models identified below, having the Director of Internal Audit report directly to the highest governing body (the elected Board of Supervisors or City Council, Model 1) is the most widely used model (50%) throughout the U.S. for similar sized counties and cities. This means that the Director of Internal Audit is an appointed position reporting directly to the elected Board of Supervisors/City Council while performing *no* management or accounting duties. This reporting model ensures the Internal Auditor's independence is in strict accordance with the standards of the U.S. Government Accountability Office (GAO), American Institute of Certified Public Accountants (AICPA), and Institute of Internal Auditors (IIA). The table below summarizes the results of our Industry Standards/Best Practices Research of Internal Audit Reporting Models for Large U.S. Counties and Cities:

Model No.	Description of Reporting Model	% Used
1	The Auditor/Internal Audit Director is an <b>appointed</b> position that reports to the elected Board of Supervisors/City Council and <b>performs no management or accounting duties.</b> <a href="#">(OC Reporting Model)</a>	50%
2	The Auditor/Internal Audit Director is an <b>appointed position</b> that reports to the County/City Manager and <b>performs no management or accounting duties.</b>	10%
3	The Auditor/Auditor-Controller is <b>elected</b> and <b>performs both internal audit and management duties such as acting as the Controller of the books and records of the entity.</b> <a href="#">(OC Reporting Model at the Time of the 1994 Bankruptcy)</a>	23%
4	The Auditor/Auditor-Controller is an <b>appointed position</b> that reports to the elected Board of Supervisors/District Judges and <b>performs both internal audit and management duties.</b>	13%
5	The Auditor/Auditor-Controller is an <b>appointed position</b> that reports to the Chief Administrative Officer and <b>performs both internal audit and management duties.</b>	4%

# Letter from Director Peter Hughes



Each month I submit an **Audit Status Report** to the Board of Supervisors (BOS) and the results of this report will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to address areas of interest to the Board of Supervisors and Audit Oversight Committee. Please feel free to call me should you wish to discuss any aspect of our report.

## **Attachments**

Other recipients of this report are listed on the Internal Auditor's Report on page 5.

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## INDUSTRY STANDARDS/BEST PRACTICES RESEARCH RESULTS

Report No. 1407-1

August 29, 2014

TO: Members, Board of Supervisors  
Members, Audit Oversight Committee

FROM: Dr. Peter Hughes, CPA, Director

SUBJECT: Industry Standards/Best Practices Research: Internal Audit Reporting Models for Large U.S. Counties and Cities

### Highlight

Orange County's IAD reporting model is the most widely used (50%) throughout the U.S. for similar sized counties and cities.

This means that the Internal Auditor is an appointed position reporting to the elected Board of Supervisors/City Council and performing *no* management or accounting duties.

This reporting model ensures the Internal Auditor's independence is in strict accordance with the standards of the U.S. Government Accountability Office (GAO), American Institute of Certified Public Accountants (AICPA), and Institute of Internal Auditors (IIA).

### Background

The Audit Oversight Committee (AOC), at their September 5, 2007 meeting, requested that the Internal Audit Department identify other similarly sized counties and cities throughout the U.S. that have an independent internal audit function similar to Orange County where the Internal Auditor is an appointed position reporting to the elected Board of Supervisors/City Council and performing no management duties.

We presented our initial results in 2007 that the OC Internal Audit Department (IAD) reporting model was in fact widely used in large U.S. counties and cities. In 2008, we confirmed again that Orange County's reporting model is the most widely used throughout the U.S. in large counties and cities.

Recently the issue as to how to best preserve the impartiality of the Internal Audit function was raised. To assist in answering this question, we cite the universal professional standards for internal auditing as well as identify the most regularly and widely used models or approaches to internal audit reporting for similarly sized counties and cities in the U.S.

In this report, we identify the "Industry Standards" and compare them to the Best Practices recommended by the three most widely recognized authoritative bodies in auditing; the U.S. Government Accountability Office's (GAO) Generally Accepted Government Auditing Standards (GAGAS), the American Institute of Certified Public Accountants (AICPA), and the Institute of Internal Auditors (IIA). All three professional bodies support the internal audit function reporting to the "highest governing body" in the organization, as Orange County has been doing since 1995.

Specifically GAGAS states that "*Auditors should avoid situations that could lead reasonable and informed third parties to conclude that the auditors are not independent and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work.*" (2011 GAGAS, section 3.04). [See Attachment C](#)



Additionally, GAGAS states that “*The credibility of auditing in the government sector is based on auditors’ objectivity in discharging their professional responsibilities. Objectivity includes independence of mind and appearance when providing audits, maintaining an attitude of impartiality, having intellectual honesty, and being free of conflicts of interest.*” (2011 GAGAS, section 1.19).

## U.S. GAO Independence Standards

It is important to note GAGAS independence standards are developed after careful consideration of all perspectives during an extensive public comment evaluation. The resulting standards are regarded by the profession as balanced and fair in addition to being authoritative.

GAGAS places as much emphasis on the importance of the “appearance” of independence regarding both the audit organization and its individual auditors, as on the actual “fact” of their impartiality due to the critical need for governmental entities to maintain the “trust” of the public regarding the impartiality and objectivity of governmental audits. It is for this reason that the GAO has identified seven categories and 29 specific examples of relationships and circumstances that may threaten either the appearance or fact of independence/impartiality for governmental audit organizations and the individual auditors.

For purposes of this survey, we have identified the three categories of threats pertaining to the placement of the audit organization within a governmental entity. GAO standards assert that the most impartiality of an internal audit organization will be exercised when the Chief Auditor/Director of the Internal Audit function reports directly to the “highest governing body” of the entity, or the Chief Auditor/Director of the Internal Audit function is elected by the public. However, to fully meet the independence standards, in both instances, the Chief Auditor must not also have concurrent managerial duties such as maintaining the accounting function while also serving as the Controller of the entity.

## Threats to Auditor Independence and Objectivity in Reporting Results

Any situation that includes managerial duties presents a potential “**management participation threat.**” In essence, this threat, to at least the appearance of impartiality, is due to the fact that the public rightfully is doubtful that anyone can truly remain “impartial” and “objective” when auditing themselves and reporting to the public the results. This skepticism is strongest when the results may have devastating consequences to that individual.

Another potential threat to impartiality to both the internal audit function itself and the individual auditors identified by GAGAS is called a “**structural threat.**” This occurs when the internal audit function reports to and its Audit Head is hired and fired by an executive or officer, whether appointed or elected, that has concurrent management duties for the entity. This type of reporting relationship raises the concern that the Head Auditor and staff may be hesitant or reluctant to point out deficiencies found in their boss’ operations.

Logically, it can be seen why both a “management participation threat” and a “structural threat” also correspondingly presents a potential “**undue influence**” threat that occurs whenever an auditor would feel “pressures” whether imagined or actually asserted by management not to offend management by revealing deficiencies or lapses that reflect poorly on management. In essence, GAGAS recognizes the inherent “conflict of interest” that inevitability occurs whenever a subordinate “audits” a superior or boss who controls their employment future.

**Our research continues to reveal that the most widely used reporting model was the one adopted by the Orange County Board of Supervisors in 1995 and continues to this day.** This reporting model has the entity’s internal audit function report directly to the elected Board of Supervisors/City Council while performing *no management or accounting duties.*



## Safeguards to Address Levels of Threats to Independence

According to the GAO Standards on Independence, there are measures that can be taken to eliminate or reduce threats to independence to an acceptable level threat, and state that “Safeguards are controls the auditors can apply that address the specific facts and circumstances under which threats to independence exist. In some case, multiple safeguards may be necessary to address a threat.” [Attachment C – U.S. GAO Standards on Independence Sections 3.16 and 3.17](#) provides examples of safeguards that can be used to reduce and/or eliminate threats to independence in the models where independence could be impaired.

## Research Performed

We identified **5 different internal audit reporting models** used by the **15 largest U.S. counties and 15 largest cities** by population. We determined the best source of readily available information regarding county and city internal audit functions was directly from the relevant city and county audit websites. See source data in [Attachments A and B](#).

## Results

**Our research continues to reveal that Orange County’s Internal Audit Department reporting model is the most widely used throughout the U.S. in large counties and cities.** A combined average of **50%** of the largest U.S. Counties and Cities, including Orange County, **share the Orange County model (Model 1)**. This means that the Internal Auditor is an *appointed* position that reports to the elected Board of Supervisors/City Council and performs *no management or accounting duties*. This reporting model ensures the Internal Auditor’s independence and complies with professional auditing standards of the GAO, AICPA and IIA.

The 5 internal audit reporting models had the following combined average percentages of use:

Model No.	Description of Reporting Model	% Used
1	The Auditor/Internal Audit Director is an <b>appointed</b> position that reports to the elected Board of Supervisors/City Council and <b>performs no management or accounting duties</b> . <a href="#">(OC Reporting Model)</a>	50%
2	The Auditor/Internal Audit Director is an <b>appointed position</b> that reports to the County/City Manager and <b>performs no management or accounting duties</b> .	10%
3	The Auditor/Auditor-Controller is <b>elected</b> and <b>performs both internal audit and management duties</b> such as acting as the Controller of the books and records of the entity. <a href="#">(OC Reporting Model at the Time of their 1994 Bankruptcy)</a>	23%
4	The Auditor/Auditor-Controller is an <b>appointed position</b> that reports to the elected Board of Supervisors/District Judges and <b>performs both internal audit and management duties</b> .	13%
5	The Auditor/Auditor-Controller is an <b>appointed position</b> that reports to the Chief Administrative Officer and <b>performs both internal audit and management duties</b> .	4%

**Model 1 (OC Model): 50%** The Auditor/Internal Audit Director is an *appointed* position that reports to the elected Board of Supervisors/City Council and performs *no management or accounting duties*. This is the *predominate model* used to best ensure the Internal Auditor’s independence/impartiality and fully complies with the professional auditing standards of the GAO, IIA and AICPA.

**Model 2: 10%** The Auditor/Internal Audit Director is an *appointed position* that reports to the County/City Manager and performs *no management or accounting duties*. This model could impair compliance with independence requirements and result in “*undue influence*” and “*structural threats*” as the internal audit function is not reporting to the highest governing body of the entity, and instead is reporting one level down to the County/City Manager who directly manages all the entity’s business and program operations.



This type of reporting relationship raises the concern that the Head Auditor and staff may be hesitant or reluctant to point out deficiencies found in their boss' operations. As such, this situation gives the appearance to the public that an auditor may feel "pressures" whether imagined or actually asserted by management not to offend management by revealing deficiencies or lapses that reflect poorly on management. In essence, GAGAS recognizes as a threat to impartiality the inherent "conflict of interest" that inevitability occurs whenever a subordinate "audits" a superior or boss that has direct charge of the area audited.

**Model 3: 23%** The Auditor/Auditor-Controller is *elected* and performs *both internal audit and management duties such as acting as the Controller of the books and records of the entity*. This model could impair compliance with independence requirements of all major auditing standards because it presents potential "*management participation*," "*structural*" and "*undue influence*" threats. These threat results from the Auditor/Controller actually "auditing" him or herself through his or her internal audit function. This was Orange County's internal audit reporting model at the time of the bankruptcy in 1994.

GAGAS recognizes there is a natural skepticism in the public that an elected Auditor/Controller would allow his or her handpicked auditor to point out deficiencies found in their boss' operations. Logically, it can be seen why both "management participation threat" and "structural threat" also correspondingly presents a potential "undue influence" threat that occurs whenever an auditor would feel "pressures" whether imagined or actually asserted by management not to offend management by revealing deficiencies or lapses that reflect poorly on management. In essence, GAGAS recognizes the inherent "conflict of interest" that inevitability occurs whenever a subordinate "audits" a superior or boss who controls their employment future.

**Model 4: 13%** The Auditor/Auditor-Controller is an *appointed position* that reports to the elected Board of Supervisors/District Judges and performs *both internal audit and management duties*. This model could impair compliance with independence requirements of all major auditing standards because it presents potential "*management participation*" "*structural*" and "*undue influence*" threats. These threat results from the Auditor/Controller actually "auditing" him or herself through his or her internal audit function. GAGAS recognizes there is a natural skepticism in the public that an Auditor/Controller would allow his or her handpicked auditor to point out deficiencies found in their superiors' operations. Logically, it can be seen why both a "management participation threat" and a "structural threat" also correspondingly presents a potential "undue influence" threat that occurs whenever an auditor would feel "pressures" whether imagined or actually asserted by management not to offend management by revealing deficiencies or lapses that reflect poorly on management. GAGAS recognizes the inherent "conflict of interest" that inevitability occurs whenever a subordinate "audits" a superior or boss who controls their employment future.

**Model 5: 4%** The Auditor/Auditor-Controller is an *appointed position* that reports to the Chief Administrative Officer and performs *both internal audit and management duties*. This model could impair compliance with independence requirements of all major auditing standards because it presents potential "*management participation*" "*structural*" and "*undue influence*" threats. These threat results from the Auditor/Controller actually "auditing" him or herself through his or her internal audit function. GAGAS recognizes there is a natural skepticism in the public that an Auditor/Controller would allow his or her handpicked auditor to point out deficiencies found in their boss' operations. Logically, it can be seen why both a "management participation threat" and a "structural threat" also correspondingly presents a potential "undue influence" threat that occurs whenever an auditor would feel "pressures" whether imagined or actually asserted by management not to offend management by revealing deficiencies or lapses that reflect poorly on management.



## State Laws/Historical Precedent May Impact Our Results

When conducting our research we identified two states, California and Texas, with statewide laws generally stating that the Auditor also be given the duties of Controller. The laws were made many years ago prior to the 2011 revisions to the U.S GAO's Government Auditing Standards regarding auditor independence/impartiality.

Specifically, under the GAO's Government Auditing Standards a government internal audit function is organizationally independent if the head of the audit organization is accountable and reports to the head of the government entity and is located organizationally outside the management function and has no management duties. Our data of 30 large U.S. Counties and Cities includes 12 California and Texas counties and cities that have internal audit functions within the Auditor Departments that also perform Controller duties (i.e., accounting and management duties). As such, they do not reflect current views for independence of the internal audit function, but rather continue the historical/law based precedent.

## Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Michael Giancola, County Executive Officer  
Mark Denny, Chief Operating Officer  
Ann Fletcher, Supervising Deputy, County Counsel  
Foreperson, Grand Jury  
Susan Novak, Clerk of the Board of Supervisors  
Macias Gini & O'Connell LLP, County External Auditor



## DETAILED RESULTS 2014

Based on our research, the five most common reporting models for the internal audit function in the 30<sup>1</sup> largest U.S. counties and cities (based on population) are as follows:

**Model #1 (OC Model):** The Auditor/Internal Audit Director is an *appointed position* that reports to the elected *Board of Supervisors/City Council* and performs *no management or accounting duties*. **Combined average percentage is 50%**. See details below:

### 47% Top U.S. Counties Adopted Model #1

Size Ranking	County	State
2	Cook	IL
4	Maricopa	AZ
6	Orange – Internal Audit Dept <sup>1</sup>	CA
6	Orange – Performance Auditor <sup>1</sup>	CA
8	Miami-Dade – Commission Auditor <sup>2</sup>	FL
14	King	WA
15	Wayne	MI

### 53% of Top U.S. Cities Adopted Model #1

Size Ranking	City	State
3	Chicago	IL
7	San Antonio	TX
8	San Diego	CA
9	Dallas	TX
10	San Jose	CA
11	Jacksonville	FL
12	Indianapolis	IN
14	Austin	TX

**Model #2:** The Auditor/Internal Audit Director is an *appointed position* that reports to the *County/City Manager* and performs *no management or accounting duties*. **Combined average percentage is 10%**. See details below:

### 13% of Top U.S. Counties Adopted Model #2

Size Ranking	County	State
8	Miami-Dade – Audit and Mgmt Services <sup>2</sup>	FL
13	Clark County	NV

### 7% of Top U.S. Cities Adopted Model #2

Size Ranking	City	State
6	Phoenix	AZ

<sup>1</sup> Two New York Boroughs are not included in the County percentage as already presented in the City percentage. In addition, two counties (Orange and Miami-Dade) have two internal audit functions with countywide audit responsibilities. Both internal audit functions are included in the counts/percentages.



**Model #3:** The Auditor/Auditor-Controller is *elected and performs both internal audit and management duties*. **Combined average percentage is 23%**. See details below:

**13% of Top U.S. Counties  
Adopted Model #3**

Size Ranking	County	State
11	Riverside	CA
12	San Bernardino	CA

**33% of Top U.S. Cities  
Adopted Model #3**

Size Ranking	City	State
1	New York	NY
2	Los Angeles	CA
4	Houston	TX
5	Philadelphia	PA

**Model #4:** The Auditor/Auditor-Controller is an *appointed position* that reports to the elected *Board of Supervisors/District Judges* and performs *both internal audit and management duties*. **Combined average percentage is 13%**. See details below:

**20% of Top U.S. Counties  
Adopted Model #4**

Size Ranking	County	State
1	Los Angeles	CA
3	Harris	TX
9	Dallas	TX

**7% of Top U.S. Cities  
Adopted Model #4**

Size Ranking	City	State
12	San Francisco	CA

**Model #5:** The Auditor/Auditor-Controller is an *appointed position* that reports to the Chief Administrative Officer and *performs both internal audit and management duties*. See details below:

**7% of Top U.S. Counties Adopted Model #5**

Size Ranking	County	State
5	San Diego	CA

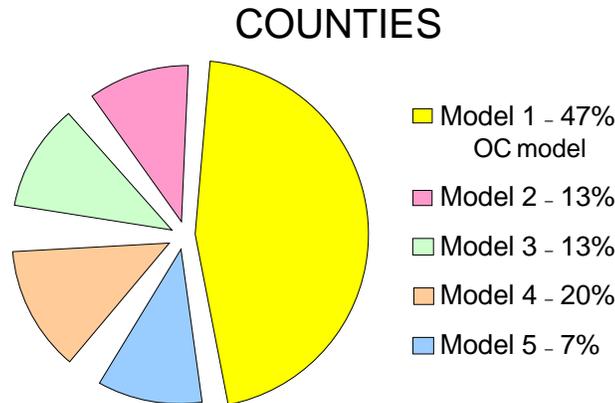
As a combined average, **50%** of the 30 largest U.S. Cities and Counties have established an internal audit function that **share the OC Internal Audit Department reporting model** where the Internal Auditor is an appointed position that reports directly to the elected County Supervisors/City Council and has no management duties.



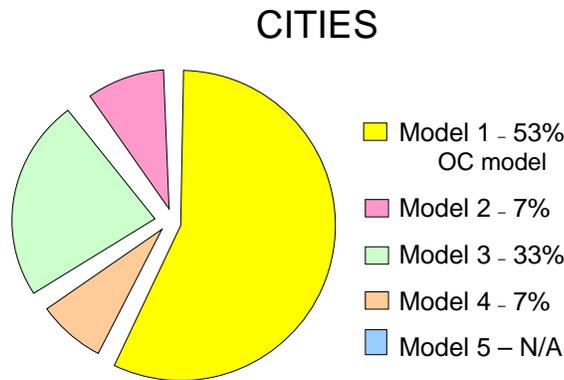
## SUMMARY

Orange County’s IAD reporting model (Model 1) is the most widely used throughout the U.S. in large counties and cities as depicted in the below charts.

47% of the 15 largest counties (based on population including Orange County) share the Orange County model:



53% of the 15 largest cities (based on population) share the Orange County model:



### LEGEND:

-  **Model 1 (OC Model)** 50% combined average percentage – The Auditor/Internal Audit Director is an appointed position that reports to the elected Board of Supervisors/City Council and performs no management or accounting duties.
-  **Model 2** – 10% combined average percentage - The Auditor/Internal Audit Director is an appointed position that reports to the County/City Manager and performs no management or accounting duties.
-  **Model 3** - 23% combined average percentage – The Auditor/Auditor-Controller is elected and performs both internal audit and management duties.
-  **Model 4** – 13% combined average percentage - The Auditor/Auditor-Controller an appointed position that reports to the elected Board of Supervisors/District Judges and performs both internal audit and management duties.
-  **Model 5** – 7% - The Auditor/Auditor-Controller is an appointed position that reports to the Chief Administrative Officer and performs both internal audit and management duties.



## ATTACHMENT A: Top 15 U.S. Counties by Population

Top 15 U.S. Counties by Population  
Similar to OC Internal Audit Department

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	
Rank	County	Population	Function Name	Key Contact Info	Has Mgmt Duties	Doesn't Have Mgmt Duties	Description of Management Duties	Elected	Appointed	If appointed, reports to:
1	Los Angeles County, CA	9,818,605	Auditor-Controller	John Naimo, Acting (213) 974-8301	X		Controller		X	Board of Supervisors
2	Cook County, IL	5,194,675	County Auditor	Shelley A. Banks (312) 803-1500		X			X	Board of Commissioners
3	Harris County, TX	4,092,459	County Auditor	Barbara Schott (713) 755-6505	X		CFO		X	State District Judges
4	Maricopa County, AZ	3,817,117	County Auditor	Ross Tate ( 602) 508-1685		X			X	Board of Supervisors
5	San Diego County, CA	3,095,313	Auditor-Controller	Tracy Sandoval (619) 531-5413	X		Controller		X	CAO
6	Orange County, CA	3,010,232	Internal Audit Department	Dr. Peter Hughes (714) 834-5475		X			X	Board of Supervisors
			Performance Auditor	Philip Cheng		X ^			X	Board of Supervisors^
7	Kings County, NY (Brooklyn)	2,504,700	A Borough of New York City		N/A *	N/A *	N/A *	N/A *	N/A *	N/A *
8	Miami-Dade County, FL	2,496,435	Audit & Management Services	Cathy Jackson (305) 349-6100		X			X	Mayor
			Commission Auditor	Charles Anderson (305) 375-4354		X ^			X	Board of County Commissioners^
9	Dallas County, TX	2,368,139	County Auditor	Virginia Porter (214) 653-6472	X		CFO		X	State District Judges
10	Queens County, NY	2,230,722	A Borough of New York City		N/A *	N/A *	N/A *	N/A *	N/A *	N/A *
11	Riverside County, CA	2,189,641	Auditor-Controller	Paul Angulo (951) 855-3800	X		Controller	X		N/A
12	San Bernardino County, CA	2,035,210	Auditor-Controller/Treasurer/Tax Collector	Larry Walker (909) 387-8322	X		Controller & Treasurer	X		N/A
13	Clark County, NV	1,951,269	Audit Department	Angela Darragh (702) 455-3269		X			X	County Manager
14	King County, WA	1,931,249	County Auditor	Kymer Walkmunson (206) 296-0159		X			X	County Council
15	Wayne County, MI	1,820,584	Legislative Auditor General	Willie Mayo (313) 224-0924		X			X	County Commission
					6	9	Total	2	13	
					40%	60%		13%	87%	

Source:  
Top 15 US Counties obtained from US Census Bureau Population Estimates for the 100 largest US Counties Based on July 1, 2010 Population Estimates. Remaining data obtained from relevant website or material available on the website.

Legend:  
\* Not included in counts/percentages because already represented by City of NY.  
^ Two separate internal audit functions for the county; both internal audit functions included in counts/percentages.

- 7 of 15 = 47%** **Model #1 (OC Internal Audit Department)** The Auditor/Internal Audit Director is an appointed position that reports to the elected Board of Supervisors/City Council (column 10) and performs no management duties (column 6).
- 2 of 15 = 13%** **Model #2:** The Auditor/Internal Audit Director is an appointed position that reports to the County Manager (column 10) and performs no management duties (column 6).
- 2 of 15 = 13%** **Model #3:** The Auditor/Auditor-Controller is an elected position (column 8) and performs both internal audit and management duties (column 5).
- 3 of 15 = 20%** **Model #4:** The Auditor/Auditor-Controller is an appointed position that reports to the elected Board of Supervisors/District Judges (column 10) and performs both internal audit and management duties (column 5).
- 1 of 15 = 7%** **Model #5:** The Auditor/Auditor-Controller is an appointed position that reports to the Chief Administrative Officer (column 10) and performs both internal audit and management duties (column 5).



## ATTACHMENT B: Top 15 U.S. Cities by Population

Top 15 U.S. Cities by Population  
Similar to OC Internal Audit Department

(1) Rank	(2) City	(3) Population	(4) Function Name	(5) Has Mgmt Duties	(6) Doesn't Have Mgmt Duties	(7) Description of Management Duties	(8) Elected	(9) Appointed	(10) If appointed, reports To:
1	New York, New York (City and Boroughs aka Counties)	8,175,133	Comptroller	X		Comptroller/CFO	X		N/A
2	Los Angeles, California	3,792,621	City Controller	X		Controller	X		N/A
3	Chicago, Illinois	2,695,598	Inspector General		X			X	Elected Mayor & City Council
4	Houston, Texas	2,099,451	City Controller	X		Controller	X		N/A
5	Philadelphia, Pennsylvania	1,526,006	City Controller	X		Approve disbursements	X		N/A
6	Phoenix, Arizona	1,445,632	City Auditor		X			X	Mayor
7	San Antonio, Texas	1,327,407	City Auditor		X			X	City Council
8	San Diego, California	1,307,402	City Auditor		X			X	City Council
9	Dallas, Texas	1,197,816	City Auditor		X			X	City Council
10	San Jose, California	945,942	City Auditor		X			X	City Council
11	Jacksonville, Florida	821,784	Council Auditor		X			X	City Council
12	Indianapolis, Indiana (City & Marion County)	820,445	Office of Audit and Performance		X			X	Mayor
13	San Francisco, California (City & County)	805,235	Controller	X		Chief Accounting Officer		X	Elected Mayor & Board of Supervisors
14	Austin, Texas	790,390	City Auditor		X			X	City Council
15	Columbus City, Ohio	787,033	City Auditor	X		Chief Accounting Officer	X		N/A
				<b>6</b>	<b>9</b>	<b>Total</b>	<b>5</b>	<b>10</b>	
				<b>40%</b>	<b>60%</b>		<b>33%</b>	<b>67%</b>	

**Source:**

Top 15 US Cities obtained from US Census Bureau Annual Estimates of the Population for Incorporated Places Over 50,000, Ranked by April 1, 2010 Population. Remaining data obtained from relevant website or material available on the website.

- 8 of 15 = 53%** **Model #1 (OC Internal Audit Department)** The Auditor/Internal Audit Director is an appointed position that reports to the elected Board of Supervisors/City Council (column 10) and performs no management duties (column 6).
- 1 of 15 = 7%** **Model #2:** The Auditor/Internal Audit Director is an appointed position that reports to the County Manager (column 10) and performs no management duties (column 6).
- 5 of 15 = 33%** **Model #3:** The Auditor/Auditor-Controller is an elected position (column 8) and performs both audit and management duties (column 5).
- 1 of 15 = 7%** **Model #4:** The Auditor/Auditor-Controller is an appointed position that reports to the elected Board of Supervisors/District Judges (column 10) and performs both audit and management duties (column 5).
- 0 of 15 = 0%** **Model #5:** The Auditor-Controller/Controller Treasurer is an appointed position that reports to the Chief Administrative Officer/Finance (column 10) and performs both audit and management duties (column 5).



## ATTACHMENT C: U.S. GAO Standards on Independence

**GAO** **United States Government Accountability Office**  
By the Comptroller General of the  
United States

December 2011

**Government  
Auditing  
Standards**

2011 Revision



GAO-12-331G



## ATTACHMENT C: U.S. GAO Standards on Independence (continued)

### Chapter 3

## General Standards

### Introduction

**3.01** This chapter establishes general standards and provides guidance for performing financial audits, attestation engagements, and performance audits under generally accepted government auditing standards (GAGAS). These general standards, along with the overarching ethical principles presented in chapter 1, establish a foundation for the credibility of auditors' work. These general standards emphasize the importance of the independence of the audit organization and its individual auditors; the exercise of professional judgment in the performance of work and the preparation of related reports; the competence of staff; and quality control and assurance.

### Independence

**3.02** In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be independent.

**3.03** Independence comprises:

**a. Independence of Mind**

The state of mind that permits the performance of an audit without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

**b. Independence in Appearance**

The absence of circumstances that would cause a reasonable and informed third party, having knowledge of the relevant information, to reasonably conclude that the integrity, objectivity, or professional skepticism of an audit organization or member of the audit team had been compromised.

**3.04** Auditors and audit organizations maintain independence so that their opinions, findings,



## ATTACHMENT C: U.S. GAO Standards on Independence (continued)

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### Chapter 3 General Standards

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conclusions, judgments, and recommendations will be impartial and viewed as impartial by reasonable and informed third parties. Auditors should avoid situations that could lead reasonable and informed third parties to conclude that the auditors are not independent and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work.

**3.05** Except under the limited circumstances discussed in paragraphs 3.47 and 3.48, auditors should be independent from an audited entity during:

**a.** any period of time that falls within the period covered by the financial statements or subject matter of the audit, and

**b.** the period of the professional engagement, which begins when the auditors either sign an initial engagement letter or other agreement to perform an audit or begin to perform an audit, whichever is earlier. The period lasts for the entire duration of the professional relationship (which, for recurring audits, could cover many periods) and ends with the formal or informal notification, either by the auditors or the audited entity, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period of professional engagement does not necessarily end with the issuance of a report and recommence with the beginning of the following year's audit or a subsequent audit with a similar objective.

**3.06** GAGAS's practical consideration of independence consists of four interrelated sections, providing:

**a.** a conceptual framework for making independence determinations based on facts and circumstances that are often unique to specific environments;



## ATTACHMENT C: U.S. GAO Standards on Independence (continued)

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### Chapter 3 General Standards

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b. requirements for and guidance on independence for audit organizations that are structurally located within the entities they audit;

c. requirements for and guidance on independence for auditors performing nonaudit services, including indication of specific nonaudit services that always impair independence and others that would not normally impair independence; and

d. requirements for and guidance on documentation necessary to support adequate consideration of auditor independence.

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### GAGAS Conceptual Framework Approach to Independence

**3.07** Many different circumstances, or combinations of circumstances, are relevant in evaluating threats to independence. Therefore, GAGAS establishes a conceptual framework that auditors use to identify, evaluate, and apply safeguards to address threats to independence.<sup>29</sup> The conceptual framework assists auditors in maintaining both independence of mind and independence in appearance. It can be applied to many variations in circumstances that create threats to independence and allows auditors to address threats to independence that result from activities that are not specifically prohibited by GAGAS.

**3.08** Auditors should apply the conceptual framework at the audit organization, audit, and individual auditor levels to:

a. identify threats to independence;

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<sup>29</sup>See Appendix II for a flowchart to assist in the application of the conceptual framework for independence.



## ATTACHMENT C: U.S. GAO Standards on Independence (continued)

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### Chapter 3 General Standards

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**b.** evaluate the significance of the threats identified, both individually and in the aggregate; and

**c.** apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level.

**3.09** If no safeguards are available to eliminate an unacceptable threat or reduce it to an acceptable level, independence would be considered impaired.

**3.10** The use of the term "audit organization" in GAGAS is described in paragraph 1.07. For consideration of auditor independence, offices or units of an audit organization, or related or affiliated entities under common control, are not differentiated from one another. Consequently, for the purposes of independence evaluation using the conceptual framework, an audit organization that includes multiple offices or units, or includes multiple entities related or affiliated through common control, is considered to be one audit organization. Common ownership may also affect independence in appearance regardless of the level of control.

**3.11** The GAGAS section on nonaudit services in paragraphs 3.33 through 3.58 provides requirements and guidance on evaluating threats to independence related to nonaudit services provided by auditors to audited entities. That section also enumerates specific nonaudit services that always impair auditor independence with respect to audited entities and that auditors are prohibited from providing to audited entities.

**3.12** The following sections discuss threats to independence, safeguards or controls to eliminate or reduce threats, and application of the conceptual framework for independence.



## ATTACHMENT C: U.S. GAO Standards on Independence (continued)

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### Chapter 3 General Standards

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#### Threats

**3.13** Threats to independence are circumstances that could impair independence. Whether independence is impaired depends on the nature of the threat, whether the threat is of such significance that it would compromise an auditor's professional judgment or create the appearance that the auditor's professional judgment may be compromised, and on the specific safeguards applied to eliminate the threat or reduce it to an acceptable level. Threats are conditions to be evaluated using the conceptual framework. Threats do not necessarily impair independence.

**3.14** Threats to independence may be created by a wide range of relationships and circumstances. Auditors should evaluate the following broad categories of threats to independence when threats are being identified and evaluated:<sup>30</sup>

**a.** Self-interest threat - the threat that a financial or other interest will inappropriately influence an auditor's judgment or behavior;

**b.** Self-review threat - the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services performed as part of the nonaudit services when forming a judgment significant to an audit;

**c.** Bias threat - the threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective;

**d.** Familiarity threat - the threat that aspects of a relationship with management or personnel of an

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<sup>30</sup>See A3.02 through A3.09 for further discussion and examples of threats.



## ATTACHMENT C: U.S. GAO Standards on Independence (continued)

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### Chapter 3 General Standards

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audited entity, such as a close or long relationship, or that of an immediate or close family member, will lead an auditor to take a position that is not objective;

**e.** Undue influence threat - the threat that external influences or pressures will impact an auditor's ability to make independent and objective judgments;

**f.** Management participation threat - the threat that results from an auditor's taking on the role of management or otherwise performing management functions on behalf of the entity undergoing an audit; and

**g.** Structural threat - the threat that an audit organization's placement within a government entity, in combination with the structure of the government entity being audited, will impact the audit organization's ability to perform work and report results objectively.

**3.15** Circumstances that result in a threat to independence in one of the above categories may result in other threats as well. For example, a circumstance resulting in a structural threat to independence may also expose auditors to undue influence and management participation threats.

#### Safeguards

**3.16** Safeguards are controls designed to eliminate or reduce to an acceptable level threats to independence. Under the conceptual framework, the auditor applies safeguards that address the specific facts and circumstances under which threats to independence exist. In some cases, multiple safeguards may be necessary to address a threat. The list of safeguards in this section provides examples that may be effective under certain circumstances. The list cannot provide safeguards for all circumstances. It may, however, provide a starting point for auditors who have identified threats to independence and are considering what



## ATTACHMENT C: U.S. GAO Standards on Independence (continued)

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### Chapter 3 General Standards

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safeguards could eliminate those threats or reduce them to an acceptable level.

**3.17** Examples of safeguards include:

- a. consulting an independent third party, such as a professional organization, a professional regulatory body, or another auditor;
- b. involving another audit organization to perform or reperform part of the audit;
- c. having a professional staff member who was not a member of the audit team review the work performed; and
- d. removing an individual from an audit team when that individual's financial or other interests or relationships pose a threat to independence.

**3.18** Depending on the nature of the audit, an auditor may also be able to place limited reliance on safeguards that the entity has implemented. It is not possible to rely solely on such safeguards to eliminate threats or reduce them to an acceptable level.

**3.19** Examples of safeguards within the entity's systems and procedures include:

- a. an entity requirement that persons other than management ratify or approve the appointment of an audit organization to perform an audit;
- b. internal procedures at the entity that ensure objective choices in commissioning nonaudit services; and
- c. a governance structure at the entity that provides appropriate oversight and communications regarding the audit organization's services.



## ATTACHMENT C: U.S. GAO Standards on Independence (continued)

<hr/> <b>Chapter 3</b> <b>General Standards</b> <hr/>	
<b>Internal Auditor Independence</b>	<p><b>g.</b> statutory access to records and documents related to the agency, program, or function being audited and access to government officials or other individuals as needed to conduct the audit.</p> <p><b>3.31</b> Certain entities employ auditors to work for entity management. These auditors may be subject to administrative direction from persons involved in the entity management process. Such audit organizations are internal audit functions and are encouraged to use the Institute of Internal Auditors (IIA) <i>International Standards for the Professional Practice of Internal Auditing</i> in conjunction with GAGAS. In accordance with GAGAS, internal auditors who work under the direction of the audited entity's management are considered independent for the purposes of reporting internally if the head of the audit organization meets all of the following criteria:</p> <ul style="list-style-type: none"><li><b>a.</b> is accountable to the head or deputy head of the government entity or to those charged with governance;</li><li><b>b.</b> reports the audit results both to the head or deputy head of the government entity and to those charged with governance;</li><li><b>c.</b> is located organizationally outside the staff or line-management function of the unit under audit;</li><li><b>d.</b> has access to those charged with governance; and</li><li><b>e.</b> is sufficiently removed from political pressures to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal.</li></ul> <p><b>3.32</b> When internal audit organizations perform audits of external parties such as auditing contractors or outside party agreements, and no impairments to independence exist, the audit organization can be</p>
<hr/> <b>Page 39</b> <b>GAO-12-331G Government Auditing Standards</b>	



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### Chapter 3 General Standards

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considered independent as an external audit organization of those external parties.

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#### Provision of Nonaudit Services to Audited Entities

**3.33** Auditors have traditionally provided a range of nonaudit services that are consistent with their skills and expertise to entities at which they perform audits. Providing such nonaudit services may create threats to an auditor's independence.

#### Requirements for Performing Nonaudit Services

**3.34** Before an auditor agrees to provide a nonaudit service to an audited entity, the auditor should determine whether providing such a service would create a threat to independence, either by itself or in aggregate with other nonaudit services provided, with respect to any GAGAS audit it performs. A critical component of this determination is consideration of management's ability to effectively oversee the nonaudit service to be performed. The auditor should determine that the audited entity has designated an individual who possesses suitable skill, knowledge, or experience, and that the individual understands the services to be performed sufficiently to oversee them. The individual is not required to possess the expertise to perform or reperform the services. The auditor should document consideration of management's ability to effectively oversee nonaudit services to be performed.

**3.35** If an auditor were to assume management responsibilities for an audited entity, the management participation threats created would be so significant that no safeguards could reduce them to an acceptable level. Management responsibilities involve leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, physical, and intangible resources.

**3.36** Whether an activity is a management responsibility depends on the facts and circumstances and auditors