

CALIFORNIA ASSOCIATION OF STATE AUDITORS

CASA Officers

President: Roberto Zavala
Vice-President: Jennifer Whitaker
Secretary: Laura Langston
Treasurer: Karen Dailey



May 25, 2017

Paula Rivera, Chief Audit Executive
Internal Audit Office
California High-Speed Rail Authority
770 L Street, Suite 620
Sacramento, CA 95814

Dear Ms. Rivera:

We have completed a peer review of the California High-Speed Rail Authority (Authority) for the period February 1, 2016 through January 31, 2017. In conducting our review, we followed the standards and guidelines contained in the *CASA Peer Review Guide*.

We reviewed the internal quality control system of your audit organization and conducted tests in order to determine if your internal quality control system operated to provide reasonable assurance of the following:

1. Compliance with *Generally Accepted Government Auditing Standards* issued by the Comptroller General of the United States, during the period of February 1, 2016 through January 31, 2017.
2. Conformance with *the International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors, during the period of February 1, 2016 through January 31, 2017.

Our procedures included:

- Reviewing (Audit organization's) written policies and procedures.
- Reviewing (Audit organization's) monitoring procedures and reported results.
- Reviewing a sample of audit and attestation engagements and working papers.
- Reviewing documents related to independence, training, and development of auditing staff.
- Interviewing auditing staff and management to assess their understanding of, and compliance with, relevant quality control policies and procedures.

Ms. Paula Rivera

May 25, 2017

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We have prepared a separate letter offering suggestions to further strengthen your internal quality control system.

Due to variances in individual performance and judgment, compliance does not imply adherence to standards in every case, but does imply adherence in most situations.

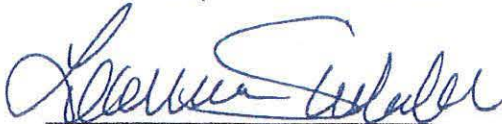
Based on the results of our review, it is our opinion that the Authority's internal quality control system was suitably designed and operating effectively to provide reasonable assurance of compliance with *Government Auditing Standards* for audits and non-audit engagements during the period of February 1, 2016 through January 31, 2017 and conformance with *the International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors for assurance and consulting engagements, during the period of February 1, 2016 through January 31, 2017.



Robert Scott, Team Leader
Office of State Audits and Evaluations
California Department of Finance



Brent Hinsz, Team Member
Internal Audits office
California Department of Consumer Affairs



Leanna Sinibaldi, Team Member
Internal Audits Branch
California Department of Motor Vehicles

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May 25, 2017

Paula Rivera, Chief Audit Executive
Audit Office
California High Speed Rail Authority
770 L Street, Suite 620
Sacramento, CA 95814

Dear Ms. Rivera:

We have completed a peer review of the California High Speed Rail Authority, Audit Office (Authority) for the period of February 1, 2016 through January 31, 2017 for audits, attestation and non-audit engagements *conducted* under *Government Auditing Standards*, and February 1, 2016 through January 31, 2017 for assurance engagements conducted under the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors.

Noteworthy Mentions

We would like to mention some of the areas in which we believe your office excels:

- Executive and senior management has a strong commitment to supporting the internal audit function.
- The Authority's Audit Manual is comprehensive and up to date. In addition, the manual is effectively organized and easy to follow.
- Continuing professional education is supported by management and is well documented.

Observations and Suggestions

We believe the Authority's quality control system complies and conforms to standards for both audits and attestation engagements. However, we offer the following observations and suggestions to help the Authority improve its quality control system and audit/attestation practice.

Observation 1: The Yellow Book Quality Control System (QCS) Independence Documentation can be Improved.

The Audit Charter and Audit Manual do not address certain independence documentation requirements such as the consideration and evaluation of independence threats, impact on the

engagement and appropriate actions or resolution. The absence of a policy to document independence threat considerations may negatively impact the quality of the engagement reports, compliance with yellow book requirements, or both.

Additionally, the Audit Charter and the Audit Manual both state the Chief Executive Officer (CEO) "is responsible for review and acceptance of draft audit reports", which threatens the Audit Office's organizational independence.

Yellow Book General Standards provide the following:

- Paragraph 3.14 states "Auditors should ... evaluate ... threats to independence when threats are being identified and evaluated."
- Paragraph 3.25 states "Certain conditions may lead to threats that are so significant that they cannot be eliminated or reduced to an acceptable level through the application of safeguards, resulting in impaired independence" or resulting in an audit being declined or terminated.
- Paragraph 3.26 states "If a threat to independence is initially identified after the auditors' report is issued, the audit should evaluate the threat's impact on the audit and on [yellow book] compliance."
- Paragraph 3.31 states "internal auditors who work under the direction of the audited entity's management are considered independent for the purpose of reporting internally if the head of the audit organization...reports the audit results both to the head of the government entity *and* [emphasis added] to those charged with governance."

Suggestion:

- Add a procedure or process in the Audit Manual to document auditors':
 - evaluation of identified threats to independence
 - its impact on the audit
 - whether the audit was declined or terminated as a result of a significant threat
 - or if the audit must be performed, that the above significant threat and impact is disclosed in the audit report as required by paragraph 3.44.
- Modify or clarify the Audit Charter and Audit Manual so that the CEO is not responsible for draft audit report acceptance.

Observation 2: The QCS can be Improved by Defining the Internal Audit Engagement types provided under Red Book.

The Audit Charter does not define the nature of red book assurance and consulting services. The audit charter formalizes the internal audit services, if any, provided by the Audit Office for the consideration of senior management and the board of directors in discharging their monitoring responsibilities. Without a clear identification of services available the effectiveness and efficiency of the audit activities may be reduced if the engagement performed does not fulfill the needs of the senior management and the board.

Red Book Attribute Standard 1000 states the purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter.

- 1000.A1 states the nature of assurance services provided to the organization must be defined in the internal audit charter.
- 1000.C1 states the nature of consulting services must be defined in the internal audit charter.

Suggestion:

Update the Audit Charter to provide management and the board of directors with a list of audit and consulting services provided by or not available from the Audit Office.

Observation 3: Working paper documentation for Audit and Attestation Engagements did not always comply with the Authority's Audit Manual.

The peer reviewers observed the QCS documented in the Audit Manual provided procedures and processes to ensure quality audit and attestation engagements with well supported reports. However, we found a few instances where the Audit Manual was not followed. Below are the examples of non-compliance identified in our review sample.

- Three out of the five attestation or audit engagements reviewed did not evidence supervisor review in accordance with the Audit Manual.
- Two out of the three yellow book audits reviewed did not consistently use source document tick marks or cross-referencing to support facts and numbers.
- One out of five audits did not have a statement of independence.

The Audit Manual section:

- 2.1.5 provides the "goal of quality assurance is to ensure that all work is performed in accordance with ... auditing standards and office policies and procedures."
- 3.5.1 provides "All working papers should undergo a detailed, first level review by ... the audit manager. Further, "... all working papers are signed and dated by the reviewer after the detailed review is completed."
- 3.5.2 provides that "A Supervision, Review, and Approval Form ... should be prepared for all engagements to provide additional documentation of the supervisory review."
- 3.3.5 provides that "To produce clear and effective working papers auditors should use the following working paper techniques:
 - Tick Marks ...
 - Cross-Referencing ..."
- 3.2.3 provides that "Auditors need to prepare and sign the Statement of Independence form ... stating that no impairments exist either individually or as an organization. ... Include a copy of this form in the working papers."

Suggestion:

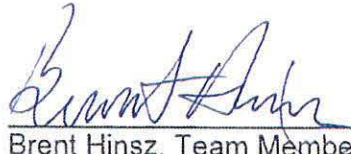
Consistently follow the QCS documented in the Audit Manual.

Ms. Paula Rivera
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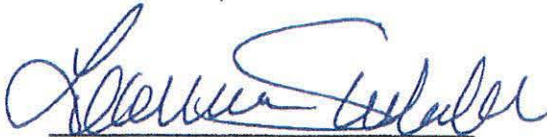
We extend our thanks to you, your staff, and the other Authority officials we met for the hospitality and cooperation extended to us during our review.



Robert Scott, Team Leader
Office of State Audits and Evaluations
California Department of Finance



Brent Hinsz, Team Member
Internal Audits office
California Department of Consumer Affairs



Leanna Sinibaldi, Team Member
Internal Audits Branch
California Department of Motor Vehicles



May 31, 2017

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Roberto Zavala, President
California Association of State Auditors

Dear Mr. Zavala,

I would like to thank the California Association of State Auditors for providing a program where state agencies can obtain a peer review in accordance with Government Auditing Standards and International Standards for the Professional Practice of Internal Auditing. A peer review was performed of the California High-Speed Rail Authority Audit Office in April 2017.

The peer review team has issued a management letter which identifies that the Authority's quality control system complied with and conforms to standards. In addition, three observations were made with accompanying suggestions. We appreciate the observations and suggestions and will make appropriate changes to our audit charter and audit manual. Specifically, we will do the following:

- Observation 1: Strengthen our existing Audit Manual guidance related to independence and make appropriate revisions to the Audit Charter.
- Observation 2: Revise the Audit Charter to list services provided by the Audit Office.
- Observation 3: Communicate the importance of quality documentation.

The Authority Audit Office is committed to performing audits that comply with audit standards and providing high-quality audit services. If you have any questions or concerns, please contact me at 916-403-2679 or paula.rivera@hsr.ca.gov.

Sincerely,

Paula Rivera
Chief Auditor

- cc: Mr. Michael Rossi, Chairman, Finance and Audit Committee, California High-Speed Rail Authority
- Mr. Tom Richards, Vice-Chairman, Finance and Audit Committee, California High-Speed Rail Authority
- Jeff Morales, Chief Executive Officer

EDMUND G. BROWN JR.
GOVERNOR

