

**Quality Assessment Report**  
**For**  
***Louisville Metro Government***  
***Office of Internal Audit***  
*December 13, 2006*



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## Executive Summary

### Introduction

At the request of the Louisville-Jefferson County Metro Government, Office of Internal Audit (OIA) Titus has completed a Quality Assessment of your internal audit activity (IA Activity). We appreciate the opportunity to present the results of the engagement in the narrative which follows.

The Louisville-Jefferson County Metro Government (Metro Government or Metro) began operations January 6, 2003. It was created with the merger of the government of the former City of Louisville (founded in 1778 and incorporated in 1828) and the government of Jefferson County, Kentucky (created in 1780). Louisville Metro operates under a Mayor-Council form of government providing services to citizens in an area of some 386 square miles. Louisville is the 16<sup>th</sup> largest city in the United States. Metro employs about 6,500 full time equivalents and has revenues of about \$665 million.

The Metro's current IA Activity consists of eight full time professional staff. The OIA reports jointly to the Mayor and the Metro Council. OIA is responsible for conducting audits of all Metro departments, agencies, offices, boards, activities and other appropriations. Recommendations resulting from OIA's audits are made to the Mayor, Agency Directors and the Metro Council. OIA allocates its time to Assurance Services (audits) 50%, Consulting 35%, Information Technology 10% and Integrity Services 5%.

### The Titus Solution

OIA acted to comply with the Institute of Internal Auditors (IIA) *Standard* 1312 Quality Assessment (QA) by hiring Titus to perform an external QA. Specifically, the *Standards* state that all internal audit activities are required to conduct an external assessment by January 1, 2007 in order to provide assurance that the activity is in conformity with the IIA *Standards* and the Code of Ethics. The external QA is also required by *Generally Accepted Government Auditing Standards* (GAGAS). This review was intended to ensure compliance with both IIA *Standards* and GAGAS.

The Office of Internal Audit's last external quality assessment was issued in 2002. Unless otherwise noted, all prior issues have been addressed.

Titus utilized proven methodology to execute this QA. As a first step the IA Activity prepared a self-study which provided detailed information about the organization. OIA also sent out surveys to a representative sample of internal audit clients (executives and managers). The Titus team compared these survey results to historical data available from prior QAs conducted by the IIA. The survey results are summarized on page 15 of this report.

While on-site, interviews were conducted with internal audit staff and the following Metro executives, the external auditor, the Council President and the Audit Committee (AC) Chairman:

<u>Name</u>	<u>Title</u>
Jerry Abramson	Mayor
Larry Hayes	Deputy Mayor
Kevin Kramer	Metro Council President
James Peden	Metro Council Audit Committee Chair
Bill O'Brien	County Attorney's Office
Jane Driskell	Chief Financial Officer
Kim Statts	Chief Accounting Officer
Beth Niblock	Director, Information Technology
Mary Miles	Compliance & Training Coordinator
Bill Schreck	Director Inspections, Permits & Licenses
Bill Hornig	Director, Human Resources
Chris Boone	Organizational Performance Administrator
Bill Meyer	Strothman (External Auditor) Partner

In addition, the team reviewed the IA Activity's risk assessment and audit planning processes, audit tools and methodologies (including information technology), engagement and staff management and development processes, and a sample of internal audit work papers.

## Comments

We found numerous positive aspects about the Metro's Office of Internal Audit (OIA). As evidenced by interviews, surveys, document reviews, and observations, OIA currently uses "Innovative Practices" in its audit operations and administration. Some of the more notable positive aspects and practices include:

- Seventy-five per cent of the staff are certified or have passed one or more parts of the Certified Internal Auditor exam
- Staff is professional and generally well-respected
- OIA has a well-developed Internal Audit Manual
- The annual Risk Assessment process is based on the COSO model and is well documented
- Use of a Quality Assessment Checklist to ensure work papers are complete
- Use client surveys after all assurance engagements
- Perform a pre-engagement risk assessment on assurance audits

## Conformity Rating

The IIA QA framework provides a system for rating conformity to the *International Standards for the Professional Practice of Internal Auditing (Standards)*, which consists of three categories: generally conforms, partially conforms, and does not conform.

The framework describes these categories as follows:

- “Generally conforms” means that an internal audit activity has a charter, policies, and processes that are judged to be in accordance with the *Standards*, but some opportunities for improvement may exist
- “Partially conforms” means that practices were noted that are judged to deviate from the *Standards*, but they did not preclude the internal audit activity from performing its responsibilities in an acceptable manner
- “Does not conform” means that deficiencies in practices were 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

The *Standards* are divided into two primary subsets; *Attribute Standards* and *Performance Standards*. **The QA team rates Metro’s Internal Audit Department as “generally conforming” to the *Attribute* and *Performance Standards*. Thus, overall the Office of Internal Audit “generally conforms” to the *International Standards for the Professional Practice of Internal Auditing*.**

Also, **the QA team rates the OIA as “generally conforming” to *Generally Accepted Government Auditing Standards*.**

## Opportunities and Innovative Practice Suggestions - Summary

Opportunities and innovative practice suggestions which we believe will enhance conformity with the *Standards* and further improve the effectiveness of the OIA are listed below.

### Opportunities to Improve Conformity with the *Standards*

1. **Ensure the annual audit plan, staffing plan and financial budgets, and subsequent changes to them, are approved** to ensure management and the Audit Committee are aware of their current status (*Standard 2020*)
2. **Perform periodic internal quality assessments** to ensure compliance with the *Standards* (*Standard 1311*)
3. **Improve coordination with other external auditors (federal, state and local)** to ensure that audit efforts aren’t duplicated (*Standard 2050*)
4. **Improve reporting to senior management and the Audit Committee** by providing them with comparative analyses (*Standard 2060*)
5. **Acknowledge superior performance in audit reports** to provide more balanced information to the readers (*Standard 2410.A1*)

### Opportunities to Improve Conformity with the Practice Advisories

1. **Issue audit reports electronically** to reduce costs and enhance delivery time (Practice Advisory 2410-1)
2. **Improve the time to issue audit reports** to ensure that management has timely information (Practice Advisory 2420-1)

### Innovative Practice Suggestions for Consideration by the IA Activity

1. **Amend the IA Activity Charter** to include statements about activities that the OIA is prohibited from performing
2. **Review the number of staff required** to ensure the audit universe can be audited in a reasonable period of time
3. **Ensure that OIA staff members receive formal annual evaluations** to provide feedback to help staff develop

### Innovative Practice Suggestions for Consideration by Senior Management

1. **Issue a Management Control Policy** to ensure that all associates are aware of the roles of Management, the OIA and the Audit Committee regarding internal controls.
2. **Develop, and have the Committee adopt, an Audit Committee Charter** to guide Committee members in their duties
3. **Approve the OIA budget before it is included in the Metro overall budget** to enhance OIA independence
4. **Create an Audit Advisory Committee** to provide guidance and assistance to the elected officials serving on the Audit Committee

Additional detail about the previously listed opportunities and innovative practices is provided below. Thank you again for the opportunity to provide you our quality assessment services.

Respectfully,



David M. Walsh III  
Team Leader  
Titus – Quality Assessment Services

Team Members:  
Richard Epping  
William O'Hara

## Report Detail

### Opportunities to Improve Conformity with the *Standards*

Observations	Recommendations	IA Activity Responses
<p><b>1. Approve the Annual Audit Plan.</b> OIA currently prepares an annual audit plan based on a risk assessment. Management input is requested during the planning process. The annual audit plan is presented to management at the beginning of the year. There is no requirement that the plan be approved. Interim changes to the plan are not communicated to management or the Audit Committee for approval. Normally, we would expect that the Audit Committee would approve the annual audit plan, financial budget and staffing plan and any significant interim changes to any of the plans.</p>	<p>The annual audit plan, financial budget and staffing plan should be submitted to the Audit Committee for approval at the beginning of the year. The Audit Committee should also approve all significant interim changes to the budget or plans. If the Audit Committee is unwilling to accept this responsibility for any reason, the Audit committee should create a panel of voluntary experts from the community of academicians and business leaders to advise the Audit Committee regarding these responsibilities. (<i>Standard 2020</i>) [See 4. below]</p>	<p>Louisville Metro Government’s Audit committee is a standing committee of the Metro Council. It is comprised of elected Council officials, and is responsible for government administration, rules, ethics, and audit. It is important to understand the public sector environment in assessing the audit committee. The Metro Council is the legislative body of Louisville Metro Government, while the Mayor is the executive body. This distinction is critical in that the Mayor is responsible for administration and management of government operations. The Council is responsible for legislative matters, including funding appropriations.</p> <p>The audit plan is presented to the audit committee. This is informational only; the audit committee is not given the discretion to change the audit plan. The reason for this is to protect the elected officials from the perception that they improperly influenced an audit. If they were given the discretion to remove projects from the audit plan, there could be a misperception of their activities. This is a very real concern in a political environment.</p> <p>The Office of Internal Audit supports the concept of an advisory committee to help the audit committee. There are several issues that will need to be addressed. Ultimately, it is not the Office of Internal Audit’s decision. The concept will be discussed with appropriate Metro officials.</p>

### Opportunities to Improve Conformity with the *Standards* (Cont.)

Observations	Recommendations	IA Activity Responses
<p><b>2. Perform Periodic Internal Quality Assessments.</b> The OIA Policy and Procedure Manual includes a section requiring periodic internal reviews to assess compliance with the <i>Standards</i>, <i>Code of Ethics</i> and the efficiency and effectiveness of the OIA. Periodic internal reviews have not been conducted by the OIA.</p>	<p>OIA should include time in the annual audit plan to perform and document on-going and periodic reviews of compliance with <i>Standards</i>, the <i>Code of Ethics</i> and the efficiency and effectiveness of the department. (<i>Standards</i> 1311)</p>	<p>Internal QA reviews are performed on all projects. These reviews are extensively documented through the use of project review notes. In addition, all OIA members are expected to conform to policies and procedures, which specifically include the Code of Ethics. Policies and procedures are monitored and updated to reflect necessary changes. Efficiency and effectiveness are evaluated throughout the year, including during annual audit planning and budget development.</p> <p>The OIA will more thoroughly document the periodic reviews as necessary.</p>
<p><b>3. Improve Coordination with External Auditors.</b> The current OIA Charter does not require the OIA to coordinate with and provide oversight of other control and monitoring functions. Metro Louisville is subject to audit by various federal, state and local bodies. There is no single point of contact for external auditors. Consequently, multiple audits may be performed when one might suffice.</p>	<p>The CAE should recommend that the OIA Charter be revised to include a provision requiring all external auditors to clear their activities through the OIA. Having a single point of contact will allow a better appraisal of external audits and might lead to an integration of some audit thereby lessening the burden on the operating departments. (<i>Standard</i> 2050)</p>	<p>The Office of Internal Audit will discuss this service with its clients. It is envisioned that this could be a coordination role in partnership with other Metro functions, including grants management. If this service provides enough value to warrant it, then the necessity of changing the OIA charter will be reviewed. Since the charter is codified in Metro Ordinance, changes require formal legislative action.</p>
<p><b>4. Improve Management Reporting.</b> OIA provides management and the Audit Committee with an annual plan at the beginning of the year and a separate report stating what has been accomplished during the period at the end of the year. No comparative analyses are prepared. Management and the Audit Committee are unaware of scheduled audits not completed, audits added to the plan or other changes.</p>	<p>The CAE should prepare comparative analyses of the audit plan versus the actual work accomplished with appropriate explanations for variances. (<i>Standard</i> 2060)</p>	<p>Performance data is presented in several different formats, including the annual report of activities and the audit plan. However, a formal comparative analysis as recommended has not been explicitly included. The feasibility of doing so will be investigated, including reporting on scheduled audits not completed, audits added to the plan, and other information. It is envisioned that this analysis will be incorporated into either (or both) the annual report or the audit plan.</p>

**Opportunities to Improve Conformity with the *Standards* (Cont.)**

Observations	Recommendations	IA Activity Responses
<p><b>5. Acknowledge Superior Performance.</b> Current OIA audit reports do not contain any acknowledgement of superior performance by clients. Acknowledging superior performance gives Internal Audit the opportunity to create balance in reporting and to spread information about successful practices throughout the Metro government.</p>	<p>Audit reports should acknowledge successful practices to provide proper balance in the report and to share successful practices with their readers. (<i>Standard 2410.A1</i>)</p>	<p>The Office of Internal Audit has attempted to include best practices and commendable actions in its reports. This has been included in the body of the report, not highlighted separately. The feasibility of including a section more prominently, perhaps in the transmittal letter, will be investigated.</p>

### Opportunities to Improve Conformity with the Practice Advisories

Observations	Recommendations	IA Activity Responses
<p><b>1. Issue Audit Reports Electronically.</b> Bound audit reports are distributed widely throughout the Metro Louisville government and operations. As many as 50 copies may be distributed.</p>	<p>The CAE should distribute audit reports electronically to reduce costs and improve the time to issue a report. A signed manual copy of the report should be kept on file in the OIA. (Practice Advisory 2410-1)</p>	<p>The Office of Internal Audit monitors its report distribution process, and periodically surveys recipients on their preferred format (e.g., paper or electronic). These efforts will continue with the goal of eliminating redundant paper copies. However, the report is oftentimes the only work product seen by recipients. The professional presentation of it is lost in the electronic format. Therefore, some recipients will always receive hard copies of the reports.</p>
<p><b>2. Improve the Time to Issue Audit Reports.</b> Based on the results of our work paper review, we noted that audit reports take a long time to be issued after the end of field work. Part of the reason for the delay seems to be the time it takes to get management responses.</p>	<p>The CAE should request that the Mayor issue a policy for Metro Government and its operations requiring that acceptable responses to audit issues are required in x days. Such a policy would help ensure that careful consideration and communications are timely leading to expedient and appropriate action. (Practice Advisory 2420-1)</p>	<p>The client response deadline is explicitly addressed in the Office of Internal Audit’s charter (ordinance). In the past, this deadline has not been enforced. This was done in order to facilitate a collaborative, not confrontational, relationship. The draft issuance process will be modified to stress the deadlines. If this is not successful, then the feasibility of asking the Mayor to issue a directive will be explored.</p>

### Innovative Practice Suggestions for Consideration by Internal Audit Activity

Observations	Recommendations	IA Activity Responses
<p><b>1. Update the IA Charter.</b> The OIA Charter does not specifically address activities (operational) in which the CAE and his staff are not authorized to engage. Members of the OIA are aware of the prohibitions, but others outside OIA may not be aware.</p>	<p>The OIA Charter should be amended to include a provision stating the activities in which the OIA is not allowed to engage. These activities are:</p> <ul style="list-style-type: none"> <li>• Perform any operational duties for the organization or its affiliates</li> <li>• Initiate or approve accounting transactions external to the OIA</li> </ul> <p>Direct the activities of any Metro employee not employed by the OIA unless that person has been assigned to assist on an audit engagement (Innovative Practice)</p>	<p>There are many activities in which the Office of Internal Audit is not allowed to engage, not just the three noted here. Including a partial list could be misperceived as allowing activities not included. Thus, the Office of Internal Audit will focus efforts on client education whenever any prohibited activity is requested. This will be monitored, and if necessary, the feasibility of changing the charter will be explored.</p>
<p><b>2. Review the Number of Staff Required.</b> The current staffing level of the OIA does not allow the audit universe to be completely audited in a reasonable period of time.</p>	<p>Sufficient staff should be available to ensure that the audit universe can be audited in a period of reasonable time, say four years. The CAE should prepare an analysis to determine the appropriate number of staff required to accomplish a long range plan covering the entire audit universe in a reasonable period of time. This analysis combined with professional judgment on associated risk levels can be used to demonstrate the appropriateness of staffing levels. (Innovative Practice)</p>	<p>The Office of Internal Audit will prepare this type of analysis during the next annual audit plan development. It will be presented to the appropriate Metro officials.</p>
<p><b>3. Perform Annual Evaluations of OIA Staff.</b> Staff evaluations were temporarily put on hold after the merger of the City and County Governments. Evaluations were resumed during the summer of 2006. OIA practice is to review work papers after every engagement and discuss performance with each auditor on the job. However, no formal (written) reviews were performed.</p>	<p>While OIA was required to comply with the mandate from Human Resources that no formal evaluations be prepared, we believe that staff members will be better developed with a formal evaluation process. The CAE should ensure that all staff members receive formal evaluations, even if it is for OIA use only. (Innovative Practice)</p>	<p>Performance reviews have always been prepared on a project basis and documented in the review notes. These are more beneficial for staff development than the former annual evaluations. The former evaluations were generic and used mainly to process proficiency increases. Metro’s new evaluation system is more flexible and will be beneficial in staff development. The Office of Internal Audit will adhere to Metro policy in its staff evaluation schedule,</p>

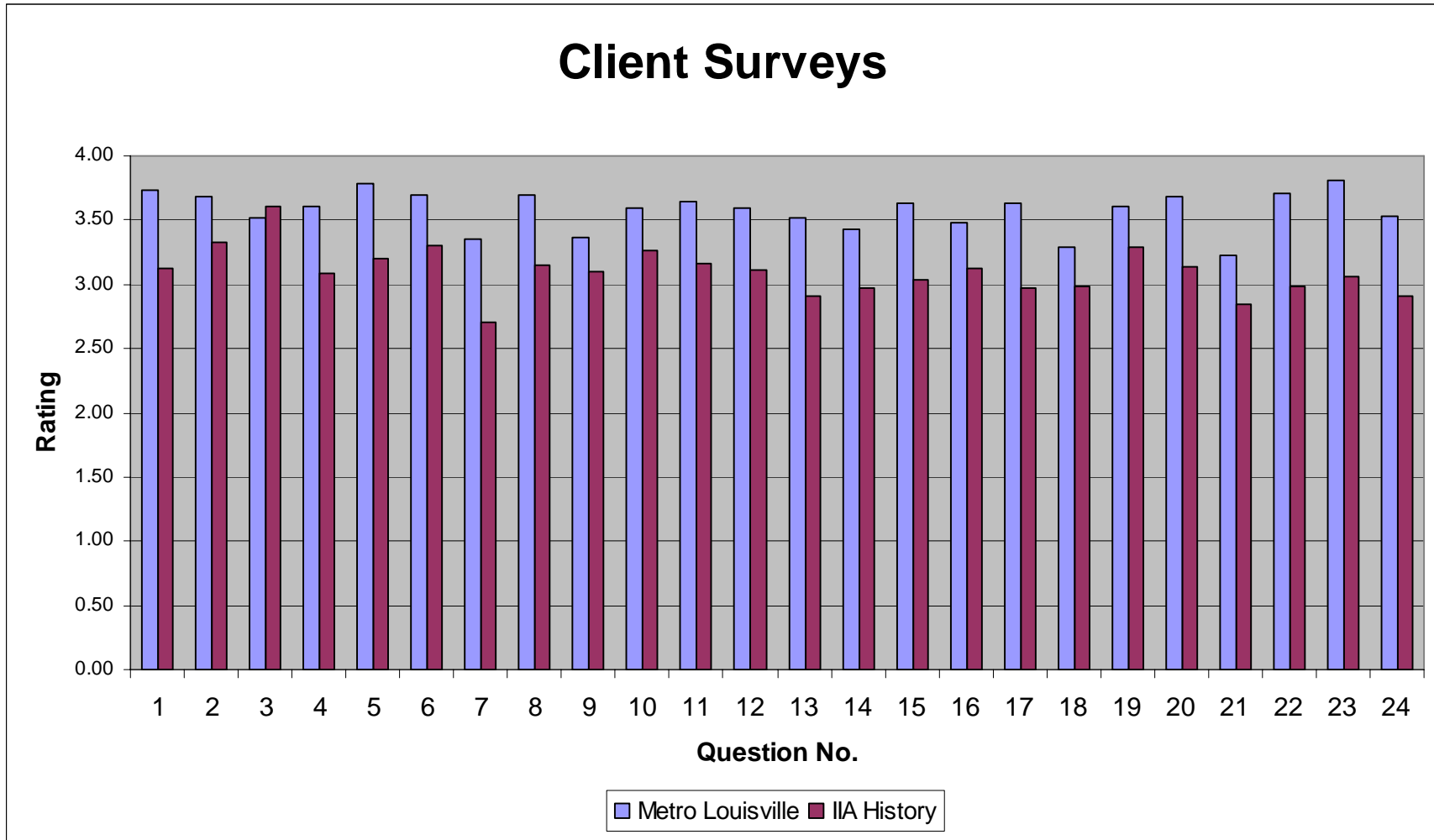
### Innovative Practice Suggestions for Consideration by Senior Management

Observations	Recommendations	Senior Management Responses
<p><b>1. Issue a Management Control Policy</b> – Metro Louisville has been proactive in enhancing internal control policy that promotes operating management’s responsibility for internal controls. However, an entity level policy is not in place that links the responsibilities between the Audit Committee (AC), senior management, and the OIA. As the demand for robust corporate governance processes grows, management is continuously charged with enhancing the governance structure by identifying all parties, their responsibilities and by issuing policy statements for controlling organization activities. With this in mind, a concise Management Control Policy Statement, issued at the Mayor/Council level which clearly defines the responsibilities of the AC, senior management, and the OIA has been recognized as a best practice by the IIA. A model policy example was provided to the CAE.</p>	<p>The Mayor and Council should have the CAE draft a Management Control Policy Statement that clearly defines management’s role in, and responsibility for, internal control and the associated roles of the Audit Committee and the OIA. This policy should be submitted to senior management and the Council for review and approval. (Innovative Practice)</p>	<p>The Office of Internal Audit understands the value of a Management Control Policy. However, the necessity and feasibility of such a policy for Louisville Metro Government is uncertain. The Office of Internal Audit will discuss the issue with the external auditors. This will help determine the necessity of a policy as well as determine if there is an opportunity to coordinate efforts for recommending one.</p>
<p><b>2. Create and Adopt an Audit Committee Charter</b> - The AC does not have a written Audit Committee Charter to spell out the duties and responsibilities of the Committee. The purpose of the Charter is to assist the Committee in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the audit process and the organization’s process for monitoring compliance with laws and regulations and the code of conduct. A model Charter has been provided to the CAE.</p>	<p>The Audit Committee should have a written Charter to delineate its duties and responsibilities. (Innovative Practice)</p>	<p>Louisville Metro Government’s Audit committee is a standing committee of the Metro Council. It is comprised of elected Council officials, and is responsible for government administration, rules, ethics, and audit. As a standing committee of the Metro Council, it does not have, nor is it required to have, an audit committee charter or similar document.</p> <p>The Office of Internal Audit understands the benefit of an audit committee charter. The feasibility of addressing this issue in various ways will be discussed with appropriate Metro officials.</p>

**Innovative Practice Suggestions for Consideration by Senior Management (cont.)**

Observations	Recommendations	Senior Management Responses
<p><b>3. Approve the OIA Budget.</b> The OIA budget is not approved separately from the overall Metro budget. We believe that OIA independence would be further strengthened if its budget was approved prior to it being included in the overall Metro budget.</p>	<p>The Advisory Committee (below) should approve the OIA budget prior to it being included with the overall Metro budget. (Innovative Practice)</p>	<p>The Office of Internal Audit concurs with the recommendation. This could be especially beneficial once the audit universe analysis (addressed above) is completed. However, the mechanics of doing this will need to be worked out so that the legislative / executive powers are not violated.</p>
<p><b>4. Create an Advisory Committee.</b> Audit Committee members are elected officials serving on the Metro Council. These officials may not have the experience or credentials necessary to perform all of the functions of an engaged, active Audit Committee.</p>	<p>Members of the Council should consider establishing an Advisory Committee for the Audit Committee. To provide appropriate independence, members of the Advisory Committee could come from local universities and businesses. The Advisory Committee would not have any oversight responsibilities, but would serve in an advisory capacity to help ensure that the members of the Audit Committee carry out their responsibilities as defined in their Charter. (Innovative Practice)</p>	<p>The Office of Internal Audit supports the concept of an advisory committee to help the audit committee. While there are several issues that will need to be addressed, there are models available for guidance. The concept will be discussed with appropriate Metro officials.</p>

The following chart summarizes the results of the client surveys:



## Customer Survey Questions

### Relationship with Management

1. Internal auditing as a valued member of the management team
2. Organizational placement of the internal auditing function
3. Auditors have free and unrestricted access
4. The department promotes a customer orientation by providing quality work

### Audit Staff

5. Objectivity of the internal auditors
6. Professionalism of auditors
7. Knowledge of your business process and success factors
8. Quality of relationship and rapport between auditors and department

### Scope of Work

9. Selection of important operating areas for Audit
10. Per-audit notification to you of audit purpose and scope
11. Inclusion of your suggestions for areas to audit

### Audit process and Report

12. Feedback to you on emerging issues during audit
13. Duration of the audit
14. Timeliness of the audit report
15. Accuracy of the audit findings
16. Clarity of the audit report
17. Usefulness of the audit in improving business process and controls
18. Internal audit follow-up on corrective action

### Management of internal auditing Department

19. Your understanding of the internal auditing department purpose
20. Effectiveness of internal auditing management
21. Quality of staff development for subsequent transfer to/from operating departments

### Value Added

22. Partnership with management on control issues
23. Degree of impact on corporate governance
24. Assistance to management in risk assessment