

**OFFICE OF THE INSPECTOR GENERAL**

**STEVE WHITE, INSPECTOR GENERAL**

*• PROMOTING INTEGRITY •*



**MANAGEMENT REVIEW OF THE AUDIT FUNCTIONS  
OF THE CALIFORNIA DEPARTMENT OF CORRECTIONS  
OFFICE OF COMPLIANCE**

**OCTOBER 2002**

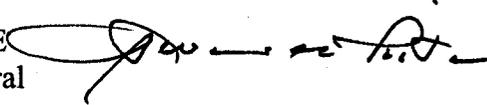
**GRAY DAVIS, GOVERNOR**



## Memorandum

Date: October 22, 2002

To: EDWARD ALAMEIDA, Director  
California Department of Corrections

From: STEVE WHITE   
Inspector General

Subject: MANAGEMENT REVIEW OF THE AUDIT FUNCTIONS OF THE  
CALIFORNIA DEPARTMENT OF CORRECTIONS, OFFICE OF COMPLIANCE

Enclosed is the final report of the management review conducted by the Office of the Inspector General of the audit functions of the California Department of Corrections, which are carried out by the department's Office of Compliance. The review was conducted pursuant to *California Penal Code* Section 6126.

The Office of the Inspector General found that the Office of Compliance does not follow appropriate professional standards in performing its audit functions and that audit activity is inadequately coordinated with the needs of executive management and is not targeted toward issues posing the highest risk to the department. The review also revealed a fragmented internal audit organization in which ineffective planning and monitoring of audit assignments has led to a significant backlog of reports.

Before the report was finalized, the Office of the Inspector General furnished a draft version of the report to the department for response. The department's written response to the draft report, included in the final report as Attachment A, does not adequately address the serious management problems identified in the report and furthermore reflects a fundamental lack of understanding of the internal audit function. The department asserts, for example, that it is not required to adhere to the *Standards for the Professional Practice of Internal Auditing* of the Institute of Internal Auditors, when in fact state law requires it. Not only must the department follow the standards, but adhering to the standards would enable the department to correct all of the other deficiencies identified in the report. The response of the department to the report's remaining findings is similarly misguided. The specific comments of the Office of the Inspector General in reply to the department's response are included in the report as Attachment B.

Given the magnitude of Department of Corrections programs, the complexity of its systems and processes, and the diversity of its operations, department management would benefit greatly from a well-managed professional internal auditing office. And with an auditing staff of approximately 50, in addition to another 11 positions funded at the Department of Finance to perform a portion of the department's auditing work, the resources available for

this purpose are sufficient. But the department's failure to respond adequately to the substance of this report calls into question its ability to operate a modern and professional auditing department.

Please call me if you have questions concerning this report.

cc: Robert Presley, Secretary, Youth and Adult Correctional Agency  
Elizabeth Mitchell, Deputy Director, Policy and Evaluation Division, Department of  
Corrections

**OFFICE OF THE INSPECTOR GENERAL**

**STEVE WHITE, INSPECTOR GENERAL**



**MANAGEMENT REVIEW OF THE AUDIT FUNCTIONS OF THE  
CALIFORNIA DEPARTMENT OF CORRECTIONS  
OFFICE OF COMPLIANCE**

**REPORT**

**OCTOBER 2002**

**• PROMOTING INTEGRITY •**

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## EXECUTIVE SUMMARY

This report presents the results of a management review conducted by the Office of the Inspector General of the audit functions of the California Department of Corrections Office of Compliance. The review, which was performed under the Inspector General's oversight responsibilities under *California Penal Code* Section 6126, examined the management practices and administrative procedures of the units within the Office of Compliance that carry out performance, financial-related, and information security audits. The review was conducted in February and March 2002.

The Office of the Inspector General identified serious policy and operational deficiencies as a result of the review of the auditing activities of the Office of Compliance. The deficiencies require the attention of the California Department of Corrections. The most important deficiencies are the following:

- The Office of Compliance does not adhere to appropriate professional standards, calling into question its ability to accomplish its objectives and meet its assigned responsibilities.
- Audit planning and communication with the department executive staff is inadequate.
- The management of the Program and Fiscal Audits Branch does not target internal audit activity toward issues that pose the highest risk.
- The Program and Fiscal Audits Branch of the Office of Compliance is not responsive to executive management requests for special audits.
- The Office of Compliance does not adequately monitor the status of audit projects.
- The Program Compliance Unit of the Program and Fiscal Audits Branch uses a highly structured auditing approach that may fail to reveal important issues relating to the entities under audit.
- The audit functions of the California Department of Corrections are fragmented, with a lack of coordination of audit activities and incomplete coverage of areas requiring audit, resulting in a failure to comply with state law governing financial accountability.

The Office of the Inspector General recommends that the Department of Corrections consolidate all of its auditing activities into a professional internal auditing unit consistent with standards prescribed in *Standards for the Professional Practice of Internal Auditing*. The chief of internal audits should report to the chief deputy director for Support Services. The chief of internal audits should possess training, knowledge, and experience necessary to manage an internal auditing unit.

## INTRODUCTION

*California Penal Code* Section 6125 established the Office of the Inspector General to provide oversight of the Youth and Adult Correctional Agency and its subordinate departments. The management review of the Office of Compliance of the California Department of Corrections was conducted pursuant to *California Penal Code* Section 6126, which authorizes the Inspector General to initiate an investigation or an audit on his own accord to identify areas of noncompliance with policies and procedures, specify deficiencies, and recommend corrective actions. The purpose of the review was to determine whether or not the management practices and administrative procedures relating to the audit functions of the Office of Compliance are being carried out in accordance with applicable laws, regulations, policies, and procedures. The review also assessed the efficiency and effectiveness of these functions in fulfilling the department's mission and responsibilities, and measured the performance of these functions based on criteria established by professional standards.

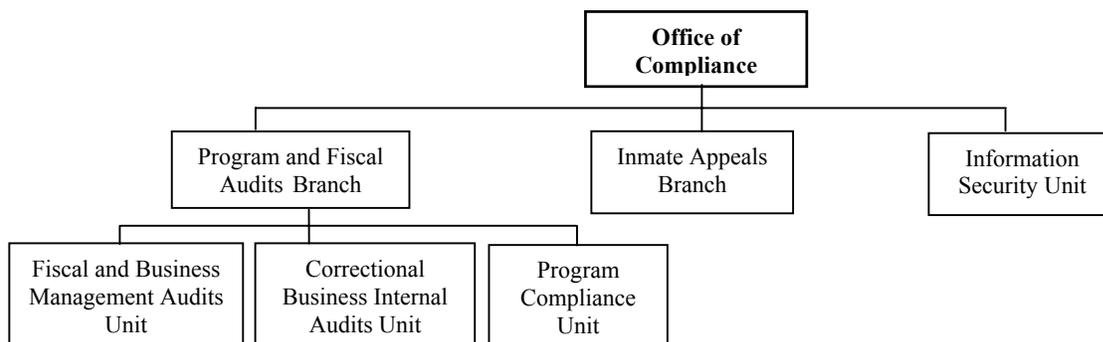
## BACKGROUND

The audit functions of the Office of Compliance of the California Department of Corrections were established to fulfill the requirements of *California Penal Code* Sections 5057. That section provides as follows:

*Subject to the powers of the Department of Finance under Section 13300 of the Government Code, the director must establish an accounting and auditing system for all of the agencies and institutions including the prisons which comprise the department, except the Youth Authority, in such form as will best facilitate their operation, and may modify the system from time to time.*

As specified in *California Department of Corrections Operations Manual*, Section 11010.26, the Office of Compliance was established to support and serve the department's divisions and offices and to provide internal program audits, external vendor audits, inmate appeal reviews, and consulting services on management and operational issues. The Office of Compliance is located at the Aerojet Facility in Rancho Cordova, eighteen miles east of California Department of Corrections headquarters in Sacramento, California.

In April 2000, the Department of Corrections implemented an operational restructuring and budget realignment plan, which changed the makeup of the Office of Compliance, rendering some of the related provisions of the present *California Department of Corrections Operations Manual* obsolete. The review by the Office of the Inspector General addresses the organizational structure of the Office of Compliance in effect at the time of the review, as shown below:



At the time of the review, the Office of Compliance was under the management of an assistant director, who reported to the chief deputy of support services, who in turn reported to the department director. The office had an operating budget of almost \$6 million supporting 80 positions consisting of professional, custody, and clerical staff. Fifty positions were budgeted in the Program and Fiscal Audits Branch and Information Security Unit, 25 positions were budgeted for the Inmate Appeals Branch, and five positions served as administrative support for the office. Since the time of the review, the Department of Corrections has further reorganized the Office of Compliance. In June 2002, the Office of Compliance was combined with the Office of Correctional Planning to form the Policy and Evaluation Division. The Program and Fiscal Audits Branch, the Information Security Office, and the Inmate Appeals Branch now report to the deputy director of the Policy and Evaluation Division. The deputy director reports to the chief deputy director of Support Services, who in turn reports to the department director. The functions and responsibilities of the units included in the Office of the Inspector General's review have not changed. Those functions and responsibilities are described below.

***Program and Fiscal Audits Branch.*** The Program and Fiscal Audits Branch, the primary audit entity within the Department of Corrections, is responsible for providing timely, objective, and professional audit services to management. The branch consists of the following three units:

- ***Fiscal and Business Management Audits Unit.*** The Fiscal and Business Management Audits Unit is the largest of the three units, with most of the positions in the unit management auditor positions. The unit is responsible for performing performance and financial-related audits that include:
  - Contract and interagency agreement audits that determine whether private contractors are in conformance with applicable contract provisions, laws, rules and regulations.
  - Jail rate audits and desk reviews of city and county detention facilities that receive reimbursement for housing parole violators.
  - Fiscal consultant activities advising executive management on key issues involving state laws and regulations, contract terms, and requirements. The unit's responsibilities also include providing advice on how to strengthen internal controls and improve program processes.
- ***Correctional Business Internal Audits Unit.*** The Correctional Business Internal Audits Unit is responsible for performing management assessment audits of business services within the Department of Corrections. The unit is also responsible for performing special reviews at the request of management and advises executive management on the status of its internal business operations. The unit is staffed with seven management auditor positions. The areas audited include:
  - Personnel
  - Inmate trust accounting
  - Materials management
  - Food services
  - Plant operations
  - Occupational health and safety
  - Environmental health and safety
  - Fire protection

- **Program Compliance Unit.** The Program Compliance Unit conducts performance audits, which include program compliance audits and court compliance audits at the institutions. This unit has eight custody positions and one program analyst. The specific programs audited include:
  - Administrative segregation and due process
  - Security of sensitive information
  - Community correctional facilities
  - Special audits as requested by executive management.

**Inmate Appeals Branch.** The Inmate Appeals Branch provides the third and final level of review for the inmate appeals process, which affords inmates and parolees their due process rights and offers them the opportunity to address grievances by filing an appeal.

**Information Security Unit.** The Information Security Unit, which consists of one data processing manager and one associate information services analyst, is responsible for the overall security of the department's information system—a responsibility that includes conducting information technology security audits. The unit provides institutions with technical support in the development of individual information disaster recovery plans and serves as the departmental contact for handling and reporting information security incidents.

## **OBJECTIVES, SCOPE AND METHODOLOGY**

The management review of the audit functions of the Department of Corrections Office of Compliance examined the policies and procedures developed by the Office of Compliance management and looked at the extent to which the management of the Department of Corrections uses the Office of Compliance in addressing key issues facing the department.

The Office of the Inspector General also examined the operations of the Office of Compliance for adherence to applicable laws, regulations, policies, and procedures, evaluated the quality of its operational practices, and measured the performance of its audit functions based on criteria established by professional standards.

The review scope included all operational aspects of the Program and Fiscal Audits Branch and its three sub-units as delineated earlier. The review of the Information and Security Unit was limited to obtaining and reviewing work plans and work products and to the unit's coordination with executive management and other lateral reporting units within the Office of Compliance.

The Office of the Inspector General reviewed the operations of the Inmate Appeals Branch and reported findings and recommendations resulting from that review to the director of the Department of Corrections in February 2001. The Inmate Appeals Branch was not reviewed during the present engagement.

The review procedures included, but were not necessarily limited to the following:

- Interviews with management and staff from the Office of Compliance;
- Review of policies and procedures related to the operations of the Office of Compliance;
- Review of staff qualifications and continuing education;

- Review of systems used to monitor, track, and manage audits;
- Review of audit reports, audit work papers, and related documentation;
- Review of contracts and related documentation with outside entities used to provide audit services to the Department of Corrections;
- Review of Department of Corrections budget and expenditure data.

The review was performed during February and March 2002 at the Office of Compliance. The Office of the Inspector General received excellent cooperation in the course of the review from the management and staff of the Department of Corrections.

## FINDINGS AND RECOMMENDATIONS

### FINDING 1

**The Office of the Inspector General found that the Program and Fiscal Audits Branch does not adhere to professional standards for internal auditing.**

Under its mission and responsibilities as set out in the *California Department of Corrections Operations Manual*, the Program and Fiscal Audits Branch constitutes an “internal audit unit” as defined by the Institute of Internal Auditors and, as such, is required by state law to abide by the *Standards for the Professional Practice of Internal Auditing*. The Office of the Inspector General found, however, that the branch does not follow the standards and that the Program and Fiscal Audits Branch management, in fact, is not knowledgeable about their provisions. Many of the problems identified in other findings in this report can be attributed to the failure to adhere to the standards, with the problem compounded by a lack of management oversight and direction from the executive staff at the California Department of Corrections. As a result, the value added by the auditing efforts of the Program and Fiscal Audits Branch does not appear to be commensurate with the resources expended.

*California Government Code* Section 1236 requires all state agencies having their own internal auditors to adhere to the *Standards for the Professional Practice of Internal Auditing* of the Institute of Internal Auditors. The Institute of Internal Auditors describes internal auditing as follows:

*(I)nternal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.*

The Department of Corrections and the management of the Program and Fiscal Audits Branch, however, have made no discernible effort to ensure that the branch follows professional internal auditing standards. In reviewing the branch’s operations, processes, and procedures, the Office of the Inspector General found a number of areas in which the branch failed to adhere to the standards.

Some of the most significant departures from standards are listed below. A more complete summary of the departures from internal auditing standards noted by the Office of the Inspector General is provided in an Appendix to this report.

- **Section 1110 – Organizational Independence.** The standard provides: “The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities.” Practice Advisory 1110-1 of the Institute of Internal Auditors provides additional guidance concerning organizational independence. The advisory states: “Ideally, the chief audit executive should report functionally to the audit committee, board of directors, or other appropriate governing authority, and administratively to the chief executive office of the organization.”

At present the Program and Fiscal Audits Branch reports to the assistant director of the Office of Compliance, who reports to the chief deputy director for Support Services, who

reports to the department director. A reorganization to allow the Program and Fiscal Audits Branch to report directly to the chief deputy director for Support Services or to the department director would more effectively ensure that internal audit activity is free from interference in determining internal auditing scope, performing work, and communicating results. The direct reporting relationship would also provide the chief of the Program and Fiscal Audits Branch with a clear line of communication with respect to department priorities.

- **Section 1210 – Proficiency.** The standard provides: “Internal auditors should possess the knowledge, skills and other competencies needed to perform their individual responsibilities.” The standards often refer to the responsibilities of the “chief audit executive.” In the case of the Program and Fiscal Audits Branch, the chief is a correctional administrator who does not have proficiency in applying internal auditing standards, procedures, or techniques.
- **Section 1300 – Quality Assurance and Improvement Program.** The standard provides: “The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. The program should be designed to help the internal auditing activity add value and improve the organization’s operations and to provide assurance that the internal audit activity is in conformity with the *Standards* and the *Code of Ethics*.” No such program presently exists within the Program and Fiscal Audits Branch.
- **Section 2000 – Managing the Internal Audit Activity.** The standard provides: “The chief audit executive should effectively manage the internal audit activity to ensure it adds value to the organization.” As discussed more fully in a later finding in this report, the Program and Fiscal Audits Branch does not use a tracking or information system to provide the information necessary to determine whether the internal audit activity adds value to the organization.

## FINDING 2

**The Office of the Inspector General found that the Program and Fiscal Audits Branch, which performs most of the department’s audit work, is not effectively communicating with the department’s executive staff in planning annual audit activities and in reporting audit performance.**

The Office of the Inspector General found a lack of communication between the Department of Corrections executive staff and the Program and Fiscal Audits Branch. The Program and Fiscal Audits Branch does not prepare a comprehensive annual work plan as required by professional auditing standards and by the *California Department of Corrections Operations Manual*. Nor does the Program and Fiscal Audits Branch routinely provide reports to the department executive staff summarizing the results of auditing activities. An annual work plan is an effective means of providing input to the department’s internal audit function, and periodic reporting to the executive staff provides a means of evaluating audit performance in relation to the plan. Such communication is essential in meeting the goals of the department and in realizing the greatest possible benefit from the internal audit activity, particularly given the magnitude and complexity

of the department's programs and operations. The absence of communication evident here may be attributable in part to the fact that the Program and Fiscal Audits Branch is headed by a correctional administrator with a custody background who may lack the understanding necessary to managing an audit operation of this size.

Following is a more detailed analysis of the issues involved.

- ***The Program and Fiscal Audits Branch does not prepare an annual work plan.*** Although each unit within the Program and Fiscal Audits Branch prepares its own schedule of audits to be completed during the year, the branch management does not perform a risk-based assessment for prioritizing audit projects for the branch as a whole. As a result, instead of the branch management establishing priority and allocating staff resources accordingly, the selection of audit assignments is left primarily to the discretion and judgment of the supervisors and staff of each individual unit within the branch.

The purpose of the annual work plan is to contribute to the effective management of the internal audit activity by ensuring that scheduled projects add value to the organization. The development of the annual plan also affords the executive staff an opportunity to provide input to the planning process in determining audit priority. *California Department of Corrections Operations Manual* Sections 22080.8 and 22080.8.1 require the Program and Fiscal Audits Branch to establish an annual work plan and to distribute the plan to the executive staff for review and comment. Those requirements are consistent with Section 2010A1 of the *Standards for the Professional Practice of Internal Auditing* of the Institute of Internal Auditors, which provides as follows:

*The internal audit activity's plan of engagements should be based on a risk assessment, undertaken at least annually. The input of senior management and the board should be considered in this process.*

The Office of the Inspector General found that only the Fiscal and Business Management Audits Unit of the Program and Fiscal Audits Branch submits its annual plan for review and that only some of the department deputy directors and assistant directors receive the plan. Moreover, from the responses to the plan and the subsequent actions of the branches, it is apparent that there is no clear understanding on the part of the department executive staff about what the reviews are intended to accomplish or, in fact, do accomplish. For example:

- The deputy director of the Department of Corrections Institutions Division, when asked to review and respond to the Fiscal and Business Management Audits Unit audit plan for the 2000 calendar year, responded in a hand-written note, "I signed the first one some time ago & commented that I don't know why I am signing this, as I don't know the issues and don't have the staff or expertise to do any review which would be of any value."
- In a memorandum dated March 16, 2000, a deputy director, in responding to the plan for 2000 calendar year, said that she was given insufficient time to review the list and she disputed the assertion of the branch that she had been previously contacted for input on the audits. She also said that the assistant deputy director expected the community correctional facilities to be audited using the financial management handbook and the

contract between the facility and the department as the basis for the audits. Yet there is no evidence that this comment was considered.

- In responding to a proposed audit plan for 2001-02 fiscal year on July 6, 2001, an assistant deputy director requested an immediate audit of a contractor, noting that the contractor “is not in contract compliance. They are in heavy debt.” The assistant deputy director further noted that the issue was urgent and was of interest to the director and the legislature. Yet, that audit request was never formally incorporated into the audit plan and the audit was not initiated until March 25, 2002, after the Office of the Inspector General inquired about the status of the request.
- ***The Program and Fiscal Audits Branch does not routinely report audit performance.*** The Office of the Inspector General found minimal evidence that the Program and Fiscal Audits Branch prepares annual or periodic reports to the executive staff summarizing the results of the audits. The Program and Fiscal Audits Branch was able to produce only one report—apparently prepared as a briefing document for the new California Department of Corrections director in December 2001—summarizing the results of past audit activities and significant issues identified during past audits. The Office of the Inspector General reviewed the briefing document and concluded that it was not sufficient to allow management to assess the workload and activities of the branch and, furthermore, might be somewhat misleading. For example, the document listed 19 audit projects for the Fiscal and Business Management Audits Unit as audits performed from January 2001 through October 2001. It reported approximately \$1.4 million as potential cost recovery from the 19 audit projects. A detailed review of the information, however, reveals that \$76,000 had actually been recovered during the 2001 calendar year. Of the remaining 1.3 million, slightly more than half was attributable to two audits for which the fieldwork was completed in July 1998—not 2001, and the balance was from audits that were still pending. Some of the pending audits were far from completion, raising the possibility that the amounts could change as the audits progressed. Furthermore, the report failed to disclose the number of audits that had been scheduled, but not yet performed, an issue discussed in more detail in Finding 5 of this report.

The *Standards for the Professional Practice of Internal Auditing* address the need for reporting to senior management in Section 2060—Reporting to the Board and Senior Management:

*The chief audit executive should report periodically to the board and senior management on the internal audit activity’s purpose, authority, responsibility, and performance relative to its plans. Reporting should also include significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by the board and senior management.*

- ***Response by the management of the Office of Compliance.*** The acting assistant director of the Office of Compliance told the Office of the Inspector General that he meets with the chief deputy director of the department every two weeks and that this ensures that the Program and Fiscal Audits Branch is adequately communicating with executive staff and meeting the needs of the department. Although regular meetings with the chief deputy director with responsibility for the Office of Compliance are appropriate, such meetings are not sufficient

to satisfy the requirement for communication with executive staff in planning the audit activity.

The Office of the Inspector acknowledges that the Program and Fiscal Audits Branch does provide executive summaries or full copies of audit reports to the deputy director and chief deputy director of the program under audit to inform them of findings in areas of operation within their respective responsibilities. Unreasonable delays in issuing audit reports, as discussed more fully in Finding 5, however, may affect the usefulness of the information.

### FINDING 3

**The Office of the Inspector General found that the management of the Program and Fiscal Audits Branch does not target internal audit activity toward issues that pose the highest risk.**

The Office of the Inspector General found no evidence that the Program and Fiscal Audit Branch management has performed a risk assessment of the Department of Corrections operations to establish priorities and target issues that pose the highest risk to ensure that audit resources are deployed in the most efficient and effective manner. As a result, the branch conducts a number of audits that appear to be unnecessary or that could be performed less frequently, while many other vital areas of department and institution operations are not audited at all.

The *Standards for the Professional Practice of Internal Auditing* require the chief audit executive establish risk-based plans to determine the priorities of the internal audit activity and ensure that internal audit resources are effectively deployed to achieve the approved plan. Without a carefully considered risk assessment and appropriate management oversight and intervention, the department cannot achieve the maximum value possible from its internal audit resources.

Following are examples of audits of questionable value presently being conducted by the Program and Fiscal Audit Branch, as well as examples of audits that could be conducted less frequently:

- ***Audits of administrative segregation and due process issues.*** Since at least 1997, the Program Compliance Unit has been conducting audits of administrative segregation and due process issues at the state's 33 adult prisons on a two-year cycle. The intent is to assess the condition of the institutions' administrative segregation units to ensure that the inmates' due process rights are being observed. In 2001, the branch also began follow-up audits of the corrective action plans developed in response to previous audit findings. The chief of the Program and Fiscal Audits Branch said that these audits are conducted under Section 22080.9 of the *California Department of Corrections Operations Manual*, which requires the Program and Fiscal Audits Branch to schedule on-site program compliance evaluations for headquarters divisions and field units no less than once during each two-year period. The branch chief said that the audits are conducted for the purpose of avoiding litigation. The Office of the Inspector General noted, however, that many other programs at the institutions carry the same or greater potential for lawsuits. If the purpose of the audits is to avoid

litigation, focusing all efforts on the administrative segregation unit while failing to audit other programs and issues at the institutions and at the California Department of Corrections headquarters that might require more attention appears to be counterproductive.

- ***Audits of treatment of condemned inmates at San Quentin State Prison.*** The Program Compliance Unit conducts quarterly audits of the treatment of condemned inmates at San Quentin State Prison to ensure compliance with a consent decree that has been in effect since 1980. The Office of the Inspector General noted that the quarterly audits of the treatment of condemned inmates have resulted in no recent findings of significance, calling into question the need to continue the audits on a quarterly basis.
- ***Pelican Bay State Prison use-of-force audits.*** A June 1996 court order in the *Madrid v. Gomez* case required the development of a quarterly audit to be performed by the Department of Corrections of use of force incidents at Pelican Bay State Prison. Instead, the Program and Fiscal Audits Branch has been conducting the audits monthly. The court-appointed special master in the case closely monitored the monthly audits performed by the Program and Fiscal Audits Branch for the compliance period of February 1999 through December 2000, and, on April 20, 2001, issued a report praising the audits. In the report, the special master recommended the termination of additional monitoring of the audits. The recommendation was adopted by the court on May 10, 2001. The Program and Fiscal Audits Branch has nonetheless continued to audit the use of force at Pelican Bay State Prison monthly. A review by the Office of the Inspector General of 13 of the use-of-force audit reports for audits conducted between January 2001 through January 2002 found that the audits revealed no substantive findings concerning use-of-force incidents. The special master, moreover, has told the Office of the Inspector General that the monthly use-of-force audits could be done less frequently.
- ***Pelican Bay State Prison health care delivery system audits.*** The Program Compliance Unit audits the health care service delivery system at the Pelican Bay State Prison three times a year. Unit staff told the Office of the Inspector General that these audits are also mandated by the *Madrid v. Gomez* case, but the Department of Corrections Legal Division advised the Office of the Inspector General that the audits are not court-mandated. The court-appointed special master for the case also told the Office of the Inspector General that he has advised the California Department of Corrections to discontinue these audits because they provide little value.

The Office of the Inspector General found no evidence that the management of the Program and Fiscal Audits Branch has used a risk-based approach in choosing to conduct these repeat audits. In devoting all of its audit resources to field operations, the branch has failed to audit headquarters operations and activities, which often pose a higher degree of risk. Furthermore, *California Department of Corrections Operations Manual* Section 22080.9 requires the Program and Fiscal Audit Branch to schedule on-site program compliance evaluations for headquarters divisions and field units no less than once during each two-year period. The Office of the Inspector General found, however, that a number of areas determined to be high risk have not been audited. For example:

- In August 2000, the Department of Finance conducted a risk assessment of Parole and Community Services Division Parole Regions I and II. The risk assessment revealed material weaknesses in the division's management and oversight, as well as inadequate internal controls in many field offices. The report found, for example, that some field offices had initiated new financial assistance activities, such as providing parolees with Wal-Mart gift cards. The cards had not been authorized and their use was not restricted, allowing them to be used to purchase alcohol, tobacco, and hunting equipment. Yet, the Program and Fiscal Audits Branch management has not considered the results of this review in scheduling its audits.
- In March 1999, the Department of Finance conducted an audit of Department of Corrections headquarters and found material weaknesses in control of department property serious enough to conclude that no reliance could be placed on the department's \$173 million special fund property or its \$16 million general fund property balances. The chief of the Program and Fiscal Audit Branch has not considered the results of this audit in scheduling audits.

#### FINDING 4

**The Office of the Inspector General found that the Program and Fiscal Audits Branch is not responsive to executive management requests for special audits.**

Section 22080.8 of the *California Department of Corrections Operations Manual* requires that the Program and Fiscal Audits Branch annual work plan include conducting special reviews requested by department administrators. In reviewing the work schedules of the various units, the Office of the Inspector General found, however, that such requests have been rare. Some of the management staff interviewed said they refrain from requesting special audits out of the belief that the branch staff is too busy. Another reason may be that management requests have not been given high priority in the past. The examples noted include:

- ***An audit requested in 1998 still has not been completed.*** The acting assistant director of the Office of Community Resources wrote an e-mail to the assistant director of the Office of Compliance on June 22, 2000 stating:

*Please accept this as a formal request... This is a request that your office audit the Inmate Match Program – Match Two Sponsors. Audit to focus on the provision of services required by the contract. With shrinking resources, I think the department needs to know quickly whether or not we are getting a reasonable service for this money. If the audit is done soon, whoever succeeds me can plan to either continue, rebid (sic), or change the use of the funds. This audit was originally requested in June, 1998. Now I think it's imperative that it be done.*

The assistant director of the Office of Compliance responded in a memorandum that it would be difficult to add the audit because of staffing shortages, but that it would be scheduled in the following calendar year. Fieldwork for the audit finally began on October 2, 2000 and was completed on November 21, 2000. As of March 18, 2002, the final audit report still had not been issued.

- ***An audit requested by an assistant director in April 2000 has not been completed.*** The acting assistant director of the Office of Substance Abuse Programs requested a contract compliance audit of a provider in a letter dated April 10, 2000. The assistant director of the

Office of Compliance instructed the chief of the Program and Fiscal Audits Branch to schedule an audit by May 2, 2000. Fieldwork was completed July 13, 2000, but as of March 18, 2002, a draft report had not been prepared for this audit.

- ***An audit requested by an assistant director in February 2000 has not been completed.*** On February 28, 2000, the acting assistant deputy director of the Office of Financial Management and Support Services requested an audit of a contract between the Health Care Services Division and a medical doctor, noting that the hours billed during a six-month period appeared to be excessive. The assistant deputy director of the Office of Compliance forwarded the request to the manager and an audit supervisor of the Fiscal and Business Management Audits Unit inquiring whether the audit could be performed. Fieldwork was performed between April 10, 2000 and November 3, 2000, but as of March 18, 2002, an audit report had not been prepared.
- ***An audit may have been completed too late to be useful.*** On January 10, 2000, the Office of Compliance received a request for an audit of a Los Angeles provider from the chief of the Women and Children's Services office of the Department of Corrections. According to the documentation provided to the Office of the Inspector General staff, the chief made the request because of numerous fiscal problems with the contractor, including late payment of vendors. The contract was due to expire on June 30, 2000, and the chief wanted the audit performed before the close of the contract. In a memorandum to the assistant director of the Office of Community Resources, the assistant director of the Office of Compliance agreed to perform the audit only if one other audit planned could be postponed. The audit fieldwork was performed between July 10, 2000 and September 14, 2000, but the final audit report was not issued until May 29, 2001—nearly a year after the contract expired. This delay in issuing the report is not in compliance with the *Standards for the Professional Practice of Internal Auditing*, which requires prompt communication of engagement results.

## FINDING 5

### **The Office of the Inspector General found that the Office of Compliance does not monitor the status of audit projects.**

The Office of Compliance does not track the status of audit projects and therefore cannot ensure that they are completed in a proper and timely manner. The Office of the Inspector General requested from the management of the Program and Fiscal Audits Branch a listing of audits completed in recent years and a listing of the status of all current audits. But the branch management answered that the information was not readily available because the branch does not use a management information system to record, track, and report the status of audits. Although a budget is assigned to each audit based on available resources, there are no procedures for tracking the audit start dates or the hours spent on the assignment either by month or cumulatively. As a result, management has no formal means of determining whether assignments are completed within designated budgetary timeframes.

The Office of the Inspector General subsequently received and reviewed a document compiled by the units within the Program and Fiscal Audits Branch giving the status of various audit projects and identified a number of deficiencies that could have been addressed by the branch

management if management had been monitoring the status of the audits. The problems noted included the following:

- ***Audits are not completed in a timely manner.*** The annual plan for the 2001-02 fiscal year of the Fiscal and Business Management Audits Unit lists 24 audits that had begun in previous years and had not been completed. A review of these carryover assignments shows that the fieldwork phase of the audits had been completed between March 2, 2000 and August 2001. But as of March 2, 2002, only two of the 24 audit reports had been completed. In the oldest case, the total time required to complete audit fieldwork was 17 days (February 14, 2000 to March 2, 2000), and yet the audit report still had not been completed two years later. The Office of the Inspector General noted, moreover, that the list in the annual plan was incomplete, in that it did not reflect all assignments still outstanding. For example, the Office of the Inspector General found that the final report for an audit for which fieldwork was completed on May 17, 1999 had not been issued as of March 2002, but the project was not reflected in the annual plan listing prepared by the Fiscal and Business Management Audit Unit.
- ***The Information Security Unit is also not completing its audit reports.*** The Office of the Inspector General found that none of the 20 audits performed by the Information Security Unit in 2001 had been completed and issued as of March 2002.
- ***Audit productivity at the Fiscal and Business Management Audits Unit is low.*** The Fiscal and Business Management Audits Unit is the largest unit within the Program and Fiscal Audits Branch. Although the unit had six vacant positions at the time of this review, the unit staff was still comprised of 11 auditors, two analysts, three audit supervisors, and one manager, for a staffing total of 17 professional positions. Yet the unit completes only a fraction of its planned audits. In its fiscal year 2001-02 audit plan, the unit listed a total of 101 audits, one of which was erroneously listed twice. As of March 1, 2002, two-thirds of the way through the fiscal year, the unit had initiated only 17 of the 101 audits in the audit plan and only one had been completed. According to the work plan, the total budget for the 17 audits was 7,900 hours. Further review revealed that fieldwork on one of the 17 audits was actually completed during calendar year 2000 and that the final report was issued on May 29, 2001—indicating that the audit should not have been included in the 2001-02 fiscal year audit plan. In addition, most of the 17 audits in the audit plan do not appear to be particularly complex, in that only three were budgeted for 700 hours or more—one for 700 hours, one for 750 hours, and the third for 1,950 hours.

Because the branch does not track the time the staff spend on projects, it is not possible to determine whether the time devoted to the audit assignments was reasonable. The branch management has asserted that the six vacant positions precluded the unit from completing all of the planned assignments, but with a professional staff of 17, one would expect a higher productivity level in an eight-month period than the completion of four audits, two of which were carryovers from previous years.

- ***Unreasonable delays in the processing of final audit reports.*** At the time of the Office of the Inspector General's fieldwork, the Program and Fiscal Audits Branch administrative staff had numerous draft reports awaiting final editing before they can be issued as final reports.

The staff does not know how many reports are outstanding because the branch administrative unit does not keep track of how many draft reports it has received and how many have been released. Consequently, there is no systematic process for assigning priority to the report workflow. Since at least July 2000, most of the draft audit reports have been significantly delayed before being issued as final reports. The Office of the Inspector General found, for example, that of the 12 draft reports issued by the Correctional Business Internal Audits Unit during the 2000-01 fiscal year, six still had not been issued as final reports as of March 28, 2002. At that time, an average of 303 days had elapsed since the institutions' corrective action plans in response to the reports had been received. In one case, the draft report was issued on July 21, 2000 and the institution's corrective action plan was received on February 2, 2001; yet, after 419 days, the report still had not been finalized. According to the Office of Compliance management, the backlog of draft reports has been caused by a lack of clerical support.

## **FINDING 6**

**The Office of the Inspector General found that the Program Compliance Unit of the Program and Fiscal Audits Branch uses a highly structured auditing approach that may fail to reveal important issues relating to the entities under audit.**

The Program Compliance Unit uses a highly structured approach for most of its audits in which the staff develops a checklist identifying the program requirements for each of the programs audited and then performs reviews to determine the degree of compliance with the program requirements. For example, for audits of community correctional facilities, the Program Compliance Unit uses a checklist that includes 82 compliance requirements to be reviewed. In conducting the audit, the audit team assesses the audited entity's operations and assigns a rating of compliance, partial compliance, noncompliance, not applicable, or not ratable to each of the requirements on the checklist. The rating is summarized with a total score showing the percentage of the program requirements that the audit team found to be in compliance.

From a processing standpoint, the checklist approach has the advantage of being easy to administer, as it clearly prescribes the audit parameters by listing the areas to be audited and the criteria for evaluating compliance. In addition, the checklist approach requires little report preparation time, as the staff simply assigns a rating with brief explanatory comments explaining the basis for each rating. But conducting audits using this structured approach carries the risk that material issues not included in the checklist may be overlooked. An audit of the Folsom Community Correctional Facility conducted by the Program Compliance Unit provides an example. In that audit, which was conducted in August 2000 with a report issued more than a year later on September 13, 2001, the Program Compliance Unit assigned the facility a 90 percent compliance rate with no findings of apparent significance. The Office of the Inspector General, in contrast, conducted an audit of the same entity and issued a report on January 15, 2002 that identified numerous significant on-going problems and recommended that the state terminate its contract with the City of Folsom for the operation of the facility. The scope of the audit conducted by the Office of the Inspector General of the Folsom Community Correctional Facility was similar to the scope of the audit conducted by the Program Compliance Unit. Moreover, the problems identified by the Office of the Inspector General existed at the time the

Program Compliance Unit conducted its audit. In reviewing and analyzing the Program Compliance Unit audit report, the Office of the Inspector concluded that the differences in the audit results were caused by the following:

- ***The Program Compliance Unit checklist is overly limited.*** The checklist used by the Program Compliance Unit did not cover some of the issues noted by the Office of the Inspector General because the issues were unique to the Folsom Community Correctional Facility. For example, the audit by the Office of the Inspector General revealed significant problems with the operation of the facility's recycling plant and program. The checklist used by the Program Compliance Unit contains no provision in this regard since no other community correctional facility operates a recycling plant. Similarly, while the Office of the Inspector General report identified significant health and safety problems at the recycling plant resulting from exposure of the staff and inmates to hazardous working conditions, medical waste, and chemical spills, the Program Compliance Unit report rated the facility as in compliance in the area of safety. The Program Compliance Unit was able to issue this rating because the checklist calls for evaluating only whether the facility has written procedures governing fire safety, whether quarterly fire drills are conducted, and whether there are written procedures governing hazardous material. The audit checklist does not provide for considering whether such procedures are adequate or whether they are followed.
- ***The Program Compliance Unit audit did not fully validate information in documents.*** In the area of program cost reports, for example, the Program Compliance Unit audit team purportedly "examined Folsom CCF's quarterly and annual program cost reports and interviewed staff." The audit concluded that the facility was in compliance because it submitted the quarterly and annual reports to the California Department of Corrections. The Office of the Inspector General reviewed the program cost reports and other financial reports and found evidence of widespread fiscal mismanagement at the Folsom Community Correctional Facility, as well as misinformation about fiscal matters and misdirection of funds intended to benefit inmates. In reviewing the composition of the Program Compliance Unit audit team members assigned to this audit, the Office of the Inspector General noted that all members have custody background and none possesses the experience and skill necessary to properly evaluate the program cost issues.
- ***The Program Compliance Unit audit placed too much reliance on superficial factors.*** The Program Compliance Unit audit of the Folsom Community Correctional Facility relied heavily on surface appearances, staff representations, and the existence of written policies and procedures. It is apparent from the audit report that much of the audit work of the Program Compliance Unit consisted of cursory observation, staff interviews, and determination of whether written policies or procedures governing the area under audit existed. Although these are necessary and appropriate audit steps, they do not constitute sufficient and competent evidence for drawing conclusions. Written policies and procedures may have been intentionally or unintentionally ignored. Staff interviews do not always provide accurate and reliable results. Systemic deficiencies or hazardous conditions may not be apparent at the time the audit staff makes its observation and may require closer examination of records and documents.

***Program Compliance Unit audits do not identify causes or recommend solutions.*** The Office of the Inspector General found in addition that although the checklist audit approach may identify instances of noncompliance with program requirements, the Program Compliance Audit staff has made little attempt to place issues into perspective by quantifying the cause and effect of the problems. Nor does the Program Compliance Unit recommend changes to resolve the problems. Instead, it relies on the entity under audit to provide a corrective action plan to address the problems—yet, it is often not possible to assess the adequacy of the corrective action plan unless the causes and effects of the problems have been identified. For example, in the Folsom Community Correctional Facility audit performed in April 1999, the Program Compliance Unit staff found that the facility did not provide a pre-release program meeting program requirements. The facility responded by stating that budget reductions by the California Department of Corrections in 1993 had eliminated funding for the program and that the facility could not provide the service without additional funding. Following the checklist approach, the Program Compliance Unit did not pursue the issue further by analyzing the underlying cause and effect of this important matter—even though the very mission of a community correctional facility is to prepare inmates for parole. Then, during a second audit of the facility conducted by the Program Compliance Unit in August 2000, the staff judged the requirement for a pre-release program “not ratable” because of the “discontinued budget for this program,” as asserted by the Folsom Community Correctional Facility. Because the Program Compliance Unit audit team did not include anyone with a financial auditing background, the audit team was not aware that the contract budget for the Folsom Community Correctional Facility provided \$41,000 for inmate programs, yet the city only spent between \$796 and \$10,877 on inmate programs for each of the fiscal years from 1997 through 2001. In reviewing past reports issued by the Program Compliance Unit of audits conducted on a cyclical basis, the Office of the Inspector General further noted that many findings were repeated from audit to audit, suggesting that the institutions had failed to address the cause of the problems or to provide remedies.

## **FINDING 7**

**The Office of the Inspector General found that the audit functions of the California Department of Corrections are fragmented, with a lack of coordination of audit activities and incomplete coverage of areas requiring audit, resulting in a failure to comply with state law governing financial accountability.**

Other units within the Department of Corrections in addition to the Program and Fiscal Audits Branch are engaged in audit activities. The Program Development Unit of the Parole and Community Services Division conducts audits of designated reentry programs as well as audits of contractors providing services to parolees. The department also recently formed a resource review team to conduct audits of state prison programs and operations on an institution-wide basis. In addition, the Department of Finance conducts audits of various aspects of Department of Corrections operations. For example, the Department of Finance has statutory responsibility for performing audits of state prison inmate welfare funds. In the 1998-99 fiscal year budget, the Department of Finance received an increase in its budget of four positions and a redirection of seven positions to conduct internal control audits for the Department of Corrections. Subsequent to the audit by the Office of the Inspector General of the Folsom Community Correctional

Facility, the department also entered into an interagency agreement with the Department of Finance to conduct audits of all community correctional facilities.

Despite the resources available to the Department of Corrections for auditing department operations, the Office of the Inspector General found that the department has not established a mechanism for planning and coordinating audit activities to eliminate gaps in coverage and avoid possible duplication of effort. As a result:

- ***The department is not complying with state law.*** Under the Financial Integrity and State Manager's Accountability Act of 1983, state agency heads are responsible for establishing and maintaining a system or systems of internal accounting and administrative control within their agencies. The act requires the agency head to prepare and submit a report on the adequacy of the agency systems of internal accounting and administrative controls on a two-year cycle. The Department of Finance has issued an audit guide that separates internal controls into five transaction cycles: budget, income, expenditures, fixed assets, and financial reporting. The cycle approach assists the auditor in identifying the flow of transactions from the point of authorization through execution, the recording of transactions, and accountability for any assets. Under the *California Department of Corrections Operations Manual*, the Program and Fiscal Audits Branch is responsible for conducting internal and fiscal compliance audits to ensure compliance with the Financial Integrity and State Manager's Accountability Act.

As mentioned previously, in the 1998-99 fiscal year budget, the Department of Finance received an increase in its budget of four positions and a redirection of seven positions to conduct internal control audits for the Department of Corrections. In reviewing the various audit activities conducted by the California Department of Corrections and the Department of Finance, the Office of the Inspector General found that there has not been an audit of the budget cycle or the financial reporting cycle of the Department of Corrections since at least 1995. Moreover, citing budgetary constraints, the Department of Finance has not developed a plan or assigned staff resources to perform internal control audits of the California Department of Corrections. Yet, apparently under the belief that the Department of Finance will continue to perform the internal control audits, the Program and Fiscal Audits Branch management is proposing to delete from its responsibilities the requirement that it conduct internal and fiscal compliance audits to ensure compliance with the Financial Integrity and State Manager's Accountability Act.

The Office of the Inspector General also found that department administrators appear to lack the understanding of internal control issues and necessary corrective actions needed to fulfill the department's reporting responsibility under the Financial Integrity and State Manager's Accountability Act. For example, the department director who certified the adequacy of the department's internal controls in a December 31, 2001 document relied in part on Department of Finance "audits" of two parole regions that in fact were not audits, but only limited scope surveys. The surveys disclosed significant problems resulting from weak management and internal control at the two parole regions. When the survey disclosed the deficiencies, the next reasonable step would have been for the director to order a full-scale audit to quantify the possible extent of the problems. Instead, the department simply took actions to address the specific issues noted in the survey without requesting an audit of the

two parole regions (and the two other parole regions) by either the Department of Finance or the Program and Fiscal Audits Branch.

- ***Audit efforts may be duplicated.*** The recently established resource review team was formed to perform cyclical reviews of the operations, programs, and activities of the state prisons on an institution-wide basis. Meanwhile, the Program and Fiscal Audits Branch also conducts audits and reviews of selected operations and functions, such as administrative segregation units, business offices, and information security units within institutions. There appears to be limited coordination between the units to avoid duplication of effort.

#### **RECOMMENDATION**

**The Office of the Inspector General recommends that the California Department of Corrections consolidate all department auditing activities into a professional internal auditing unit consistent with standards prescribed in *Standards for the Professional Practice of Internal Auditing*. The chief of internal audits should possess the training, knowledge, and experience to manage an internal auditing unit and should report to the chief deputy director for Support Services.**

## APPENDIX

Departures from the *Standards for the Professional Practice of Internal Auditing* noted by the Office of the Inspector General in its review of the Program and Fiscal Audits Branch.

SECTION NUMBER	<i>STANDARDS FOR THE PROFESSIONAL PRACTICE OF INTERNAL ACCOUNTING</i>	
	ATTRIBUTE STANDARD	DEPARTURE FROM STANDARD
1110	<p><b>Organizational Independence</b> The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities.</p>	The chief of the Program and Fiscal Audits Branch reports to the assistant director of the Office of Compliance, who reports to the chief deputy director for Support Services, who reports to the department director. Ideally, the chief audit executive should report functionally to the audit committee, board of directors, or other appropriate governing authority, and administratively to the chief executive officer of the organization.
1210	<p><b>Proficiency</b> Internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.</p>	Neither the current nor the former chief of the Program and Fiscal Audits Branch has had audit experience or training. Similarly, many staff members have had no audit experience or training.
1230	<p><b>Continuing Professional Development</b> Internal auditors should enhance their knowledge, skills, and other competencies through continuing professional development.</p>	No evidence exists that Program and Fiscal Audits Branch auditors obtained education that would provide information about improvements and current developments in internal auditing standards.
1300	<p><b>Quality Assurance and Improvement Program</b> The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. The program should be designed to help the internal auditing activity add value and improve the organization's operations and to provide assurance that the internal audit activity is in conformity with the <i>Standards</i> and the <i>Code of Ethics</i>.</p>	No such program exists. The Program and Fiscal Audits Branch does not use a tracking system to provide even basic information.
1310	<p><b>Quality Program Assessments</b> The internal audit activity should adopt a process to monitor and assess the overall effectiveness of the quality program. The process should include both internal and external assessments.</p>	No such program exists.
1311	<p><b>Internal Assessments</b> Internal assessments should include:</p> <ul style="list-style-type: none"> <li>• Ongoing reviews of the performance of the internal audit activity; and</li> </ul>	No such assessment exists.

	<ul style="list-style-type: none"> <li>Periodic reviews performed through self-assessment or by other persons within the organization, with knowledge of internal auditing practices and the <i>Standards</i>.</li> </ul>	
1312	<p><b>External Assessments</b> External assessments, such as quality assurance reviews, should be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization.</p>	No evidence of such assessment exists.
1320	<p><b>Reporting on the Quality Program</b> The chief audit executive should communicate the results of external assessments to the board.</p>	No evidence of such assessment exists.
1330	<p><b>Use of “Conducted in Accordance with the Standards”</b> Internal auditors are encouraged to report that their activities are “conducted in accordance with the <i>Standards for the Professional Practice of Internal Auditing</i>.” However, internal auditors may use the statement only if assessments of the quality improvement program demonstrate that the internal audit activity is in compliance with the <i>Standards</i>.</p>	<i>Standards for the Professional Practice of Internal Auditing</i> not followed by the Program and Fiscal Audits Branch.
1340	<p><b>Disclosure of Noncompliance</b> Although the internal audit activity should achieve full compliance with the <i>Standards</i> and internal auditors with the <i>Code of Ethics</i>, there may be instances in which full compliance is not achieved. When noncompliance impacts the overall scope or operation of the internal audit activity, disclosure should be made to senior management and the board.</p>	<i>Standards for the Professional Practice of Internal Auditing</i> not followed by the Program and Fiscal Audits Branch.
	<b>PERFORMANCE STANDARDS</b>	
2000	<p><b>Managing the Internal Audit Activity</b> The chief audit executive should effectively manage the internal audit activity to ensure it adds value to the organization.</p>	The Program and Fiscal Audits Branch does not use a tracking or information system to provide the information necessary to determine if the internal audit activity adds value to the organization. (See Finding 5)
2010	<p><b>Planning</b> The chief audit executive should establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization’s goals.</p>	The Program and Fiscal Audits Branch does not perform risk-based analysis for the purpose of setting priorities. Each unit within the branch separately prepares a schedule of audits to be completed during the year. The branch does not assess and prioritize the audit projects proposed by the units to develop a comprehensive work plan for the branch. (See Finding 2)
2010.A1	The internal audit activity’s plan of engagements should be based on a risk assessment, undertaken at least annually. The input of senior management and the board should be considered in this process.	Same as above. (See Finding 2)

2020	<p><b>Communication and Approval</b> The chief audit executive should communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and to the board for review and approval. The chief audit executive should also communicate the impact of resource limitations.</p>	The plans are not submitted to all executive staff for review and comment. (See Finding 2)
2030	<p><b>Resource Management</b> The chief audit executive should ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan.</p>	The Program and Fiscal Audits Branch management has no system or procedures in place to properly manage audit resources. (See Findings 3 and 5)
2040	<p><b>Policies and Procedures</b> The chief audit executive should establish policies and procedures to guide the internal audit activity.</p>	The Program and Fiscal Audits Branch has no written policies or procedures for the guidance of the internal audit activity. The Fiscal Business Management Audits Unit has an audit manual, but it does not follow the correct standards.
2050	<p><b>Coordination</b> The chief audit executive should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts.</p>	Minimal coordination exists of audits between the Program and Fiscal Audits Branch and other groups conducting audits. (See Finding 7)
2060	<p><b>Reporting to the Board and Senior Management</b> The chief audit executive should report periodically to the board and senior management on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting should also include significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by the board and senior management.</p>	No evidence of any such reporting was found except for a briefing document filed in December 2001. (See Finding 2)
2100	<p><b>Nature of Work</b> The internal audit activity evaluates and contributes to the improvement of risk management, control and governance systems.</p>	Audits performed by the Program and Fiscal Audits Branch provide little value in the improvement of risk management, control, and governance systems.
2110	<p><b>Risk Management</b> The internal audit activity should assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.</p>	The audit objectives of the Program Compliance Unit do not address risks, controls, and governance process.
2120.A1	<p>Based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization's governance, operations, and information systems. This should include:</p> <ul style="list-style-type: none"> <li>• Reliability and integrity of financial and operational information.</li> <li>• Effectiveness and efficiency of operations.</li> </ul>	Few of the Program and Fiscal Audits Branch audit activities are risk-based.

	<ul style="list-style-type: none"> <li>• Safeguarding of assets.</li> <li>• Compliance with laws, regulations, and contracts.</li> </ul>	
2120.A2	Internal auditors should ascertain the extent to which operating and program goals and objectives have been established and conform to those of the organization.	No evidence of such evaluation exists.
2120.A3	Internal auditors should review operations and programs to ascertain the extent to which results are consistent with established goals and objectives to determine whether operations and programs are being implemented or performed as intended.	No evidence of such evaluation exists.
2120.A4	Adequate criteria are needed to evaluate controls. Internal auditors should ascertain the extent to which management has established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, internal auditors should use such criteria in their evaluation. If inadequate, internal auditors should work with management to develop appropriate evaluation criteria.	No evidence of such evaluation exists.
2130	<p><b>Governance</b></p> <p>The internal audit activity should contribute to the organization's governance process by evaluating and improving the process through which (1) values and goals are established and communicated, (2) the accomplishment of goals is monitored, (3) accountability is ensured, and (4) values are preserved.</p>	No evidence of such evaluation exists.
2130.A1	Internal auditors should review operations and programs to ensure consistency with organizational values.	No evidence of such evaluation exists.
2200	<p><b>Engagement Planning</b></p> <p>Internal auditors should develop and record a plan for each engagement</p>	Program Compliance Unit and Correctional Business Internal Audits Unit are structured with an audit instrument (checklist) that is used for each audit. Planning is not done for each individual audit.
2201	<p><b>Planning Considerations</b></p> <p>In planning the engagement, internal auditors should consider:</p> <ul style="list-style-type: none"> <li>• The objectives of the activity being reviewed and the means by which the activity controls its performance.</li> <li>• The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level.</li> <li>• The adequacy and effectiveness of the activity's risk management and control systems compared to a relevant control framework or model.</li> <li>• The opportunities for making significant improvements to the activity's risk management and control systems.</li> </ul>	Only the Fiscal Business Management Audit Unit prepares audit-planning memoranda. However, elements in the memoranda are not fully developed.

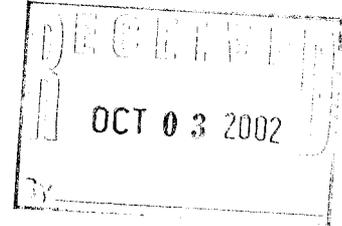
2210	<b>Engagement Objectives</b> The engagement's objectives should address the risks, controls, and governance processes associated with the activities under review.	No evidence that such objectives have been considered during the audit process.
2210.A1	When planning the engagement, the internal auditor should identify and assess risks relevant to the activity under review. The engagement objectives should reflect the results of the risk assessment.	No evidence that such evaluation exists.
2210.A2	The internal auditor should consider the probability of significant error, irregularities, noncompliance, and other exposures when developing the engagement objectives.	No evidence that such evaluation exists.
2220	<b>Engagement Scope</b> The established scope should be sufficient to satisfy the objectives of the engagement.	Because the Program Compliance Unit and the Correctional Business Unit use checklist type audit instruments, the scope of the audit is predetermined and is not established for each individual audit.
2220.A1	The scope of the engagement should include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties.	Scope is predetermined and is not established for each individual audit.
2400	<b>Communicating Results</b> Internal auditors should communicate the engagement results promptly.	Audit reports are not issued in a timely manner. (See Finding 5)
2410	<b>Criteria for Communicating</b> Communications should include the engagement's objectives and scope as well as applicable conclusions, recommendations, and action plans.	Reports do not always clearly quantify the cause and effect of the problems and make recommendations to resolve the problems (See Finding 5)
2420	<b>Quality of Communications</b> Communications should be accurate, objective, clear, concise, constructive, complete, and timely.	Same as above.
2500	<b>Monitoring Progress</b> The chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management.	The Program and Fiscal Audits Branch has no formal system to monitor the progress of corrective action taken by management.
2500.A1	The chief audit executive should establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.	The Program and Fiscal Audits Branch has no formal system to monitor the progress of corrective action taken by management.

**ATTACHMENT A**  
**RESPONSE OF THE DEPARTMENT OF CORRECTIONS**

# Memorandum

Date : October 2, 2002

To : John Chen  
Chief Deputy Inspector General  
Office of the Inspector General  
801 K Street, Suite 1900  
Sacramento, CA 95814



Subject: **RESPONSE TO THE OFFICE OF THE INSPECTOR GENERAL'S DRAFT REPORT: MANAGEMENT REVIEW OF THE AUDIT FUNCTIONS OF THE CALIFORNIA DEPARTMENT OF CORRECTIONS**

This is in response to your Draft Management Review of the Audit Functions of the California Department of Corrections (CDC), Office of Compliance (OOC). Since the initiation of your audit in February 2002, the OOC was reorganized to the Policy and Evaluation Division. In addition to the general comments below, we have attached responses to the specific findings in the draft report.

The CDC appreciates the Office of Inspector General's (OIG) efforts in conducting the Management Review of the Audit Functions of the California Department of Corrections. However, I have serious concerns regarding the most significant findings contained within your report, specifically the appropriate audit standards and the Financial Integrity and State Managers Accountability Act reporting requirements. Additionally, the finding regarding audit standards is of such magnitude that it has subsequently negatively affected the majority of the remaining findings contained within your report.

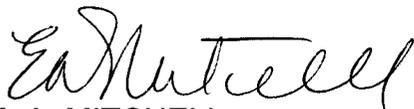
Finding 1, "The Office of the Inspector General found that the Program and Fiscal Audits Branch does not adhere to professional standards for internal auditing," is based upon the premise that the Program and Fiscal Audits Branch's (PFAB) primary function is that of an internal audit unit. This is not the case. As acknowledged in your report (page 20), PFAB was restructured in Fiscal Year (FY) 1998/99, which resulted in the Department of Finance (DOF) assuming the responsibility for conducting internal control audits for the CDC. At that time, the focus of PFAB was shifted to conduct external contract compliance audits, revamp and reinstitute institution management assessment reviews, and conduct specific institution operational reviews and court mandated monitoring functions. Therefore, based upon the functions that PFAB now performs, the appropriate standards to be followed are the Generally Accepted Government Auditing Standards, which specifically relate to the external audit function. This position has been conveyed to

the OIG auditors on numerous occasions throughout the audit. I believe that the OIG's decision to ignore these facts has resulted in an unsupported finding regarding audit standards. This in turn has an adverse affect upon many of the remaining findings contained in the report.

Finding 7, page 20, "The department is not complying with state law," relates to the Financial Integrity and State Manager's Accountability (FISMA) Act, concerning certification of adequacy of the Department's internal controls. The finding cites an outdated CDC Operations Manual section that was last revised in February 1993, indicating that it is the PFAB's responsibility for conducting internal and fiscal audits of the Department. As we stated to your auditors and as acknowledged in the OIG report, this function was transferred to the DOF in FY 1998/99. It appears that Finding 7 is based upon the OIG's decision to ignore the fact that the DOF assumed the role of conducting internal audits for the CDC and a presumption of what may or may not occur in the future. Additionally, prior to issuance of the draft report, the OIG auditors were informed that the departmental FISMA certification cited in the audit report appropriately reflected that the DOF conducts CDC's internal control audits. The auditors were also informed that the DOF had stated that they would continue to perform the internal control audit function for the CDC.

Lastly, the overall tone of the OIG report is exceedingly harsh. The OIG compared operational methodologies employed by the OIG to that of the PFAB, rather than evaluating our specific audit units based upon their function. While we acknowledged deficiencies in our timely issuance of reports and the lack of a comprehensive tracking system, these were issues we had started to improve prior to the initiation of the OIG audit. Significant improvements in these areas have occurred subsequent to the period audited by the OIG, which was not recognized in the draft report. As a whole, my staff found the OIG reporting methodology disheartening and one which does not present a foundation for positive improvements.

Attached you will find our more detailed responses to the findings contained within the OIG report. If you have any questions, please contact me at (916) 322-6676.



E. A. MITCHELL  
Deputy Director  
Policy and Evaluation Division  
Department of Corrections

Attachment

cc: E. Alameida, Director, Department of Corrections  
K. Kinser, Chief Deputy Director, Support Services

# MANAGEMENT REVIEW OF THE AUDIT FUNCTIONS OF THE CALIFORNIA DEPARTMENT OF CORRECTIONS

## FINDINGS AND RESPONSE

**FINDING 1:** The Office of the Inspector General found that the Program and Fiscal Audits Branch does not adhere to professional standards for internal auditing.

**RESPONSE:** California Department of Corrections (CDC) Disagrees with the Finding.

The Program and Fiscal Audits Branch (PFAB) does not adhere to the Standards for the Professional Practice of Internal Auditing (SPPIA) because the PFAB is not an internal audit unit. However, the Fiscal and Business Management Audits Unit (FBMAU), which is a unit within the PFAB, adheres to other appropriate professional standards (i.e., Generally Accepted Government Auditing Standards [GAGAS]).

The Office of Inspector General (OIG) evaluated the PFAB's success in complying to audit standards based upon the provisions of Department Operations Manual (DOM), Article 17, Section 22080.1–22080.15 and the California Government Code (GC), Section 1236, which specifically apply to State Administrative Manual (SAM), Section 20000 audits. The DOM was last revised on February 1, 1993. However, due to organizational changes, the DOM and GC sections are no longer applicable to the PFAB. The DOM sections are currently in the process of being revised to appropriately reflect the changes made in Fiscal Year (FY) 1998/99 through FY 2002/03.

During the period of FY 1983/84 to FY 1998/99, CDC did have an internal audit unit performing audits in accordance with SPPIA. In the Budget Change Proposal (BCP) for FY 1998/99, CDC transferred the workload and remaining auditing function of the Internal Audit Unit to the Department of Finance (DOF). Compliance to SPPIA was terminated.

The PFAB has three unique audit units:

- The FBMAU performs external audits of contractors who provide services for the CDC, such as hospitals, in-community substance abuse treatment programs, and inmate arts facilitation (Arts-In-Corrections, [AIC]) programs. The FBMAU follows GAGAS as published by the General Accounting Office (GAO).

- The Correctional Business Internal Audits Unit (CBIAU) performs management assessment reviews of institutional business functions. Prior to FY 1998/99, this unit performed CDC's internal audit functions. In the BCP for FY 1998/99, the CDC transferred the workload and remaining auditing function of the Internal Audit Unit to the DOF and renamed the unit the CBIAU. The focus of the CBIAU is to perform management assessment peer reviews of nine key areas of each of the Department's 33 correctional institutions business services office. The CBIAU cites policies and procedures from the SAM, DOM, and federal laws and regulations.
- The Program Compliance Unit (PCU) performs reviews to ensure compliance with legislative mandates and court orders. The unit is comprised of custody classifications that possess knowledge in the areas of inmate programming, housing, and security. The PCU does not reference any audit standards in its reports.

There are three primary generally accepted standards that the PFAB has considered for use by the FBMAU as follows:

- GAAS: Generally Accepted Auditing Standards are primarily used in auditing financial statements and expressing an opinion.
- GAGAS: Generally Accepted Government Auditing Standards are widely used by government auditors conducting audits of government activities and auditors performing audits of organizations receiving federal funds.
- SPPIA: Standards for the Professional Practice of Internal Auditing are primarily used by State department auditors when conducting the SAM, Section 20000 audits.

All three standards are similar and require the following attributes:

- Adequate planning, supervision, and staff qualifications.
- Due professional care in conducting an audit and preparing an audit report.
- Adequate working papers or supporting documentation.
- Review of internal controls.

The primary difference is that SPPIA applies to the management function while the GAAS and GAGAS are silent.

Based upon the scope of audits performed, the FBMAU selected the GAGAS standards and adopts some of the SPPIA standards. The GAGAS is the standard that is generally accepted by other State departments conducting audits similar in nature, such as the California Department of Transportation, the Department of Justice, and the California Youth Authority.

After reviewing the DOF's "Directory of Internal Audit Organizations for the Year 2000", PFAB found that out of 37 State departments, 33 (89 percent) use more than one standard. In addition, the 37 State departments perform various types of audits (see Attachment 1) and use various types of standards to conduct the audits. Attached is a list of the 37 State departments audit units and the various standards that they use (see Attachment 2). The SPPIA is primarily used by State departments in performing Internal Control Reviews – SAM, Section 20000 audits. Internal control reviews are conducted by the DOF for the CDC.

**FINDING 2: The Office of the Inspector General found that the Program and Fiscal Audits Branch, which performs most of the department's audit work, is not effectively communicating with the department's executive staff in planning annual audits activities and in reporting audit performance.**

**RESPONSE: CDC Disagrees with the Finding.**

The OIG identified two items of concern stemming from communication issues:

- (1) The PFAB has no annual audit plan; and (2) the PFAB does not communicate findings to CDC Executive Management.
  - Historically, the FBMAU, CBI AU and PCU have developed annual audit plans, which were approved by the CDC Executive Management. The PFAB continues the practice of obtaining input from affected program areas then develops an audit plan that is submitted to the Deputy Director, PED, for approval.
  - Since 1998, the PFAB has sent executive summaries of each completed audit to the two Chief Deputy Directors. In addition, copies of draft and final reports are forwarded to wardens and the Deputy Director of the program areas. The PFAB also sends Management Memorandums to the Deputy Director of the program areas when auditors discover internal issues or process improvements that would enhance CDC operations.
  - The CDC recently reorganized to create the new Policy and Evaluation Division (PED). This action elevated the management position for the new division to the Deputy Director level. The change will ensure greater

access to the CDC Executive Management and to all cabinet members. The Deputy Director will be able to present and explain the annual audit plan and risk assessment process, in addition to answering questions that arise and assist with the prioritization of the selected audits based on risk factors and overall impact to the CDC.

The OIG believes that PFAB has misled management on the reported cost recovery. This is not the case; the FBMAU explained the cost recovery information in the December 2000 Executive Quarterly meeting. FBMAU clearly articulated to the directorate that monetary recovery identified as pending was still under review and may not actually be collected, should additional supporting documentation be provided by the contractor.

On page 10, paragraph 2, the OIG states that: "Management does not perform a risk-based assessment for prioritizing audit projects for the branch as a whole. As a result, instead of the branch management establishing priority and allocating staff resources accordingly . . . the selection of audit assignments is left primarily to the discretion and judgment of the supervisors and staff of each individual unit within the Branch."

The OIG asserts that PFAB dictates to upper management what assignments will be performed. Upper management delegates the responsibility of performing a "risk-based assessment" to the managers of each unit. The PFAB staff communicates with CDC program staff to formulate an audit plan. The plan is reviewed, adjusted, approved by PFAB management, and then submitted up the chain of command for approval by the Deputy Director, PED.

**FINDING 3: The Office of the Inspector General found that the management of the Program and Fiscal Audits Branch does not target internal audit activity toward issues that pose the highest risk.**

**RESPONSE: CDC Agrees in Part.**

The PFAB agrees that there is merit in re-evaluating current audit activities. The PFAB will develop a process/procedure that will assist in identifying the frequency for performing reviews. However, this will be done carefully, with full management, program and legal involvement due to the sensitivity of many of the audits.

The PFAB audits are audits referencing specific laws, policies, and procedures that the CDC operates within. In the court cases, findings are structured and specific in setting acceptable standards.

**Within this finding, the OIG identified four audits of questionable value that could be conducted less frequently.**

**(a) Audits of administrative segregation and due process issues.**

Administrative segregation houses less than 10 percent of the institutions' population, but creates a high volume of inmate appeals with issues that are relevant to prior litigation against the CDC (i.e., conditions of confinement). The administrative segregation audit was developed based upon the Judgment of Permanent Injunction In re **Toussaint v. McCarthy**. Additionally, due process items were incorporated within **Toussaint** under **Wright v. Enomoto**. However, this is a program and site-specific audit. The PFAB will continue to perform this audit based upon the security and high sensitivity of the area. The PFAB will evaluate annually for need and/or frequency.

**(b) Audits of treatment of condemned inmates at San Quentin State Prison.**

Prior to the OIG audit, the PFAB was in contact with the Director's Office and the State of California Attorney General's Office concerning the further need to continue this audit of the condemned population.

The complaint in this case was filed in 1979. A consent decree was entered in 1980. In 1985, a special master (the Monitor) was appointed to monitor the consent decree. Over the years the Monitor and plaintiffs' counsel reviewed changes in policies and procedures at San Quentin State Prison. The Monitor filed six reports on the status of compliance with the consent decree. In December 1997, Judge Charles A. Legge, United States District Judge, terminated the Decree. The Prison Law Office, representing the condemned inmates, filed an immediate appeal. Based on the continued outside interest, the directorate has determined that this audit will continue. The PFAB will evaluate and report to the directorate the need and/or frequency of this audit.

**(c) Pelican Bay State Prison use of force audits.**

Prior to the OIG's audit, it was recognized by PFAB that this audit could be accomplished on a quarterly basis rather than monthly. This audit is currently being conducted on a quarterly basis.

**(d) Pelican Bay State Prison health care delivery audits.**

The PFAB will evaluate the necessity to continue this review.

**FINDING 4: The Office of the Inspector General found that the Program and Fiscal Audits Branch is not responsive to executive management requests for special audits.**

**RESPONSE: CDC Disagrees with the Finding.**

The PFAB recognizes the importance of honoring any and all requests for special audits. When special requests are made, the PFAB does prioritize the request based on audits already in process, pending special requests by other Deputy Directors, its impact on the audit plan, and the Department's availability of staff.

The PFAB has conducted many special requests, including:

- A request by the Legal Affairs Division for a special review at Salinas Valley State Prison.
- A request by the executive management in 1999 to audit all 33 institutions on the processing, safeguarding, and documentation of sensitive personnel information of CDC employees.
- A Parole and Community Services Division request in 1998 to audit all 16 Community Correctional Facilities.
- A request in March 2000 by the Chief Deputy Director to conduct a review of the budgeting process at California Medical Facility. The CBIAU conducted the review from April through June 2000.
- In February 2001, CDC's Chief Financial Officer requested that the CBIAU perform audits with the Budget Deficit Review Team and limit its audit scope to focus on specific procedures in the areas of Plant Operations, Food Services, Inmate Trust Accounting Operations, Personnel Transactions, and departmental restrictions placed on purchasing. The PFAB approved the request and worked on the project from February 2001 to November 2001. The directorate was involved throughout the review process and attended all pre-exit and exit conferences. The directorate was responsive to all findings and provided immediate oversight and direction to CDC management.
- Recently, the Warden at Mule Creek State Prison requested that the CBIAU perform a follow-up in six to eight months from the date of the last audit. The request was approved and the annual schedule was revised.
- There were four special requests that were cited by the OIG that had not been completed. Final reports have been issued on three of the four special requests. One is scheduled to be issued on October 30, 2002.

**FINDING 5: The Office of the Inspector General found that the Office of Compliance does not monitor the status of audit projects.**

**RESPONSE: CDC Agrees in Part.**

At the time of the OIG review, the PFAB maintained multiple tracking systems that resulted in inconsistent tracking and contributed to some late reports. However, late reports were also attributed to clerical support staff vacancies. The PFAB has implemented a new comprehensive audit tracking system to provide management with current status information of audit reports and assignments. The PFAB is now using the Standardized Correspondence Control System (SCCS) to give each new audit a unique tracking number and 13 different milestone dates (such as date of the draft report, exit conference, auditee's response, etc.). A weekly "Outstanding Audit Report" is provided to supervisors each Friday and an updated version is provided to management on Monday. The SCCS is a network-based system accessible by any CDC management.

**Audits are not completed in a timely manner.**

At the time of the OIG review, draft and final audit reports were in various stages of completion. Subsequent to the OIG review, FBMAU made every effort to process and complete the audits that were outstanding. Of the 24 carryover audits cited in the OIG report for FY 2001/02, 21 final audit reports have been issued, 1 draft audit report is in progress, and 3 final audit reports are still in progress as of September 19, 2002.

**The Information Security Unit is also not completing its audit reports.**

The Information Security Unit (ISU) has changed its in-field audit practices, in order to eliminate backlogs and issue a Final Report in a timely manner. The ISU is now issuing a field draft report at the end of the first week of auditing. Additionally, ISU staff stays onsite to work with institution staff to complete the final report to the Warden at the end of the second week.

**Audit productivity at the Fiscal and Business Management Audits Unit is low.**

From January 2000 through June 30, 2002, various audits were listed on the audit plans. However, during this period, audit vacancies and clerical shortages occurred after the audit plans were developed. Thus, FBMAU was not able to conduct all the audits on the audit plans. The 101 audits the OIG cited is questionable. The OIG may have arrived at the total because a single audit may consist of multiple contracts. Additionally, audits in progress at the end of the FY are carried over into the subsequent year's audit plan. The PFAB determined

that there were 61 audits conducted from the audit plan of which 56 were finalized as of September 24, 2002.

**Unreasonable delays in the processing of final audit reports.**

The PFAB was without sufficient clerical support. Draft and final reports were submitted to clerical, but due to a shortage of clerical support a backlog of these reports occurred. In addition, the PFAB has also experienced audit staff vacancies for the past three years. The PFAB continues to make efforts to fill all clerical vacancies, and has eliminated the cited backlog of final reports.

**FINDING 6: The Office of the Inspector General found that the Program Compliance Unit of the Program and Fiscal Audits Branch uses a highly structured auditing approach that may fail to reveal important issues relating to the entities under audit.**

**RESPONSE: CDC Agrees in Part.**

This finding is a result of comparing the OIG audit methodology to the methodology employed by the PCU. Often the OIG engages in a review without a defined scope established at the initiation of the review. This is normally not the case for the PCU. The PCU utilizes a highly structured auditing approach, based upon the scope of their review. The PCU staff use documented and approved authority to support their findings. Audit instruments are approved by management and cover the scope and standards of the specific audit to be performed. The PCU appropriately makes determinations of compliance with many of the requirements of the audit through careful review of written local policies, procedures, directives, and/or written files and logs. The PCU staff use checklists as one measure to ensure that all elements of the approved standards have been met. These audits are not fiscal audits, but program compliance audits (or management reviews).

In Finding 6, the OIG cited several comparisons between their review of the City of Folsom Community Correctional Facilities (CCF) conducted in 2001, to the Folsom CCF program audit conducted by the PCU in 2000. The scope of the PCU audit of the Folsom CCF was one of evaluation of the facility's security, compliance with the terms and conditions of State regulations, departmental policy, and contract agreement. The scope of the OIG review contained these same elements but also included a fiscal component. On November 27, 2000, the PFAB, Fiscal and Business Management Audits Unit (FBMAU), issued their final report of a limited scope financial audit of the Folsom CCF which identified a majority of the fiscal issues cited in the OIG audit. In fact the OIG auditors utilized the FBMAU report to assist them in their review of the Folsom CCF.

The following respond to the comparisons cited by the OIG:

**(a) The Program Compliance Unit checklist is overly limited.**

The PCU checklist reviewed by the OIG is a reminder of items to be reviewed. The PCU utilizes an audit guide to conduct its audit. The guide is designed to be very specific to the area of audit. The OIG report identified significant health and safety problems at the Folsom CCF recycling plant program. However, the PCU "rated the facility as in compliance in the area of safety." This difference resulted from the scope of audits and the point in time the audits were conducted. Although the recycling program is a part of the facility, operational procedures regarding the sorting functions are the responsibility of Prison Industry Authority (PIA). An evaluation of the operational efficiency of the PIA recycling program was not within the scope of the PCU audit. The PCU's review was limited to security aspects of the operation only.

**(b) The Program Compliance Unit did not fully validate information in documents.**

The OIG reports that the PCU audit team "examined Folsom CCF's quarterly and annual program cost reports and interviewed staff. Additionally, the audit concluded that the facility was in compliance because it submitted the quarterly and annual reports to the CDC." The OIG did a fiscal audit of the quarterly, annual and "other financial reports" and found Folsom CCF with "widespread fiscal mismanagement."

The PCU audit does address Program Cost Reports. The standard reads, "**The contractor has submitted the required quarterly and annual program cost reports to the Community Correctional Centers Association (CCCA).**" The PCU report did not represent that a fiscal review of the quarterly cost reports was completed, nor does the report provide an opinion on the propriety of the quarterly cost reports. The standard is clear; the quarterly and annual reports are not audited but are verified to determine if submitted to the Community Correctional Facility Administration. The PCU's audit does not assume nor have the appearance of a fiscal review. The PCU staff are selected based upon their correctional background and are not fiscal auditors. All PCU audits focus on correctional operational functions within an institution or facility. However, the November 2000 FBMAU limited scope audit did examine aspects of the annual cost report and reported findings similar to many of the issues cited by the OIG.

**(c) The Program Compliance Unit audit placed too much reliance on superficial factors.**

Determination of compliance with many of the requirements of the audit are established through careful review of written local policies, procedures, directives, and/or written files. Audits are conducted referencing specific laws,

policies, and procedures that govern the CDC operations. In addition, PCU staff physically observes the areas audited for the specific purpose of validating that operations of the institution are conducted in accordance with the established written policies and procedures. The PCU has found that utilization of a checklist pertinent to the observations is highly useful and contributes to time efficiency.

**(d) Program Compliance Unit audits do not identify causes or recommend solutions.**

The PCU focus has not been to assess causes, which are highly subjective in nature, or recommend changes to resolve problems. The audit specifically reviews operations in respect to departmental mandates, written local policies, procedures, directives, and State law. The audit is designed to assist management in improving operations by providing real-time information to management regarding deficiencies that require management attention. The deficiencies are addressed by the facility Administrator along with his/her executive staff. The PCU will at times, if requested, assist in providing solutions for deficiencies.

**FINDING 7: The Office of the Inspector General found that the audit functions of the California Department of Corrections are fragmented, with a lack of coordination of audit activities and incomplete coverage of areas requiring audit, resulting in a failure to comply with state law governing financial accountability.**

**RESPONSE: CDC Disagrees with the Finding.**

The BCP for FY 1998/99 was a step taken to consolidate fiscal audits and carry out the task of performing peer reviews in critical areas within the institutions. The PFAB has relied upon the DOF to perform the function of conducting SAM, Section 20000 audits. The DOF has informed the PFAB that they will continue to conduct CDC's internal control audits. These audits are used in part to satisfy the goals and objectives of the Financial Integrity and State Manager's Accountability Act (FISMA). Subsequent to issuance of the OIG report, the DOF reviewed CDC's FISMA report as submitted for the biennial period ending December 31, 2001. The DOF stated that the CDC met the reporting requirements established by the DOF.

**RECOMMENDATION:**

**The Office of the Inspector General recommends that the California Department of Corrections consolidate all auditing activities within the department into a professional internal auditing unit consistent with standards prescribed in Standards for the Professional Practice of Internal**

**Auditing. The chief of internal audits should report to the Chief Deputy Director for Support Services. The chief of internal audits should possess the training, knowledge, and experience to manage an internal auditing unit.**

- The CDC recently reorganized to create the new PED. This action elevated the management of PED to cabinet level. This change will ensure greater access to the CDC Executive Management and to all cabinet members for discussion and review of audit activities. The Chief of PFAB will not report directly to the Chief Deputy Director for Support Services.
- Based upon current resources, PFAB's existing operations represent the most efficient use of audit staff. However, this will not preclude management assessment of future needs and the possibility of establishing an internal audit unit within the PFAB should resources become available in the future.
- When the Chief of PFAB position becomes vacant, a review will be performed to determine the most appropriate skill set and classification for the position.

**ATTACHMENT B**  
**COMMENTS OF THE OFFICE OF THE INSPECTOR GENERAL**

**COMMENTS OF THE OFFICE OF THE INSPECTOR GENERAL  
ON THE RESPONSE OF THE DEPARTMENT OF CORRECTIONS TO THE DRAFT REPORT**

**FINDING 1**

The department maintains that the Program and Fiscal Audits Branch is not an internal audit organization and therefore is not required to adhere to the *Standards for the Professional Practice of Internal Auditing*. This contention is incorrect and illustrates a lack of understanding of the internal audit function.

Although it is true that the *California Department of Corrections Operations Manual* does not reflect all of the structural and policy changes that have occurred over the years, the mission of the Program and Fiscal Audits Branch as described in Sections 11010.26.3 and 22080.3 of the manual remains the same:

*The Program and Fiscal Audits Branch exists to independently review, evaluate, and better assure that institutions, parole regions, and headquarters are operated in accordance with CDC standards, State and federal law, and court mandates.*

*PFAB shall assist the Director and other departmental executives with increasing the effectiveness of management by systematically reviewing departmental activities to provide recommendations for improvements.*

These statements embody the very definition of internal auditing as set forth in the *Standards for the Professional Practice of Internal Auditing* of the Institute of Internal Auditors — standards to which *California Government Code* Section 1236 specifically requires all state agencies that have their own internal auditors or that perform internal audit activities adhere. That definition reads:

*[I]nternal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.*

As the department explains in its response, the Program and Fiscal Audits Branch consists of three audit units, each of which performs specific types of audits — but the essential factor to note is that all of the audits are performed for the purpose of providing Department of Corrections management with information needed to evaluate and improve department operations. Regardless of how the audits conducted by the Program and Fiscal Audits Branch are labeled —“management assessment reviews” “program compliance audits,” or “management reviews”— they fall into the meaning of internal audit activity under *California Government Code* Section 1236 and as such are required to be conducted in accordance with the *Standards for the Professional Practice of Internal Auditing*.

The department also asserts in its response that the department was relieved of its duty to comply with the *Standards for the Professional Practice of Internal Auditing* when it transferred responsibility for performing internal control audits formerly conducted by its internal audit unit to the Department of Finance. But transferring those audits to another department does not relieve the Department of Corrections of responsibility for adhering to the *Standards for the Professional Practice of Internal Auditing* for all of its other internal audit activities.

The department further asserts that the Fiscal and Business Management Audits Unit of the Program and Fiscal Audits Branch adheres to *Generally Accepted Government Auditing Standards*, and that those standards, rather than the *Standards for the Professional Practice of Internal Auditing*, are appropriate for the work that unit performs. Although using *Generally Accepted Government Auditing Standards* for specific types of outside audit engagements may be beneficial and is not prohibited, the Fiscal and Business Management Audits Unit, as a component of a larger internal audit organization, is nonetheless required by law to adhere to the *Standards for the Professional Practice of Internal Auditing* in conducting internal audits. When *Generally Accepted Government Auditing Standards* are to be used, the management of the audit organization must carefully assess the audit work to be performed to ensure that appropriate standards are followed.

That other state agencies may follow generally accepted government auditing standards is irrelevant. The work performed by the Program and Fiscal Audits Branch constitutes internal audit activity, and as such, must be conducted according to the *Standards for the Professional Practice of Internal Auditing*. Not only does *California Government Code* Section 1236 require that the standards be followed for internal audit work, *California Government Code* Section 1239 requires agencies to obtain a waiver from the Joint Legislative Audit Committee if the standards are to be waived.

We would further point out that following the *Standards for the Professional Practice of Internal Auditing* would effectively address the problems described in the remaining findings of this report. Although, as the department correctly noted in its response, *Generally Accepted Government Auditing Standards* are similar in some respects to the *Standards for the Professional Practice of Internal Auditing*, the latter provide essential management components lacking in the former.

## **FINDING 2**

The response from the department reflects an apparent misinterpretation of Finding 2. The finding makes two separate points: First, that the Program and Fiscal Audits Branch does not prepare the comprehensive annual work plan required by professional auditing standards and by the *California Department of Corrections Operations Manual*; and second, that it does not communicate effectively with the department executive staff in planning annual audit activities and reporting audit performance.

The department acknowledges that the branch does not prepare an annual work plan, but goes on to describe the reporting of individual audit findings to the wardens, deputy directors, and chief deputy directors. The Office of the Inspector General described that system of reporting in the last paragraph of Finding 2. The substance of Finding 2, however, is that the department executive staff does not actively participate in the audit planning process and that the Program and Fiscal Audits Branch does not provide management with necessary information about overall audit activities. The finding speaks to the need for a periodic reporting to the executive staff on internal audit activity performance as a whole. The purpose of this reporting is not to communicate individual audit findings, but rather to evaluate how the audit department's performance is helping to fulfill the purpose and responsibilities of the agency.

### **FINDING 3**

That the Program and Fiscal Audits Branch has begun to re-evaluate the need and frequency of the audit projects is a positive development, but the response gives no indication that the management of the Program and Fiscal Audits Branch is using a risk based approach to determine audit priorities, which is the main point of the finding.

### **FINDING 4**

The department's response merely serves to underscore the finding that the Program and Fiscal Audits Branch is not responsive to executive management requests for special audits and that, apparently as a result, such requests have been rare. With 50 auditing positions, a well-managed internal audit organization should have conducted many more special audits over a four-year period than the handful cited in the department's response. A review of the list of special requests presented in the department's response, moreover, reveals that most were limited to specific segments of the institutions' operations and that none related to department-wide policies and procedures.

### **FINDING 5**

The audit plan provided to the Office of the Inspector General staff lists 101 audits in the fiscal year June 30, 2002 in addition to 24 audits reported as in progress and carried over from previous years. Although the Program and Fiscal Audits Branch management now claims in its response that a single audit may consist of multiple contracts, the audit plan provided to the Office of the Inspector General individually lists each contract with a separate audit hour budget assigned and the criteria used to select the individual contract for audit. To argue that several of the contracts actually represent one audit is disingenuous and appears to be an attempt to divert attention from the fact that nearly three quarters of the way through the fiscal year, and with an auditing staff of 50 positions, only one final audit report has been issued.

## **FINDING 6**

The division management argues that the checklist approach used by the Program Compliance Unit in performing audits of the Folsom Community Correctional Facility was appropriate because the audits were limited in scope. The Office of the Inspector General agrees that a narrow audit scope may be appropriate in particular circumstances in order to provide management with a focused response to a specific question. But the checklist method also precludes broadening the scope of an audit in situations where evidence suggests the need for an expanded scope and encourages a tunnel vision that hinders auditors in providing management with a thorough assessment of the overall operation of the facility. The audits of the Folsom Community Correctional Facility provide an excellent example of how a highly structured audit approach may fail to reveal important issues relating to the entity under audit.

The division also points out that separate audits were performed on the Folsom Community Correctional Facility by the Program Compliance Unit and by the Fiscal and Business Management Audits Unit. But this fragmented audit approach obscures the relationship of financial matters to other programs in the facility and hinders the ability of management to consider the information in its totality.

The methodology used by the Office of the Inspector General in auditing the Folsom Community Correctional Facility is not unique to the Office of the Inspector General, but rather has been developed by professional authoritative bodies and is well accepted by practitioners in the profession. The finding points to the need for using experienced auditors in developing audit plans, audit programs, and audit procedures to carry out the department's auditing function.

## **FINDING 7**

Although the Department of Corrections has taken steps to consolidate some of its audit activities, audits are still being conducted outside the Program and Fiscal Audits Branch. This fragmented approach does not lend itself to an efficient and effective audit function. In addition, despite the division management's argument to the contrary, the Department of Corrections cannot absolve itself of its own responsibilities under the Financial Integrity and State Managers Accountability Act by virtue of having transferred its internal control audits to the Department of Finance. The Department of Corrections director retains ultimate responsibility for internal and administrative control of the department, and the internal control audits the Department of Finance is funded to perform remain an integral part of establishing management accountability.