



The New York State Internal Control Act Implementation Guide:

Strengthening Compliance With the Act and Standards

September 2006

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**Compliance Roadmap for Internal Control Officers, Directors of
Internal Audit and Other Stakeholders**



Acknowledgements and Executive Summary

ACKNOWLEDGEMENTS

About the Report

The New York State Internal Control Task Force (ICTF), led by a Steering Committee, was comprised of six Work Groups coordinated by Task Force Liaisons from the Division of the Budget (DOB), the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA).

More than 70 Internal Control Officers (ICO) and Directors of Internal Audit (DIA) participated in this collaborative effort, representing 46 State agencies and public authorities. This report was made possible by the volunteerism, support, dedication and commitment of the individuals and agencies acknowledged in this report.

Research Groups

The contents of this study were developed by the NYS ICTF from its original research, professional guidance, and literature. It builds upon earlier reports by the New York State Assembly, audit reports by the OSC, and DOB budget bulletins.

Stakeholder Groups

Stakeholders in this study include State Agencies, Public Authorities, the Division of the Budget, and the Office of the State Comptroller. These stakeholders were represented by a collective group of individuals from each of these entities. They came together to form the ICTF.

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Executive Summary

OVERVIEW

This guide provides recommendations directed toward all parties responsible for the management, implementation and oversight of internal controls in New York State, including:

- Agency Management – At the direction of Executive Management, Internal Control Officers (ICO) and Directors of Internal Audit (DIA) will be expected to implement the various recommendations to strengthen compliance with the Internal Control Act.
- Division of the Budget – DOB will be revising certain reporting requirements and improve coordination and assistance provided to covered agencies and authorities.
- Office of the State Comptroller – OSC will be revising its Standards for Internal Control in New York State Government and provide additional guidance and assistance on the operation of internal audit units and continuing professional education of internal auditors.
- New York State Internal Control Association – NYSICA will be taking a more active role in providing internal control training and education.

This guide includes six workgroup reports. The first two reports apply to all covered State agencies. The remaining reports, which focus on internal auditing, apply to only those agencies that are required to have an internal audit function. The recommendations included in these reports are intended to provide you, the agency executive, with an improved level of assurance that an appropriate set of controls are in place within your agency and are functioning properly. Improving two of the key pillars of agency governance – internal control and internal audit – will also improve, in many cases, agencies' compliance with the requirements of the New York State Governmental Accountability, Audit and Internal Control Act (the Internal Control Act). As the head of your agency, you should work with your management team to ensure these important changes are adopted and implemented in your agency where needed.

BACKGROUND

In 2004, the Office of the State Comptroller (OSC) issued a report that assessed State agencies' internal audit units' compliance with the Internal Control Act. OSC's report (2003-S-14) noted a significant degree of noncompliance with the Internal Control Act by the 34 agency internal audit units that had been established under the Act. More than half of the 34 agencies had numerous instances of non-compliance; most agencies showed the need for at least some improvements. Widespread problems involved the structure of the internal audit units, including Director and staff qualifications, training, as well as individual and organizational independence. In addition, many internal audit units were not providing the proper oversight of their agencies'

operations because they did not conduct risk assessments of agency operations, prepare audit plans to guide their work, evaluate their agencies' internal controls, or have a process to monitor and assess their overall effectiveness as an internal audit unit. Two agencies did not even have an internal audit unit.

COMPREHENSIVE APPROACH TO ACHIEVING COMPLIANCE

In response to OSC's audit, the Division of the Budget (DOB) proposed a jointly sponsored "internal audit best practices group" to assist agencies in complying with the Act. Building upon this proposal, an Internal Control Task Force (ICTF) was established in October 2004 as a joint effort of DOB, OSC and the New York State Internal Control Association (NYSICA). The ICTF established six work groups comprised of over 70 auditors and internal control professionals from 46 agencies. The main objectives of these work groups were to establish baseline standards and showcase best practices for both internal control and internal auditing in New York State. More-specific issues include the following:

- Providing guidance and assistance to internal control officers in developing, evaluating and maintaining internal control systems;
- Developing an ongoing internal control education and training plan for all agency officers and staff;
- Developing guidance on organizing and staffing internal audit units;
- Developing guidance and identifying best practices for internal audit units to comply with the operational aspects of the Act and professional audit standards, including evaluation of internal controls and risk-based audit planning;
- Designing plans to help internal audit units meet mandatory continuing professional education requirements; and
- Establishing a cost-effective system for internal audit units to meet peer review requirements.

ACCOMPLISHMENTS TO DATE

In May 2005, presentations from each of the six work groups were made to over 400 internal control and audit professionals from across the State who attended a full-day leadership seminar. Each group submitted draft recommendations to the ICTF in September 2005 and action has already been taken to implement several important recommendations, including:

- Updating and re-issuing the Comptroller's Standards for Internal Control in New York State Government in December 2005 to reinforce baseline expectations for internal control systems at the agency level. These revisions were based in large part on input from ICTF participants and comments received in response to an earlier exposure draft.
- Developing an ICTF Internal Control Implementation Manual which provides guidance on establishing and maintaining an internal control system for State agencies. This manual, which is part of this report, addresses issues ranging from the roles and responsibilities of everyone from Agency Heads to line staff, and the steps they should take to design, implement, monitor, evaluate and continually update the agency internal control system. The manual has been made available to all agencies through NYSICA, which has also held conferences to introduce the new material to internal control officers.
- Developing an overall framework for a centralized web-based resource library which will make internal control training programs and materials available to all agencies through NYSICA's website. These materials are targeted toward the specific needs of agency executives, middle managers and line staff and are available in a variety of formats.
- Instituting a cooperative peer review process to help agency internal audit units meet the December 2006 deadline established by professional standards. In October 2005, OSC and DOB jointly funded a three-day training program to provide over two dozen agency internal auditors with the skills necessary to conduct professionally recognized quality assessments of internal audit operations. Coordinated by DOB, this process now organizes teams of trained auditors to conduct the mandated assessments.

REPORT RECOMMENDATIONS

This report includes significant recommendations for actions that State agencies, DOB, OSC and NYSICA can each take to strengthen internal controls and ensure continued compliance with the Act. These actions include:

- Providing this report to agency management so that they may more readily identify opportunities to improve internal control and internal audit activities and make improvements based upon the report recommendations contained in the remainder of this report.

- Expanding the Comptroller’s Standards for Internal Control in New York State Government to include a section emphasizing the value of internal auditing as a supporting activity to a comprehensive internal control system and containing baseline requirements and suggested best practices. These requirements will address many of the Work Groups’ recommendations and, in addition to requirements already established in professional standards, will form the basis for minimum standards and operating expectations for New York State agency internal audit units.
- Expansion of DOB’s internal control certification process to require additional information and documentation for critical issues such as the organization and placement of internal audit units.
- Expansion of the State’s ability to provide internal audit services to agencies that do not currently have their own audit resources. Proposed actions will range from shared service arrangements to analysis of staffing and other resource requirements and periodic re-evaluation of which agencies should be required to establish internal audit functions.

AGENCY ACTIONS

In recognition of the need to bring about meaningful improvement in State agency internal control systems and Internal Audit functions, this comprehensive, unprecedented document was prepared to assist agency management at all levels with identifying and acting upon the recommendations contained throughout the report. In order to facilitate State Agency implementation of the recommendations, the task force has compiled the list of actions items shown below. Specifically, we are recommending that agencies:

1. Improve the coordination and implementation of the internal control program by adopting the "Essential Elements for an Effective Internal Control System" contained in section 1 of the report (see pages 1 – 31);
2. Ensure that agency personnel know about internal controls by: 1) Establishing objectives and key concepts to include in internal controls training for employees; 2) developing targeted training for various employee levels (e.g., staff, supervisors, managers); and 3) establishing an ongoing training program in order to ensure the agency maintains a consistently high knowledge base regarding internal controls (see pages 33 – 43);
3. Take action to assure that the internal audit function is sufficiently independent from the organization by: 1) ensuring that Internal Audit reports directly to the highest levels of the agency, and 2) making every reasonable effort that the internal audit function is separate and distinct from having other operational responsibilities or conducting activities that are part of ongoing agency operations (see pages 45 – 61);
4. More fully utilize Internal Audit to provide agency top management with independent assessments regarding the functioning of agency operations, by considering the following: 1) require internal audit to provide annual reports to the Agency Head

- (and audit committee, if applicable) that foster the ability to review and evaluate internal audit activities; 2) evaluate staffing levels and the best approach for obtaining adequate internal audit coverage, including the ability to obtain specialists with expertise in areas being audited, such as Information Technology; and 3) have internal audit staff participate in the ongoing efforts of the ICTF to assess internal audit staffing needs and develop plans to address recognized needs; (see pages 63 – 107);
5. Establish or maintain a highly-effective internal audit function by adopting and adapting to the internal audit best practices provided in the Internal Audit Process section (pages 109 – 118), in addition to complying with the International Standards for the Professional Practice of Internal Auditing;
 6. Ensure the quality of the internal audit workforce by implementing a continuing education program that includes the elements of the NYS Internal Auditor Continuing Education Guidance document (see pages 119 – 142), utilizing shared resources established by OSC and DOB for facilitating continuing education and CPE tracking; and
 7. Have an external quality assurance review (QAR) of internal audit conducted as soon as practicable. If you prefer, participate in the cooperative internal audit peer review process being established statewide (see pages 143 – 148).

CONCLUSION AND NEXT STEPS

This report by the ICTF is the result of interagency cooperation made possible by examining the internal control and internal audit programs across agency lines in a constructive and cooperative manner. As a result of this innovative set of recommendations for these two programs, we are confident that if all who receive this report adopt its recommendations, it will result in a systematic fundamental change of a magnitude not seen in the almost 20 years since the Act was first implemented. On the other hand, individual efforts made without this guidance will take longer, and effect only smaller improvements at fewer agencies that might not be sustainable. To help facilitate implementation of these recommendations, Appendix A of this report provides a Compliance Roadmap for Internal Control Officers, Directors of Internal Audit and Other Stakeholders.

The ICTF is encouraged by the accomplishments made thus far; however, several other recommendations included in the following pages require further study. The ICTF will continue to work on these issues and welcomes input and feedback from agencies. Future ICTF reports will highlight progress on the status of implementing other significant recommendations.

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Internal Control Program Coordination and Implementation

ACKNOWLEDGEMENTS

About the Report

This is one of nine reports that were issued by the New York State Internal Control Task Force (ICTF) in the summer of 2006.

The ICTF, led by a Steering Committee, was comprised of six Work Groups coordinated by Task Force Liaisons from the Division of the Budget (DOB), the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA).

Authors

The following workgroup members were co-authors of this report:

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Research Groups

The contents of this study were developed by the ICTF from its original research, professional guidance, and literature. It builds upon earlier reports by the New York State Assembly, audit reports by the OSC, and DOB budget bulletins.

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BACKGROUND

The Internal Control Program and Implementation Workgroup was one of six workgroups established by the New York State Internal Control Task Force. The group was charged with providing guidance and assistance to NYS agencies and authorities on the development and maintenance of internal control systems, and overall compliance with the Internal Control Act.

Several outcomes were initially established for the workgroup including:

- Providing guidance on the development and maintenance of agency internal control systems and on developing guidelines and management policy statements.
- Providing guidance on implementing effective internal control review and testing programs.
- Providing guidance regarding the Internal Control Officer function and its relationship to the Internal Audit function.

RESULTS IN SUMMARY

The workgroup developed a comprehensive manual to assist agencies in establishing and maintaining internal control systems in New York State and in meeting requirements of the Internal Control Act. As a first step, a hard copy manual was prepared and is contained in this report. The manual has also been posted on the NYS Internal Control Association's website.

The manual covers the following key areas that all NYS agencies and authorities should consider in establishing their internal control programs including: background information, roles and responsibilities, processes for establishing an internal control system, organizing an internal control reporting program, reviewing and testing internal controls, developing internal control improvement areas and corrective actions, updating internal control systems, documentation requirements and quality assurance. The manual also includes a list of essential elements for developing and maintaining an effective internal control system. These elements can be thought of as baseline recommendations.

The manual's appendix includes background and resource documents including the Internal Control Act, DOB Budget Bulletin, OSC Internal Control Standards, examples of agency policy statements, educational material and pamphlets, assessment review and testing forms, DOB's Manager's testing manual, a directory of Internal Control Officers and Practitioners and links to other resources.

OBJECTIVES AND METHODOLOGY

The Workgroup's objective was to prepare a manual that could be utilized by all NYS agencies and authorities including organizations of different sizes and structures (i.e. centralized and decentralized agencies). The diverse nature of the workgroup members, who came from a cross section of State agencies, helped facilitate meeting this objective through sharing of their agencies' practices and materials.

In addition, in order to learn more and obtain input from New York State agencies and authorities, the Task Force conducted a survey. Results from the workgroup's component of that survey are also being utilized as part of the information contained in the manual.

RECOMMENDATIONS

Agency management should adopt the following "Essential Elements for an Effective Internal Control System" as outlined in Section XI of the manual.

1. Each Agency/Authority Head should provide a communication to all staff in support of that agency's or authority's internal control program, including the importance of assessing one's internal controls.
2. Each agency should determine whether its internal control program will include a preliminary risk/preliminary vulnerability self-assessment, performed by function.¹
3. Each agency's internal control program should include a detailed/in-depth assessment of each function, either for those functions that were assessed as having High or Moderate vulnerability (or higher risk) as a result of the preliminary risk/preliminary vulnerability assessments, or for all functions if the agency's internal control program does not include a preliminary risk/preliminary vulnerability assessment. This more detailed/in-depth assessment should include the identification of inherent risks and internal controls for each function.
4. Each internal control program should establish the frequency of the reporting cycles for each preliminary risk/preliminary vulnerability assessment, internal control review, and any other internal control reporting documents (please see paragraphs 2 and 3, above). In addition, each agency should establish a maximum length of time that will be acceptable between reviews or updates of internal control reporting docu-

¹ For further information, please refer to section VI, paragraph A ("Conducting Preliminary Risk or Vulnerability Assessment and Internal Control Revisions") on page 20 of this report.

- ments (preliminary risk/preliminary vulnerability assessments and internal control reviews) of low risk or low vulnerability functions, such as five years.
5. Each internal control program should establish an approval/oversight or independent review process of the preliminary risk/preliminary vulnerability assessments and the more detailed/in-depth internal control reviews, either by a Steering Committee, the Internal Control Officer (ICO), the Internal Control Coordinator or Supervisory review.
 6. Each agency's internal control program should establish the periodic review of the agency's organizational structure and its inventory of functions, with the agency establishing a maximum length of time between any needed updates, in order to ensure that the program is accurate and up-to-date.
 7. Each agency's internal control program should establish a process for the identification of improvement areas and weaknesses and their corresponding corrective actions, as well as the implementation status of all corrective actions.
 8. Each internal control program should establish and maintain documentation standards, including what needs to be kept; by whom; where; and for how long. We recommend that the ICO/IC Coordinator maintain documentation sufficient for the independent validation/audit by OSC of the certification process. The length of time established for retaining internal control documents should coincide with the maximum amount of time established between reporting cycles for low risk/low vulnerability functions, such as five years or until the next reporting cycle has been completed and approved. If the maximum amount of time between reporting cycles is longer than the minimum retention schedule as established by SARA, the agency or authority should retain the appropriate documents for the length of time that corresponds to the longest reporting cycle.

INTERNAL CONTROL TASK FORCE

Internal Control Program Coordination and Implementation Workgroup Guidance on Establishing and Maintaining Internal Control Systems in New York State Government

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II. Background Information and Introduction

- A. Definition of Internal Control
- B. Statutory Requirements (includes summary of Internal Control Act; refer to Appendix 1 for a copy of the entire statute and a link to an electronic copy)
- C. Regulatory Requirements (includes DOB BPRM Item B-350 and annual certification requirements; refer to Appendix 2 for a copy of BPRM Item B-350 and a link to an electronic copy)
- D. Internal Control Standards for NYS Government (refer to Appendix 3 for a copy of these standards and a link to an electronic copy)

III. Roles and Responsibilities

- A. Agency Head (includes importance of establishing the correct “tone at the top”)
- B. Internal Control Officer
- C. Internal Control Coordinators and Practitioners
- D. Agency Management and Supervisors
- E. Agency Staff (non-management, line staff)
- F. Internal Audit (includes potential limitations on Internal Auditor independence if also performing certain Internal Control Officer (ICO) responsibilities)

IV. Establishing a System of Internal Controls

- A. Establishing the right tone for encouraging and nurturing a healthy internal control environment. Refer to Appendix 4 for examples of agency “Tone at the Top” policy statements).
- B. Designation of an Internal Control Officer
- C. Establishing the Management, Oversight and Reporting Process for the Agency’s Overall Internal Control Program (*e.g.*, the Internal Control Act requires the ICO to report to Agency Head, how to make decisions and communicate information about the Internal Control Program)

- D. Establishing the Process for Internal Control Education, Training and Awareness (refer to Appendix 5 for examples of agency educational material/ pamphlets)

V. Organization of Internal Control Reporting Program

- A. Organizing the Agency into Assessable Units (how to segment the agency for reporting purposes – the organizational structure, functions)
- B. Identifying Each Unit’s Major Functions
- C. Examples of Assessable Units and Major Functions
- D. Assignment of Responsibilities
- E. Scheduling and Conducting Vulnerability Risk Assessments, or Internal Control Reviews, (*i.e.*, establish frequency/reporting cycles)

VI. Internal Control Review and Testing

- A. Conducting a Preliminary Risk or Preliminary Vulnerability Assessments and Internal Control Reviews (high-level review, if performed, and more detailed review and/or testing; refer to Appendices 6, 7 and 8 for examples of assessment/ review/testing forms)
- B. Testing (refer to Appendices 6, 7, and 8 for examples of assessment/review/testing forms; refer to Appendix 10 for DOB Manager’s Testing Guide)
- C. Who is Responsible for Internal Control Review and Testing?
- D. Defining Inherent Risk and Internal Controls

VII. Internal Control Improvement Areas and Corrective Action

- A. Identifying Improvement Areas/Internal Control Weaknesses and Corrective Actions
- B. Documenting, Monitoring and Reporting Corrective Actions
- C. Establishing Documentation Requirements
- D. Establishing Reporting Cycle and Monitoring of Corrective Action Implementation Status (refer to Appendix 9 for examples of assessment/corrective action forms)

VIII. Review and Update of Internal Control System (the process for updating the internal control program due to changes in either organizational structure, changes in functions, or other factors which should require update to program prior to next formal update cycle)

IX. Documentation (establish documentation process - what kept, where, by whom, how long)

X. Quality Assurance (consider methods for addressing the effectiveness of Internal Control System and who could perform such evaluating – the ICO, Internal Control Practitioner, designated committee or team)

XI. Essential Elements for an Effective Internal Control System

XII. Appendices/Document Links

Appendix 1 - Internal Control Act (include Public Authorities Law for authorities)

Appendix 2 - DOB BPRM Item B-350

Appendix 3 - OSC Internal Control Standards

Appendix 4 - Examples of Agency “Tone at the Top” Policy Statements

- a. Memo from Commissioner of Dept. of Correctional Services
- b. Memo from Director of NYS Office For the Aging

Appendix 5 - Examples of Agency Education Material/Pamphlets

- a. Internal Control Guidelines: SUNYA
- b. Brochure: NYS Dormitory Authority
- c. Brochure: NYS Office of Children and Family Services
- d. Brochure: NYS Dept. of Tax and Finance
- e. Brochures: NYS Dept of Labor
- f. E-Mail Newsletter and Poster: Dept of Labor

Appendix 6 - a. Internal Control Review: NYS Dept. of Environmental Conservation

- b. Internal Control Review: NYS Dept. of Labor
- c. Internal Control Review, Corrective Action Status Report and Testing Record: NYS Tax and Finance
- d. Internal Control Risk Assessment: NYS Office For Technology
- e. Employee Internal Control Survey developed by NYS Office of the State Comptroller
- f. NYS Division of the Budget Testing Guide

Appendix 7 - Directory of Internal Control Officers and Internal Control Practitioners

Appendix 8 - Links to other resources (addresses to websites)

To access any of these appendices, please visit The New York State Internal Control Association web page at <http://www.nysica.com> .

I. Preface

The Division of the Budget (DOB), the New York State Internal Control Association (NYSICA) and the Office of the State Comptroller (OSC) created the Internal Control Task Force in response to OSC's audit report on "State Agency Internal Audit Units' Compliance with the Internal Control Act." This interagency task force consists of six work groups and is charged with the responsibility of addressing both the internal audit compliance issues identified in the report, as well as providing compliance guidance on the internal control requirements of the Internal Control Act.

This document is the product of the Internal Control Program Coordination and Implementation Work Group. It provides general information on:

- Internal control guidance and assistance on establishing an internal control system
- Developing agency guidelines and management policy statements,
- Essential elements for an effective internal control system,
- Examples of forms, policy statements and other documents that constitute "best practices" developed and implemented by various state agencies, and
- Links to resources and reference materials.

This document provides recommended steps to take and guidance for the development and maintenance of a system of internal control. This document is designed for use by any state agency or authority, but is not intended to set forth the exact steps to be followed in order to be in compliance with the Internal Control Act. State agencies and authorities differ greatly in size, and in organizational structure (i.e., centralized vs. decentralized). There is no one, single internal control system or program to fit all. We intend that organizations should use the guidance provided in this document, along with the reference materials and any applicable or helpful sections from the best practice examples, to develop and implement a system of internal control that meets the needs of your agency or authority and also enables it to be in compliance with statutory internal control requirements and standards.

II. Background Information and Introduction

A. Definition of Internal Control

Internal control or an internal control system is the integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its objectives and mission. Simply put, internal controls are about making sure the right things are being done by the right people working together to successfully achieve the organization's goals.

A program of internal control review goes hand in hand with establishing an internal control system. The review system should be a structured, continuous and well-documented system designed to identify internal control weaknesses and/or improvement areas, identify actions that are needed to strengthen controls and/or correct these weaknesses, monitor the necessary corrective actions and periodically assess the adequacy of an agency's or authority's internal controls. A well designed and executed internal control review is intended to provide management with reasonable assurance that the internal control system is working as intended, that risks are appropriately controlled, that the system meets established standards and that it is helping management meet its goals and expectations. Agencies and authorities can adopt a system of internal control tailored to their needs, size, complexity and degree of centralization. The procedures for evaluating the adequacy of this system will vary. However, the chosen methodology should be well defined and clearly documented.

B. Statutory Requirements

More than ever, there is a demand from the public that government resources be used efficiently, economically and effectively. Government employees entrusted with public resources are responsible, among other things, for complying with laws and regulations, meeting goals and objectives, and safeguarding assets. A good internal control system can assist government employees in carrying out these responsibilities.

In 1987, the Legislature enacted a law entitled New York State Governmental Accountability, Audit and Internal Control Act of 1987. This Internal Control Act highlighted the need for agency management to promote good internal controls and accountability in government. It also required State agencies to establish effective internal control systems that are consistent with their mission and objectives and establish programs for internal control review to identify and correct control weaknesses.

The Legislature, recognizing the importance of internal control, updated and made the Internal Control Act permanent effective January 1, 1999 in Chapter 510 of the Laws of 1999. (See also, Chapter 18, Article 45 in McKinney's Consolidated Laws of New York, Executive Law §§950-954). The updated laws refined the concepts in the 1987 statute to ensure that the Act's provisions were consistent with current professional internal control standards and the practices of private and public organizations.

The Internal Control Act defines internal control and sets forth six internal control responsibilities for State agencies. These six requirements are listed below along with an explanation of State agencies' annual certification process regarding compliance with the Internal Control Act.

C. Regulatory Requirements

The Division of the Budget (DOB) has issued Budget Policy and Reporting Manual (BPRM) Item B-350 “Governmental Internal Control and Internal Audit Requirements” that outlines the efforts required of State agencies and public authorities “to provide for a comprehensive system of internal controls to enhance the integrity of governmental operations....”

While Agency Heads, authority boards, and top executives in authorities are responsible for setting the tone of their organizations, it is the Agency Head or the authority’s top executive who is accountable for the implementation of effective internal control systems in their entities, including ensuring that there are appropriate internal controls for all programs, regional offices, facilities and boards, commissions, committees, and councils. These internal controls should also be consistent with State laws, rules, regulations, and applicable statewide administrative and financial practices.

According to the Internal Control Act and DOB’s BPRM Item B-350, State agencies and covered authorities are required to perform certain internal control responsibilities. Below are six specific responsibilities, which have been excerpted from DOB’s BPRM Item B-350:

1. **“Establish and maintain guidelines for a system of internal controls for the agency or authority.** Internal control guidelines communicate the management and programmatic objectives of an agency or authority to its employees and provide the methods and procedures used to assess the effectiveness of the agency’s or authority’s internal controls in supporting these objectives.”
2. **“Establish and maintain a system of internal controls and a program of internal control review for the agency or authority.** The program of internal control review shall be a structured, continuing and well-documented system designed to identify internal control weaknesses, identify actions that are needed to correct these weaknesses, monitor the implementation of necessary corrective actions and periodically assess the adequacy of agency’s or authority’s internal controls.”
3. **“Make available to each officer and employee of the agency or authority a clear and concise statement of the generally applicable management policies and standards with which the officer or employee of such agency or authority shall be expected to comply.** Such statements shall emphasize the importance of effective internal controls to the agency or authority and the responsibility of each officer and employee for effective internal controls.”
4. **“Designate an internal control officer, who shall report to the head of the agency or authority or to their designee within the executive office, to implement and review the internal control responsibilities established pursuant to this Item [sic]. The designation of an internal control officer should also be communicated to employees.”**

5. **“Implement education and training efforts to ensure that officers and employees have achieved adequate awareness and understanding of internal control standards and, as appropriate, evaluation techniques.”**
6. **“Periodically evaluate the need to establish, maintain or modify an internal audit (IA) function.”**

Each year, DOB issues a Budget Bulletin to covered State agencies and authorities containing the “Internal Control Certification” form along with a request for additional information in support of the State agency’s certification which is to be provided and submitted in the “Internal Control Summary” along with the certification document.

Each head of a covered State agency or authority who has met the internal control responsibilities outlined above signs and submits the compliance certificate to the Director of the Budget on or before March 31 annually. Through this document, the official is affirming that his or her agency or authority has complied with the six specific responsibilities listed above. The Internal Control Certification should be accompanied by the Internal Control Summary, a brief overview of the major internal control activities undertaken during the year, including a description of the management actions to strengthen internal controls, and a synopsis of key findings and corrective actions.

Any agency or authority head who is unable to certify should submit by March 31 an outline and timetable of actions to achieve compliance and subsequent certification as soon as practicable.

D. Internal Control Standards for NYS Government

With the passing of the 1999 Internal Control Act, Article 2, Section 8 of the State Finance law was revised to require the State Comptroller to issue internal control standards. The Internal Control Act also specifically authorized the State Comptroller to issue control standards applicable to State agencies and public authorities. The purpose of the Standards is to guide government employees in carrying out their responsibilities. This guidance is not intended to take the place of management’s judgment or to dictate how management chooses to carry out its responsibilities. This document also advises government employees of the Standards against which the performance of their programs and organizations will be assessed. It may be found at the following link: (http://www.osc.state.ny.us/agencies/ictf/docs/intcontrol_stds.pdf).

III. Roles and Responsibilities

A. Agency Head

The Agency's or Authority's top executive ("Agency Head") has the ultimate responsibility for establishing and maintaining an effective system of internal control for the Agency or Authority.

The Agency Head and his or her executive management team (or in the case of an Authority, the Officers and the Chair of its governing Board, as applicable) set the organization's "tone" regarding internal control. Commonly referred to as setting the "tone at the top," this is a natural process, which occurs whether it is intentional or unintentional. If executive management does not establish strong, clearly stated support for internal control, the organization as a whole may not practice good internal control. Conversely, strong support for internal control can be effectively demonstrated by various forms of communications intended to emphasize the value and importance of internal controls and the expectation that all Agency employees will carry out their duties in accordance with good internal controls. It can also be demonstrated by the actions of the Agency Head, and management in general, by following a course of conduct which is in compliance with the Agency's system of internal control and generally accepted internal control standards.

The Act requires that the Agency Head appoint or designate an Internal Control Officer for the Agency to implement and review various responsibilities set forth in the Internal Control Act, and that this individual report to him/her. The designation should be clearly communicated to the employees of the Agency.

The Head of the Agency is also responsible for signing an annual certification (pursuant to DOB's BPRM Item B-350) that the entity is generally in compliance with the six requirements set forth in the Internal Control Act. The certification is normally required to be submitted to DOB on or before March 31 each year.

B. Internal Control Officer

The Internal Control Act requires the head of each covered State agency or authority to designate an Internal Control Officer (ICO), who shall report directly to the Agency Head. The ICO assists the Agency Head and Agency management, and has responsibility for implementing, maintaining and reviewing the Agency's system of internal controls. The ICO should be familiar with general internal control concepts and principles and be able to work with management to apply these principles to the Agency's operations to determine that the system of internal controls is

functioning and effective. For more information on the role of the ICO, please refer to section IV of this manual.

C. Internal Control Coordinators and Practitioners

The ICO may be assisted by additional agency staff to coordinate or administer various aspects of the internal control program. In some agencies, an Internal Control Coordinator or Practitioner is responsible for administration of the internal control program for the Agency.

D. Agency Management and Supervisors

Generally, managers of the organization have primary responsibility for the system of internal controls because they are most familiar with the objectives, risks and control procedures for their areas of responsibility within the organization. Managers are responsible for cooperating with the ICO and other internal control staff in carrying out responsibilities for periodically reviewing and testing the system of internal controls, as well as for identifying and implementing appropriate corrective actions.

E. Agency Staff

All Agency employees play an important role in maintaining strong internal controls. Agency staff are responsible for carrying out their assigned duties in a manner which complies with the Agency's system of internal control.

F. Internal Audit

Internal audit is an appraisal activity established by the management (or in the case of some authorities, by the board) of the organization for the review of operations as a means of assuring conformance with management policies and the effectiveness of internal controls. Internal audit activities are required to be conducted in conformance with generally accepted standards for internal auditing. These standards include a requirement that the internal auditor must maintain independence from the activities that are audited, and should not perform an audit on procedures and processes that the individual created. As such, internal audit staffs who also have responsibility for all or part of the internal control program for the Agency should exercise care in carrying out internal control program responsibilities so as not to jeopardize the ability to perform internal auditing activities in accordance with internal audit standards.

IV. Establishing a System of Internal Controls

A System of Internal Controls (IC System), as defined in the BPRM Item B-350, is “the integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its objectives and mission.” An IC System should help ensure that each program area’s (or assessable unit’s) objectives and the overall mission of the organization are achieved. According to the “Standards for Internal Control in New State Government”, an IC System needs to address all five inter-related internal control components: Control Environment, Communication, Assessing and Managing Risk, Control Activities, and Monitoring. Below are some key points in establishing an organization’s IC System.

A. Establishing the Right Tone

Establishing the right tone is a significant aspect of the Control Environment, and is therefore critical for the success of an organization’s IC System. Management must not only be committed to the organization’s IC System, but must also communicate that commitment to staff. There are several ways Executive Management generally communicates its commitment to the organization’s IC System. These include:

- A formal statement from the Agency Head supporting the concept of internal controls, and providing all staff with an understanding and awareness of the benefits of effective controls.
- Issuance of an agency policy or other such document describing the organization’s IC System and its program or process for reviewing and reporting on internal controls. By formally documenting and distributing a policy statement in this manner, management communicates to staff that this is important to the success of the organization.
- Communication of the status of the IC System to staff through normal communication channels. These might include occasional articles in the organization’s newsletter, discussion topic at employee meetings, or an annual e-mail to all staff. By continually highlighting the IC System and its benefits, management communicates its support.

In addition to communicating support for the IC System, management can establish a positive “tone at the top” by demonstrating a “*supportive attitude*” toward the program. The Standards for Internal Control in NYS Government issued by OSC describes a supportive attitude as “a disposition that encourages desired outcomes.” This supportive attitude then permeates the atmosphere of the organization, emphasizing the role of internal controls in ensuring that the organization fulfills its mission.

Management can demonstrate a supportive attitude by fully participating in IC System activities, including attending training programs and completing control assessments of their functions. Moreover, management can incorporate the results of the IC System's work products in its decision making process, attaching significance to and deriving value from the work beyond that achieved by merely complying with BPRM Item B-350.

B. Designation of an Internal Control Officer

The Internal Control Act requires the head of each agency to “designate an internal control officer to implement and review the internal control responsibilities” that are established in section 951 of Executive Law. Those responsibilities include, but are not limited to, establishing and maintaining a system of internal controls and a program of internal control review; making management policies and guidelines available for all employees; and ensuring that employees have an adequate awareness of and understanding of internal control standards through the implementation of education and training efforts. In general terms, the role of the Internal Control Officer (ICO) is to work with appropriate personnel within the organization to coordinate the internal control activities and to ensure that the organization's internal control program meets requirements established by law and by DOB. The Standards for Internal Control in NYS Government issued by OSC states that “While the ICO has responsibility for both implementing and reviewing the organization's internal control efforts, the organization's managers are still responsible for the appropriateness of the internal control system in their areas of operation.”

Based on this description, the ICO should have good communication, organization and coordination skills, as well as a strong understanding of the concepts of internal controls. Moreover, the ICO should be able to work with organization managers and staff to facilitate the implementation of the IC System.

It is important to recognize that, while the ICO analyzes internal control assessments for adequacy and completeness, he or she is not responsible for the determinations made in those assessments. Therefore, the ICO does not have to have detailed technical knowledge of all aspects of the organization's operations. Instead, the ICO should have a strong, high-level understanding of the organization's operations in order to ensure that risk and internal controls are assessed for all functions.

C. Establishing the Management, Oversight and Reporting Process for the Agency's Overall Internal Control Program

In order to establish an organization's guidelines for a system of internal control, it is common to provide certain specific information (i.e., the methods and time frames for identifying and

analyzing risks and controls). These risks and controls can be related to the organization's primary operating functions either within each assessable unit or across organizational boundaries. In addition, guidelines often provide the method of testing the implementation and effectiveness of those controls, and spell out how they are to be established and communicated. In addition, the guidelines should establish a process for developing corrective action plans relative to any improvement areas or control weaknesses identified during the risk and control assessments.

Based on the methods and time frames established in the Agency's guidelines, the ICO should report the status of assessing and testing controls, as well as implementation of any corrective action plans, to the organization's Agency Head (and, if applicable, the Board). This type of reporting should be completed on a regular basis with an established frequency.

In addition, on an annual or semi-annual basis, the ICO may want to report to the organization's Agency Head (and, if applicable, the Board) the status and results of other aspects of the IC System, including the Internal Controls Training Program or reported trends in control issues that may indicate the need for an organization-wide solution.

To facilitate the gathering of information for this reporting, the organization may want to establish a network of Internal Control Liaisons within each organizational unit. The Internal Control Liaisons would receive additional training and be responsible for coordinating the IC System activities within their program areas or assessable units and report back to the ICO. This single point of contact for each organizational unit provides a benefit for both the ICO and the unit.

D. Establishing the Process for Internal Control Education, Training and Awareness

BPRM Item B-350 requires each organization to "Implement education and training efforts to ensure that officers and employees have achieved adequate awareness and understanding of internal control standards and, as appropriate, evaluation techniques." An effective training program is essential because the success of an organization's IC System is dependent not just on management; each member of the organization must understand the IC System's process within their organization, the concepts related to Internal Controls, and their personal responsibility in helping the organization to achieve its objectives.

Different trainings can be targeted at different types of employees. All employees should be made aware of the five components of a System of Internal Controls (Control Environment, Communication, Assessing and Managing Risk, Control Activities, and, Monitoring), and how their organization is addressing each component.

Line managers, supervisors, program and administrative personnel (staff traditionally most responsible for operating functions, and therefore, most involved in assessing and managing risks) should receive additional training regarding identifying and assessing risks, establishing appropriate controls, conducting internal control reviews, and testing controls to ensure that documented controls are implemented and having the intended effect.

V. Organization of Internal Control Reporting Program

A key requirement of the NYS Internal Control Act is the responsibility for covered NYS agencies and authorities to establish a formal program of internal control review under the coordination of the Internal Control Officer (ICO). The purpose of the program is to provide for review of the agency's internal controls of its major functions.

An organized systematic process for the program should be established by the agency. The following is a suggested process for an agency to organize its review program.

A. Organizing the Agency into Assessable Units

1. The agency should be divided into "assessable units" to provide an organizational structure for the program, assignment of responsibilities and meaningful review of each unit's major functions.
2. Assessable units are generally identified based on their distinct organizational status and functions.
3. A review of the agency's organizational chart should be helpful in identifying the assessable units.
4. All major agency components should be included in identification of assessable units.

B. Identifying Each Unit's Major Functions

1. Each assessable unit should identify its major functions.
2. A major function is a set of activities that carry out the primary responsibility of a unit and allow for meaningful internal control risk assessments and reviews.
3. Major functions generally involve one or more of the following: (1) activities that consume large amounts of time; (2) involve a large number of staff; (3) result in major work products; (4) address major organizational initiatives; (5) carry out significant objectives and goals of a unit; or (6) are new or undergoing major changes.
4. Generally, major functions should not include activities for too small a process or at too low a level. Activities that form part of a series of related activities in a unit may be considered together as one major function.

5. However, a function should not be identified so broadly that a meaningful review is not possible. Also, there may be cases where a relatively small activity is considered a major function. This may occur when an assessable unit, which is identified because it is organizationally distinct, has the responsibility for a function that is unique but relatively small in scope.
6. Generally, managers are in the best position to identify their units' major functions in consultation with the agency's ICO.
7. There is no minimum or maximum number of functions to be identified by a unit.

C. Examples of Assessable Units and Major Functions

The organization of an agency into assessable units and major functions will vary from agency to agency. The following are some examples of how various NYS agencies identified some major functions:

1. **Assessable Unit:** Administrative Finance Bureau, Budget Program Section
Major Function: Review and approve personnel services expenditures.
2. **Assessable Unit:** Human Resources Division, Employee Relations Bureau
Major Function: Administer the progressive discipline and grievance system.
3. **Assessable Unit:** Sales Tax Audit Bureau, Desk Audit
Major Function: Audit Performance and Results
4. **Assessable Unit:** Operations Support Bureau, Office Services
Major Function: Health, Safety and Security

D. Assignment of Responsibilities

1. Once the agency has been divided into assessable units and major functions, assignment of responsibilities for completing and approving vulnerability assessments, internal control reviews and follow-up action plans should be clearly established.
2. Assignment of these responsibilities may vary from agency to agency. Typically, supervisors closest to the operation of a function may be assigned to perform vulnerability assessments and internal control reviews with an approval process ending with a sign-off by the Division or Bureau Director. In other agencies, an internal control committee or other independent oversight group may be involved in reviewing and approving completed internal control documents.

E. Scheduling and Conducting Vulnerability Risk Assessments/Internal Control Reviews

1. A regularly scheduled review cycle should be established for the completion of risk assessments and internal control reviews and for a tracking and follow-up process on established corrective action plans.
2. Considerations for the scheduling of review cycles may include the risk levels of major function and priorities of management. For example, an agency may decide to review high-risk functions every year, moderate-risk functions every eighteen months or two years, and low-risk functions every three years. For additional information on reporting cycles, please refer to Section XI, F. of this manual.
3. Typically, the ICO formally schedules, organizes, tracks and reports to management on all phases of the review cycle.

VI. Internal Control Review and Testing

One of the most important components of an agency's internal control program is the process used to identify and evaluate the risks and internal controls associated with each function in every assessable unit. As specified in the Internal Control Act, covered State agencies and authorities must establish and maintain a program of continuing or on-going internal control review.

A. Conducting Preliminary Risk or Vulnerability Assessments and Internal Control Reviews

Some agencies choose to have a two-level evaluation program; with the higher level assessment performed on all functions, and a more detailed assessment performed on only those functions determined to be at higher risk. In these instances, the agency's internal control program would develop and use a Preliminary Risk or Preliminary Vulnerability Assessment (higher level review) to evaluate every function. For those functions subsequently determined to have Moderate or High risk as a result of this preliminary assessment, a more detailed, more in-depth assessment or Internal Control Review would be developed and used to assess only those functions at greater risk.

Some agencies opt to develop and employ the more detailed, more in-depth assessment to evaluate every function, whether the resulting vulnerability or risk assessment is low, moderate or high, in order to comply with the requirement for continuing or on-going Internal Control Reviews. The more detailed/in-depth assessment should include the identification and rating of inherent risks and internal controls for each function. (Please refer to section D, below, for a definition and examples of inherent risk and internal controls.) Although the use of a higher level preliminary assessment tool is optional, the use of a more detailed, in-depth assessment for

either higher risk functions, or for all functions when a preliminary assessment tool is not utilized, is not optional. With either a one or two level assessment system, all functions must be evaluated on a continuing or on-going basis according to the reporting schedule established by the agency or authority.

Each internal control program must include the establishment of the reporting cycles for each review document or assessment tool. Separate reporting cycles may be established for each internal control document. Functions that have been evaluated as having higher risk or vulnerability may require more frequent review than functions with lower risk or vulnerability assessments.

B. Testing

In addition to the process developed to identify and evaluate inherent risks and internal controls, each covered agency or authority must develop and maintain a process for the testing of internal controls. Some agencies combine the testing of selected internal controls and the corresponding documentation in with their more detailed, in-depth Internal Control Reviews. Some agencies create a separate Testing Record to document compliance with the testing requirement as established in BPRM Item B-350.

The purpose of testing specific internal controls is to verify that these controls are working as expected (or as assessed on the Internal Control Review). For agencies that use a separate testing document, a separate testing reporting cycle can be established, such as the completion of testing on a specified number of controls per assessable unit, due to be completed and submitted to the ICO at the same time each fiscal year.

Testing of internal controls can be accomplished through use of any of the following methods: random sampling, spot checks, interviewing and observation. Testing may result in the verification of the strength and effectiveness of the control as assessed, or it may provide unexpected results. In the latter case, any problem uncovered should result in the analysis of potential causes, and identification of any corrective actions to strengthen the control and rectify the problem(s).

C. Who is Responsible for Internal Control Review and Testing?

In most agencies, the internal control system policy establishes that the Preliminary Risk/Preliminary Vulnerability Assessments, Internal Control Reviews, and Testing Records are considered to be self-assessments, and are therefore completed by management. In these instances managers may delegate responsibility for completion of internal control reports to mid-level managers or line supervisors in their program areas, and upper level managers may serve as the reviewers or approvers of internal control reports.

In some agencies, internal control system policy establishes that either certain internal control assessments (or reviews) or certain components of review are completed by an independent staff member, such as the Internal Control Practitioner or Coordinator, or internal audit staff, such as when assistance is either requested or needed to complete the testing. Responsibility for the completion of internal control reports is related to the approval process, as established by each agency/authority.

D. Defining Inherent Risk and Internal Controls

Inherent risk is the potential for waste, loss, abuse, and/or mismanagement due to the nature of the function/activity, or the nature and type of resources associated with the function/activity, without regard to controls. Identification of inherent risks should include significant errors or irregularities that could occur while completing or not completing the function/activity. Examples include: loss of money or resources, inaccuracy or loss of data or information, lack of timeliness, duplication of work, missed opportunities, negative customer reactions, and negative publicity.

Internal control is the integration of the activities, plans, attitudes, policies and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its mission. Internal controls are actions taken to make sure that the right things happen and the wrong things do not. Most internal controls fall into one of the following two types - preventive and detective. Internal controls are the plan of an organization and all the policies and procedures adopted to safeguard assets, check the accuracy and reliability of data, promote operational efficiency, and encourage adherence to prescribed policies. Specific internal controls usually fall into one of these major categories: documentation, recording of specific transactions and events, authorization, separation of duties, supervision, and access to and accountability for resources.

Vulnerability is the likelihood that errors and irregularities will occur and/or go undetected considering the quality of existing internal controls or the absence of internal controls, as compared to the inherent risk associated with the function/activity. In other words, we evaluate whether our internal controls effectively mitigate our (inherent) risks. The concept of reasonable assurance does not imply absolute assurance; the term “reasonable” infers that they are cost effective.

While assessing the relationship between inherent risks and internal controls, a situation may arise where it is not practical or even possible to implement or strengthen internal controls to a level desired by an individual manager. Although not mandatory, agencies may want to consider documenting the following types of risk as part of its internal control program: acceptable risk and accepted risk.

Acceptable risk is one method of managing risk exemplified in situations where a manager chooses to accept the risk when the cost of the associated control activities/techniques is greater than the cost or consequence of the inherent risk, or when the consequences of the inherent risk occurring are insignificant.

Accepted risk is another potential result from the analysis of the inherent risk and internal controls when the cost for the improvement or implementation of the internal control(s) is beyond the manager's control, such as if legislation is needed.

VII. Internal Control Improvement Areas and Corrective Actions

Another integral part of an agency's internal control program is the process used to identify improvement areas and internal control weaknesses, as well as the corrective actions that will address the improvement areas and mitigate the control weaknesses. As specified in the Internal Control Act, covered State agencies and authorities must establish and maintain a program of internal control review designed "to identify internal control weaknesses, identify actions that are needed to correct these weaknesses and monitor the implementation of necessary corrective actions."

A. Identifying Improvement Areas -- Internal Control Weaknesses and Corrective Actions

Improvement areas and internal control weaknesses are most commonly identified through an agency's internal control program, as a result of completion of one or more of the following: a Preliminary Risk or Preliminary Vulnerability Assessment; Internal Control Review; or Testing activities. Improvement areas and internal control weaknesses can also be identified as a result of internal audits or external audits conducted by such oversight agencies as the Office of the State Comptroller.

B. Documenting, Monitoring and Reporting Corrective Actions

A formal process should be established to document all corrective actions, as well as track and report on the implementation status of each corrective action. There is not just one method by which to monitor corrective actions. However, at a minimum, the corrective action report or plan should include the following:

- The specific action(s) that will be taken to address the improvement area and/or correct the internal control weakness;
- The person responsible for completing each corrective action; and
- The projected time frame for completing each corrective action.

The monitoring of corrective actions and the status of their implementation can be accomplished through use of such processes as an automated tracking system or a manual logging system. It should include a component for monitoring all identified improvement areas and internal control weaknesses to ensure that corrective actions have been identified to address each of them. The tracking system should also monitor projected implementation dates. The ICO or Internal Control Coordinator/Practitioner needs to periodically follow up on the implementation status of each corrective action and improvement area. In some agencies, the ICO requests progress reports on previously identified corrective actions as part of the subsequent cycle of internal control reviews where information regarding newly identified corrective actions is also reported.

The manager with responsibility for the function should develop a corrective action plan. Corrective action plans should address such factors as priority, availability of resources, cost-effectiveness, impact on operations, consistency with the agency's or authority's objectives, and reasonable (not absolute) assurance that the corrective action will result in the improvement and/or strengthen the specific internal control as intended. If the improvement area or weakness requires corrective action that crosses program area lines, the corrective plan may need to be completed and/or approved at a higher/broader level. Protocols, policies and procedures should be established to identify specifically who is responsible for completing the plan, what approvals are needed, and what information is needed at each level for decision making as well as the resources that will be required from each impacted program area or assessable unit.

C. Establish Documentation Requirements

An important element of implementing a corrective action plan is for appropriate documentation to be maintained related to the corrective action(s) taken. Policy should be established regarding documentation requirements – for additional information on documentation, please refer to section IX of this document. Documentation involves maintaining evidence that supports decisions regarding corrective action plans as well as supplies verification that the appropriate corrective actions were implemented.

D. Establish Reporting Cycle and Monitoring of Corrective Action Implementation Status

A formal system should be in place to ensure that all approved corrective actions are implemented in a timely manner, and provide documentation when corrective actions plans require revision or delay. The identification of improvement areas/deficiencies, approved corrective action plans and a summary of the status of the implementation of the corrective action plan are reported on a periodic basis by managers to the ICO, who has the responsibility for tracking the implementation status of corrective actions to ensure that they are completed timely. The ICO also provides technical assistance on corrective action plan development, implementation and monitoring.

VIII. Review and Update of Internal Control Systems

In order to ensure that each agency's internal control program is accurate and up-to-date, the structure of the internal control system should be reviewed and updated periodically to reflect changes in organizational structure, functions or assignment of responsibilities. This review process is usually the responsibility of the agency's ICO, or the Internal Control Coordinator/Practitioner. Listed below are several things to bear in mind.

- It is suggested that a Directory or some other source of documentation of the agency's assessable units, major functions and responsible managers be established and verified throughout the organization.
- Changes to the reporting structure may occur to reflect circumstances such as:
 1. Organizational changes resulting in updates to the identification of assessable units and/or their major functions.
 2. Changes in functions with new functions added and existing functions discontinued, updated or transferred to another assessable unit.
 3. Changes in managers responsible for the program due to reorganizations, re-assignments, promotions, and retirements.
- The ICO can update and verify the contents of the Directory or other source of documentation and make any necessary updates to the structure of the internal control program prior to the initiation of a new review cycle. Or, the ICO can update the Directory or other source of documentation and the structure of the reporting program on an on-going basis, as changes are identified or made known. Managers should be consulted to ensure all changes have been reflected in the Directory or other source of documentation prior to the initiation of a new review cycle.
- Through quality assurance efforts, the organization and scheduling processes for the program should be reviewed periodically to ensure overall effectiveness.

IX. Documentation

A documentation process or policy should be established for all internal control information. Agencies should first decide what records will be retained and who will be responsible for keeping the information. Will the information be kept by agency managers, the ICO or someone else? If multiple copies of information exist, then it must be decided who will be responsible for maintaining the “official” copy. “Official” copies should be maintained according to prescribed schedules. Other copies of information may be disposed of in accordance with the agency's Records Management Policy when no longer needed.

Next, agencies need to determine where the records will be stored. Will records be kept “in-house,” sent to the State Records Management Center or to a warehouse for storage? If so, when will this occur?

Finally, agencies should determine how long will records be kept on file. This varies depending on the type of information being stored. Records should be stored for at least as long as minimum mandated by the State Archives and Records Administration (SARA) records retention schedules. Agencies should consider retaining internal control documents for as long as the maximum amount of time between reporting cycles for low risk/vulnerability functions, as per the policy established by the agency (please see Section XI, H. of this manual). SARA produces the General Retention and Disposition Schedule for New York State Government Records which contains a section on Internal Controls. The requirements from this schedule are quoted verbatim:

Internal Controls Records Disposition Authorizations²

“90308 Internal Control Policies and Directives -- Final versions of agency policies and directives governing internal control requirements and procedures for agency program units and staff. These records may also include associated memoranda, bulletins, and manuals which explain agency internal control policies.

Minimum Retention and Disposition: Destroy master copies in the issuing office 3 years after the policy or directive is withdrawn, revised, or superseded. Destroy other copies when no longer needed for administrative reference.

Justification: The issuing office should retain policies for a minimum of 3 years after they are withdrawn, revised, or superseded for use in development of

² This records retention information can be found online at:

http://www.archives.nysed.gov/altformats/ServicesGovRecs/ns_mgr_pub_SGS04.pdf

subsequent policies and procedures. Copies of obsolete policies and procedures have no value to other offices.

90309 Vulnerability Assessment Files -- Correspondence, memoranda, survey forms, risk assessments, and reports created and collected during the course of surveys and studies which identify areas of agency operations susceptible to abuse or misuse.

***Minimum Retention and Disposition:* Destroy 3 years after completion of assessment.**

Justification: Background materials are used for reference and to plan for subsequent internal control audits.

90310 Internal Control Audit Work Papers -- Plans, analyses, research materials, draft reports, background materials and related records used to plan and prepare internal control audit reports.

***Minimum Retention and Disposition:* Destroy 1 year after completion of an audit report.³**

Justification: These records are used for reference for 1 year following release of an audit report.

90311 Internal Control Audit Reports -- Reports documenting the findings of internal control audits of agency program areas and recommendations for improvements.

***Minimum Retention and Disposition:* Retain copy in issuing office for 3 years after completion of the next internal control audit report for the concerned program area, then destroy. Destroy other copies when no longer needed for administrative reference.**

Justification: Internal control audit reports may be used during the next audit cycle to monitor compliance with internal control program recommendations.

90312 Corrective Action Files -- Reports, memoranda, and other records documenting responses by program units to vulnerability assessment reports and to internal audit reports.

***Minimum Retention and Disposition:* Destroy 3 years after issue has been settled.**

Justification: Records may be useful in program audits by Office of the State Comptroller and other control agencies.

³ This guidance sets minimum standards. If the audit work papers are the result of an internal audit, IIA or GAO standards may require a longer retention period.

90313 Internal Control Program Subject Files -- Reference files used to support the development and administration of agency internal control programs, including reports, plans, articles, policies and procedures, and related material, arranged by subject on topics such as risk management, risk assessment, management practices, operational efficiency, and audit methods.

Minimum Retention and Disposition: Destroy when obsolete or superseded.

Justification: These records have no legal or fiscal value.”

X. Quality Assurance

It is suggested that each agency consider the development and implementation of quality assurance procedures for their internal control system. These could include establishing guidelines regarding the timeframe for periodic reviews of the established review/approval process, reporting cycles, structure of the internal control reporting program and inventory of functions, and other aspects of how their internal control system is organized, as well as scheduling periodic updates of policy statements and other communications to agency staff.

It is also suggested that each agency consider the development of a method for evaluating the effectiveness of the internal control reporting program. For example, a check list could be developed for use in assessing the presence and quality of responses submitted on a given internal control document. Results of the check lists could be used to facilitate discussions with management and generate improved responses in the future. In addition, the information gathered could also serve to assist the ICO or IC Coordinator/Practitioner to develop and implement improvements to the internal control program and related education and training efforts.

Another method for evaluating the internal control reporting program is use of a survey (or questionnaire checklist) that is sent to managers to obtain feedback on the positive and negative aspects of the internal control reporting process, and to request suggestions for improvement.

Periodic quality assurance reviews can be performed by the Internal Control Officer, the Internal Control Coordinator/Practitioner, a designated management team or independent committee.

XI. Essential Elements for an Effective Internal Control System

The following is a list of recommendations regarding “baseline” elements essential to developing and maintaining an effective internal control system:

- A.** Each Agency/Authority Head should provide a communication to all staff in support of that agency’s or authority’s internal control program, including the importance of assessing one’s internal controls.
- B.** Each agency should determine whether its internal control program will include a preliminary risk/preliminary vulnerability self-assessment, performed by function.
- C.** Each agency’s internal control program should include a detailed/in-depth assessment of each function, either for those functions that were assessed as having High or Moderate vulnerability (or higher risk) as a result of the preliminary risk/preliminary vulnerability assessments, or for all functions if the agency’s internal control program does not include a preliminary risk/preliminary vulnerability assessment. This more detailed/in-depth assessment should include the identification of inherent risks and internal controls for each function.
- D.** Each internal control program should establish the frequency of the reporting cycles for each preliminary risk/preliminary vulnerability assessment, internal control review, and any other internal control reporting documents (please see paragraphs B and C above). In addition, each agency should establish a maximum length of time that will be acceptable between reviews or updates of internal control reporting documents (preliminary risk/preliminary vulnerability assessments and internal control reviews) of low risk or low vulnerability functions, such as five years.
- E.** Each internal control program should establish an approval/oversight or independent review process of the preliminary risk/preliminary vulnerability assessments and the more detailed/in-depth internal control reviews, either by a Steering Committee, the ICO, the Internal Control Coordinator or Supervisory review.
- F.** Each agency’s internal control program should establish the periodic review of the agency’s organizational structure and its inventory of functions, with the agency establishing a maximum length of time between any needed updates, in order to ensure that the program is accurate and up-to-date.
- G.** Each agency’s internal control program should establish a process for the identification of improvement areas and weaknesses and their corresponding corrective actions, as well as the implementation status of all corrective actions.

H. Each internal control program should establish and maintain documentation standards, including what needs to be kept; by whom; where; and for how long. We recommend that the ICO/IC Coordinator maintain documentation sufficient for the independent validation/audit by OSC of the certification process. The length of time established for retaining internal control documents should coincide with the maximum amount of time established between reporting cycles for low risk/low vulnerability functions, such as five years or until the next reporting cycle has been completed and approved. If the maximum amount of time between reporting cycles is longer than the minimum retention schedule as established by SARA, the agency or authority should retain the appropriate documents for the length of time that corresponds to the longest reporting cycle.

XIII. Appendices/Document Links⁴

Appendix 1 - Internal Control Act (include Public Authorities Law for authorities)

Appendix 2 - DOB BPRM Item B-350

Appendix 3 - OSC Internal Control Standards

Appendix 4 - Examples of Agency “Tone at the Top” Policy Statements

- a. Memo from Commissioner of Dept. of Correctional Services
- b. Memo from Director of NYS Office For the Aging

Appendix 5 - Examples of Agency Education Material/Pamphlets

- a. Internal Control Guidelines: SUNYA
- b. Brochure: NYS Dormitory Authority
- c. Brochure: NYS Office of Children and Family Services
- d. Brochure: NYS Dept. of Tax and Finance
- e. Brochures: NYS Dept of Labor
- f. E-Mail Newsletter and Poster: Dept of Labor

Appendix 6 - a. Internal Control Review: NYS Dept. of Environmental Conservation

- b. Internal Control Review: NYS Dept. of Labor
- c. Internal Control Review, Corrective Action Status Report and Testing Record: NYS Tax and Finance
- d. Internal Control Risk Assessment: NYS Office For Technology
- e. Employee Internal Control Survey developed by NYS Office of the State Comptroller
- f. NYS Division of the Budget Testing Guide

Appendix 7 - Directory of Internal Control Officers and Internal Control Practitioners

Appendix 8 - Links to other resources (addresses to websites)

⁴ To access any of these appendices, please visit The New York State Internal Control Association web page at <http://www.nysica.com> .

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Internal Control Education and Training

ACKNOWLEDGEMENTS

About the Report

This is one of nine reports that were issued by the New York State Internal Control Task Force (ICTF) in the summer of 2006.

The ICTF, led by a Steering Committee, was comprised of six Work Groups coordinated by Task Force Liaisons from the Division of the Budget (DOB), the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA).

Research Groups

The contents of this study were developed by the ICTF from its original research, professional guidance, and literature. It builds upon earlier reports by the New York State Assembly, audit reports by the OSC, and DOB budget bulletins.

Stakeholder Groups

Stakeholders in this study include State Agencies, Public Authorities, the Division of the Budget, and the Office of the State Comptroller.

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BACKGROUND

In response to the Office of the State Comptroller's audit report⁵ on State Agency Internal Audit Units' Compliance with the Internal Control Act⁶, the Division of the Budget (DOB) -- in conjunction with the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA) -- created an interagency work group to address both the internal audit compliance issues identified in the report, and to provide compliance guidance on the broader internal control requirements of the Act.

Formed in October of 2004, the mission of the New York State Internal Control Task Force is to improve statewide agency and authority compliance with the Internal Control Act by pursuing the following goals and objectives:

- Sharing Internal Control and Internal Audit resources and best practices;
- Providing Internal Control and Internal Audit technical assistance;
- Identifying training opportunities;
- Developing a plan for agencies to receive and/or conduct independent peer reviews; and
- Discussing options and developing recommendations for agency/authority review.

The Task Force established six working groups to provide recommendations. These work groups were comprised of staff from DOB, OSC, NYSICA, as well as agency Directors of Internal Audit, Internal Control Officers and other internal control practitioners.

The Education and Training Workgroup was charged with providing guidance on the development of an ongoing education and training plan. The plans developed were to assist agencies in complying with the training provision of the Internal Control Act, which says they are to "Implement education and training efforts to ensure that officers and employees have achieved adequate awareness and understanding of internal control standards and, as appropriate, evaluation techniques."

RESULTS IN SUMMARY

The Education and Training Workgroup identified best practices for providing training on internal controls and established guidance for developing ongoing plans so agencies can continually ensure meaningful training is provided. Additionally, the group also explored opportunities

⁵ Office of the State Comptroller Report 2003-S-14, *State Agency Internal Audit Units' Compliance with Internal Control Act*.

⁶ New York State Consolidated Laws, Executive, Chapter 18, Article 45, § 950 – 954.

for establishing arrangements between agencies to share existing resources and training materials.

The workgroup recommends that internal control education and training programs be designed to target three distinct segments of the state workforce; line staff, middle management, and executive management. The workgroup further recommends training curricula be specific to the target audience, thus achieving optimum benefits for the State.

In addition, the workgroup recognizes the need for a central resource library to house training tools, presentations and other related information and resources on internal controls. This will relieve the burden of individual agencies struggling to design meaningful training. The workgroup recommends the NYSICA continue posting training materials and best practices on the NYSICA website.

OBJECTIVES AND METHODOLOGY

The Education and Training Work Group identified two main goals:

1. Provide guidance on developing a training program designed to educate agency officers and employees on internal controls; and
2. Provide guidance for establishing an ongoing training plan to ensure that agency officers and employees have received adequate training

The workgroup focused on the issues of not only program content, but delivery and frequency as well. This was accomplished by collecting and reviewing examples of existing training programs and evaluating the strengths and weaknesses of standard approaches such as presentations or brochures.

Once a base line understanding was established, the main workgroup broke into three subgroups, each assigned to a specific targeted training level. These subgroups identified core needs and a basic training curriculum for the employee level for which they had responsibility.

RECOMMENDATIONS

Below are recommendations that, if implemented, will ensure agencies meet the internal control training needs of staff and management. The recommendations are directed to agency management and they should use their discretion in implementing them. Following each recommendation is a suggested method for implementing each recommendation.

- 1. Agency Management Should Target Training Levels:** In order to address the specific needs of various agency officers and employees, the workgroup recommends that three specific levels of training be identified to maximize the benefits of internal control training in the State. These three levels⁷ are Line Staff, Middle Managers, and Executive Management. In order to implement this recommendation, agencies should identify and assign staff to one of these three levels. Due to varying organizational structure, this must be done on an agency by agency basis.

Level 1: Line Staff

This “basic” level targets agency staff whose job responsibilities are clearly defined according to established procedures. Generally speaking, staff at this level do not have specific supervisory responsibilities, and are not responsible for establishing policy.

Level 2: Middle Managers

This level includes those managers who are responsible for setting expectations of employees consistent with agency-established standards. Further, these managers are responsible for evaluating staff performance to ensure accountability. Managers may be responsible for establishing policy within their operational area. Within this level, participants should be identified in terms of the function(s) they perform rather than the title or grade level they hold.

Level 3: Executive Management

Individuals classified at this level are responsible for providing organizational leadership and defining an agency vision, and in some cases setting agency-wide policy.

⁷ A fourth level - Internal Control Officers and practitioners was also identified. It was decided that efforts to train these practitioners in implementing effective programs would be addressed by the Program Coordination & Implementation Workgroup and NYSICA.

2. Agency Management Should Identify Training Objectives and Key Concepts:

The Work Group identified certain learning objectives, or key concepts (see Appendix), for each of the levels. Although some of these concepts will be found in all three levels, others will be specific to a targeted area. Therefore, agency management may use their discretion to identify other training needs.

Level 1: Line Staff

The objective at this level is to provide education and awareness of the basic fundamentals of why internal controls are important and how they serve as an effective means to control risks. Each line staff employee must understand that it is their responsibility to seek ways to identify and eliminate wasteful controls that impede performance and to strengthen those controls designed to provide accountability and to preserve assets and scarce resources.

Sample Learning Objectives:

- Definition of risks, how they arise and how to handle them;
- Identify everyday controls; and
- Identify controls in the workplace.

Level 2: Middle Managers

Middle managers are charged with responsibilities that rely on internal controls in order to perform their job effectively -- although they might not be aware that they are using such tools.

Sample Learning Objectives:

- Internal controls as a management tool ~ what's in it for me?
- Case studies that demonstrate what happens when controls are ineffective/lacking.
- Basic components of a sound internal control program.
- Time-tested techniques, tools and templates for establishing and maintaining effective internal controls within the work unit.

When developing training for this level, emphasis will be given to understanding both *hard* and *soft* controls within an organization, evaluating staff development needs in order to maintain effective internal controls, instilling self-confidence when advocating for procedural

improvements, maintaining a heightened sense of professional ethics in public administration, and heightening the level of sensitivity to recognizing the potential for questionable dealings.

Level 3: Executive Staff

At this level, it is important to address specifically the needs of agency executive staff, focusing on issues of organizational culture and risk management. Specifically, internal controls are a system to ensure that stated goals and objectives are met while safeguarding assets and promoting operational efficiency, (i.e., to manage risk). An agency's success, like any organizational culture issue, is dependent upon the tone set at the top.

Sample Learning Objectives:

- The importance of organizational culture;
- Management's role in defining the mission and goals;
- What defines a strong system of internal controls; and
- Internal Controls as safeguards, not guarantees.

- 3. Agency Management Should Identify Methods of Delivery and Frequency:** To reach the three targeted levels, and deliver programs containing the key learning concepts, the workgroup recommends a basic framework for internal control education and awareness training. This framework forms an overall agency communication plan and contains recommended methods of delivery and frequency. Each group is designed to address the needs of one of more of the targeted training levels as follows:

Method A: "Quick Hitters"

These are items which are brief in nature and are intended to promote a general awareness of the basic concepts of internal controls. Delivery methods in this group will take the form of timesheet messages, broadcast emails, brochures, newsletters and bulletins. A brochure, pamphlet, or short document regarding internal controls should be distributed to new employees at initial hiring or during agency orientation.

Frequency: Training and education periodically; at least once a year.

Target Levels: Line Staff, Middle Managers, Executive Management

Method B: Instruction-based Education

General Awareness:

Delivery methods include classroom training, web-based training and facilitated forums. Depending on available resources, these “classes” may be delivered in person or through other electronic means, such as PowerPoint presentations.

Frequency: Training/education at least once every two years

Target Levels: Middle Managers

Job Specific:

Line staff should receive training on controls that are specific to their job responsibilities. It is the responsibility of the middle managers to deliver this training to their staff.

Frequency: Training/education at least once every two years

Target Levels: Line Staff

Method C: Executive Meetings

Delivery methods will include open discussion forums, roundtables and an annual report from the agency’s Internal Control Officer to discuss the annual certification process and risk assessment/management concerns.

Frequency: Training and education at least annually

Target Levels: Executive Management

- 4. The NYSICA Should Establish a Centralized Resource Library:** The workgroup believes a primary reason that internal control training has fallen short in many agencies, is the labor intensive effort to design training tools. To this end, we see the need for a central resource library to house training tools, presentations and other related information and resources on internal controls. This would need to be a sustaining effort, with continual additions to the library. By having a common resource library of training tools that all agencies can access, internal control practitioners will be relieved of the burden of struggling to design meaningful training. A central resource library hosted by NYSICA would house tools such as newspaper articles, brochures, PowerPoint presentations, newsletters, posters, etc., all accessible electronically via the internet.

The New York State Internal Control Association (NYSICA) has agreed to house a resource library on its website. We anticipate that the effort to actively maintain such a site would be led by volunteers from the workgroup, NYSICA and other interested parties. Part of these groups' efforts would include collecting and cataloging training tools, approving and revising content, and posting the information to the web. This effort would be sustained so that internal control practitioners have a wide array of timely and relevant training tools available to them on an ongoing basis.

APPENDIX

Learning Objective (Key Concepts)	Line Staff	Middle Managers	Executive Management
A well-defined mission provides provide direction and stability to an organization.		X	X
Agency objectives must be clearly stated and communicated.		X	
Accountability at all levels is a key component of an effective organization.	X	X	X
Communication is the exchange of information between and among people and organizations.	X	X	X
Communication should be timely, useful and complete.	X	X	X
Lines of communication should be up, down and across an organization.	X	X	X
Staff should be able to communicate problems and suggestions.	X	X	X
Employee responsibilities should be well-defined and clearly communicated.		X	
Employees should be empowered to act within established guidelines.		X	
Internal controls are safeguards, but they do not guarantee success.		X	X
Controls should be routinely monitored, tested and updated.		X	
Internal Controls as a management tool – what is in it for me?		X	
Identify everyday controls.	X		
Identify everyday controls in the workplace.	X		
An effective system of Internal Control requires commitment and coordination of effort.		X	
Identify opportunities to enhance existing controls when appropriate.	X	X	
Everyone has a role to play in an internal control system.	X	X	
Internal Control reflects the qualities of management – good and bad.		X	X
Internal control is a process, not merely procedures, policies and separation of duties.	X	X	
Internal Control will succeed or fail depending on the attention people give it.	X	X	X
Internal Controls are built into an organization, not an added feature. They are part of the culture.		X	X
Internal Controls impacts every aspect of an organization.		X	X
Internal Controls improve the likelihood that the right things happen and the wrong things don't.	X	X	
Are we doing the right things (performing the right mission, planning strategically)?		X	
Are we doing the right things right (achieving the needed results)?		X	
Are we making needed changes in the right order (prioritizing and applying resources correctly)?		X	X
Are we operating as efficiently as possible (in applying people and other resources)?	X	X	
Achieving results is dependent upon people - Control Environment.		X	X
Management should lead by example to foster ethical values and integrity in the organization.		X	X
Management must communicate its commitment to Internal Controls.			X
Management should establish training programs to support staff development.		X	X
Management should foster positive employee morale – and monitor within the organization.		X	X
Management should have a supportive attitude.		X	X
Management's operating style and philosophy have a pervasive influence in		X	X

APPENDIX

Learning Objective (Key Concepts)	Line Staff	Middle Managers	Executive Management
the organization.			
Policies and procedures should be routinely reviewed and updated.		X	
Procedures and controls should ensure accurate, reliable and timely financial and management data.		X	
Procedures and controls should ensure adherence to laws, regulations, and management directives.		X	
Procedures and controls should safeguard resources against loss due to waste, abuse, and fraud.		X	
Control over-rides should be minimal and carefully monitored.		X	
It is critical that agencies acquire and maintain competent staff.		X	
Definition of risks, how they arise and how to handle them.	X	X	
Risk is measured in terms of likelihood and impact.		X	X
Risks should be appropriately managed (accepted, controlled or avoided).		X	X
Risk should be assessed at all levels of an organization.		X	
Corrective actions are essential to effective risk management.		X	X
Provisions of the Internal Control Act.			X
Case studies that demonstrate what happens when controls are ineffective/lacking.		X	
Basic components of a sound internal control program.		X	
Time-tested techniques, tools and templates for establishing and maintaining effective controls.		X	

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Internal Audit Organizational Placement and Independence

ACKNOWLEDGEMENTS

About the Report

This is one of nine reports that were issued by the New York State Internal Control Task Force (ICTF) in the summer of 2006.

The ICTF, led by a Steering Committee, was comprised of six Work Groups coordinated by Task Force Liaisons from the Division of the Budget (DOB), the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA).

About the Authors

The research for this study was conducted by Michael Abbott, Joel Biederman, William Gritsavage, Thomas Howe, James Nellegar and Theresa Vottis with assistance from Phillip Maher, Bradley Moses, David Koshnick and Kevin O'Donoghue.

The report was written by James Nellegar, Joel Biederman and Michael Abbott.

Research Groups

The contents of this study were developed by the ICTF from its original research, professional guidance, and literature. It builds upon earlier reports by the New York State Assembly, audit reports by the OSC, and DOB budget bulletins.

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Feel free to contact the following individuals should you require additional information:

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BACKGROUND

Internal auditors add value by bringing a systematic, disciplined approach to an organization's evaluation and management of risk, making recommendations to improve the internal control structure and promoting corporate governance. To be successful in that role, it is important that the internal audit function be organizationally independent of other business activities, free from interference in establishing the scope of its work and the communication of results.⁸

The objectivity of internal audit staff – a personal trait – is closely related to the concept of independence and is fundamental to the success of the internal audit organization. Objectivity allows the auditor to maintain an impartial, unbiased attitude and avoid conflicts of interest. The organizational alignment of the internal activity can affect an auditor's ability to remain objective.

Internal audit independence and objectivity are not only important to an internal audit organization's credibility; they are hallmarks of executive management's commitment to promoting a strong, introspective approach to corporate governance. These values provide a basis that executive managers, audit committees and third parties can rely upon when considering the internal auditor's findings and recommendations.

The importance of auditor independence and objectivity are emphasized throughout the *International Standards for the Professional Practice of Internal Auditing (internal audit standards)*, published by the Institute of Internal Auditors (IIA) and *Generally Accepted Government Auditing Standards (government auditing standards)*,^{9,10} published by the United States Government Accountability Office (GAO).

The New York State Assembly (“*Who’s Minding the Store*” 1997) and the New York State Office of the State Comptroller (Office of the State Comptroller Report 2003-S-14, “*State Agency Internal Audit Units’ Compliance with Internal Control Act*”, August 2004) reported a lack of internal auditor independence in State agencies due to the placement of the internal audit activity within the agency and/or the assignment of duties which impaired the internal auditor's ability to remain independent.

In October of 2004 the Division of the Budget (DOB) – in conjunction with the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA) – created an interagency workgroup to address both the internal audit (IA) compliance issues identified in the Comptroller's report, as well as to provide guidance on the broader internal control (IC) requirements of the Act. The Task Force created six working groups. The Task

⁸ IIA Auditor Practice Advisory 1110.A1.1

⁹ Internal Audit Standards 1100 – 1130.C2

¹⁰ Government Audit Standards: 1.24, 3.01 – 3.32

Force assigned the issue of organizational placement and independence of internal audit units to the organization and staffing workgroup (Workgroup).

RESULTS IN SUMMARY

Thirty-four agencies responded to the Task Force survey on internal audit oversight, guidance and reporting. Of the thirty-four responses, thirty were BPRM Item B-350 agencies. While most of those agencies described an organizational structure, assignment of responsibilities and reporting relationship with executive management that are characteristic of an independent internal audit function, some internal audit units continue to have responsibilities that may impair their ability to remain independent of the business processes they may be called upon to audit. We also identified some general issues related to the conduct of the internal audit activity that affect auditor independence.

The Workgroup believes that all but the smallest of agencies can achieve organizational independence. We recommend broadening BPRM Item B-350 and annual internal control certifications to include the independence issues and proposals made in this report; and utilizing the peer review process to evaluate key independence issues on an ongoing basis.

OBJECTIVES AND METHODOLOGY

Our objective was to provide guidance on the organizational placement of the internal audit activity and on duties which are incompatible with the internal auditor's role and need for independence.

To accomplish our objectives, we reviewed applicable laws, budget bulletins and professional guidance. We also surveyed executive branch agencies regarding the organizational placement and independence of the internal audit function. Thirty-three executive branch agencies are required to maintain internal audit units per BPRM Item B-350.

RESULTS OF REVIEW

Organizational Independence

The Act, BPRM Item B-350 and professional audit standards consistently emphasize the need for internal audit units to organize in a manner that ensures they can operate independently:

- The Act requires the internal audit director report to the head of the agency.
- Internal audit standards require that the internal auditor report “to a level within the organization that allows the internal audit activity to accomplish its responsibilities.”¹¹ IIA practice advisories state that, ideally, the internal audit director should be organized under the chief executive and report to the audit committee, board of directors or other governing authority.¹²
- Government auditing standard 3.27 states that a government internal audit organization can be presumed to be free from organizational impairments to independence when reporting internally to management if the head of the audit organization meets all of the following criteria:
 - a. Accountable to the head or deputy head of the government entity;
 - b. Required to report the results of the audit organization’s work to the head or deputy head of the government entity; and
 - c. Located organizationally outside the staff or line management function of the unit under audit.
- BPRM Item B-350 states the internal auditor report “shall report directly to the State Agency Head or their designated executive deputy or equivalent position.”

Organizational Placement of the Internal Audit Unit

The reporting requirement described in BPRM Item B-350 is consistent with government auditing standards (i.e., allows reporting to the Agency Head or their designated deputy or equivalent position). The Workgroup believes this reporting relationship is appropriate and will help ensure that internal audit units can operate independently. However, BPRM Item B-350 does not address situations where the deputy head of an agency has line or staff responsibilities, as described in government auditing standard 3.27. When the designated deputy has line or staff management responsibilities, the internal auditor should meet directly with the Agency Head, or with the audit committee,¹³ on a periodic basis.

¹¹ Internal Audit Standard 1110

¹² IIA Auditor Practice Advisory 1110-1

¹³ Audit committees are discussed in further detail later in this report.

Of the 34 agencies responding to our survey, most reported an organizational alignment to the executive deputy or higher. However, one agency did describe a reporting relationship with executive management that was two-levels below the agency's chief executive. The agency did not have an audit committee and is covered by BPRM Item B-350.

Government auditing standard 3.32 states that "the audit organization should document the conditions that allow it to be considered free of organizational impairments to independence to report internally...." Each agency should clearly define the organizational placement of an internal audit unit in organization charts that are readily available to all agency employees. In addition, reporting on the organizational alignment of internal audit units, as part of each agency's annual internal control certification, would promote the independence of these units across the long-term. Government standard 3.32 also states that reviewing the conditions that allow internal audit units to be free of organizational impairments should be part of the peer review process.

Frequency of Internal Auditor Meetings with Executive Management

Professional standards require periodic meetings between the internal auditor, executive management and the board¹⁴ or audit committee but do not prescribe, specifically, the frequency with which those meeting should take place. The Workgroup believes regular meetings between these two parties are essential to ensure the independence, effectiveness and accountability of the internal audit activity and recommends such meetings be held at least quarterly.

Distribution of Internal Audit Reports

The timely distribution of internal audit reports is integral to the independence, effectiveness and credibility of the internal audit organization. Distributing the audit reports to all stakeholders, including executive management, provides reasonable assurance that the agency will take action on the findings and recommendations contained therein. Professional standards address the distribution of internal audit reports:

- Internal audit standard 2440 states that the internal audit director is responsible for communicating the final results of consulting engagements to clients.
- Government auditing standard 8.57 states that "Internal auditors should follow their entity's own arrangements and statutory requirements for distribution. Usually they report to their entity's head or deputy head, who is responsible for distribution of the report. Further distribution of reports outside the organization should be made in accordance with applicable laws, rules, regulations, or policy."

¹⁴ Internal Audit Standard 2060. Most State agencies do not have a board of directors. A board structure is more common in public authorities.

Most of the internal audit units that replied to our survey told us they distribute reports to the Agency Head or deputy head, as well as other key managers and the auditee.

The Workgroup believes there is value in providing State agencies with guidance on the distribution of internal audit reports. The Workgroup recommends the internal audit director be responsible for the distribution of the audit report and provide it to the Agency Head, deputy head, audit committee (see next section of this report), auditee and to the Internal Control Officer (ICO) when it effects the individual's areas of responsibility.¹⁵ Any further distribution of audit reports should be made only with the knowledge/permission of executive management. The Workgroup recommends this distribution protocol be reflected in BPRM Item B-350.

Audit Committees

Thirteen of the 34 internal audit units responding to our survey reported that they have an audit committee. Of the thirteen, twelve were BPRM Item B-350 agencies.

While neither internal audit nor government auditing standards require an audit committee, both encourage the development of establishing such an oversight body:

- Government auditing standard 3.30 states that “The audit organization’s independence is enhanced when it also reports regularly to the entity’s independent audit committee and/or the appropriate government oversight body.”
- IIA’s Model Internal Audit Legislation for State Government¹⁶ (IIA Model Legislation) recommends that “An audit committee may be established, if appropriate, to monitor the activities of the organization's internal and external audit activities....”

In recent years, the importance of audit committees has received increased recognition, particularly in the private sector. A properly constituted internal audit committee enhances the internal auditor’s real and perceived level of independence by providing a direct link to an oversight body that is not part of agency management.

¹⁵ Further discussion of the relationship between the internal auditor and the internal control officer is presented later in this report.

¹⁶ http://www.theiia.org/index.cfm?doc_id=3976

Audit committee duties that enhance the independence of the internal auditor include:

- Overseeing financial, compliance, information technology and performance audits;
- Ensuring the agency has taken appropriate actions to identify key business and operational risks and has an appropriate system of internal controls for addressing those risks;
- Reviewing of the annual audit plan and budget for the internal audit activity;
- Assessing how well the internal audit plan addresses key business and operational risks;¹⁷
- Receiving internal audit reports and follow-up reports;
- Periodically meeting with the Agency Head and assessing whether management has acted appropriately on the findings and recommendations of the report; and
- Ensuring there is adequate follow-up on internal audits.

The audit committee requires a range of competencies to be effective. These areas of expertise may include, but are not limited to: an understanding of the government environment and accountability structure; an understanding of the functions of the organization; and financial, accounting, auditing and management skills. IIA guidance recommends that the audit committee “Include individuals who are *external* (emphasis added)¹⁸ to the organization’s management structure, and who have the program and/or management expertise to perform the review and oversight function effectively.” Eleven of the 13 agencies that told us they had audit committees said those committees were comprised of agency managers.

The Workgroup encourages the formation of audit committees as a means to enhance the independence and effectiveness of internal audit organizations.

Compatibility of Other Duties with the Internal Audit Function

Individual independence entails refraining from duties that are incompatible with the objective appraisal of operations. The Office of the State Comptroller’s Audit Report 2003-S-14, *State Agency Internal Audit Units’ Compliance with Internal Control Act*, identified 16 agencies

¹⁷ It is not the task of an audit committee to substitute for the executive function in the management of the internal audit activity. The audit committee should offer opinions or recommendations on the manner in which such management is conducted.

¹⁸ In agencies that have a management board structure, the audit committee should be a committee, or sub-committee, of the Board. This measure also ensures the audit committee knows and understands the Board’s priorities.

whose internal audit units (i.e., internal audit directors) did not have individual independence because of incompatible duties, including 12 whose internal audit director also served as internal control officer (ICO).

Professional standards state that internal auditors should refrain from activities that may impair their independence:

- Internal audit standards and auditor practice advisories¹⁹ state that auditors should refrain from assessing operations for which they either had responsibility or assumed operating responsibilities (e.g., assigned to prepare bank reconciliations) in the last year. Further, auditors should disclose any impairment to independence or objectivity to the appropriate parties.
- Government auditing standard 3.14 states that “audit organizations should not perform management functions or make management decisions” and that assuming these roles creates a situation that impairs the audit organization’s independence, “both in fact and in appearance, to perform audits of that subject matter and may affect the audit organization’s independence to conduct audits of related subject matter.”

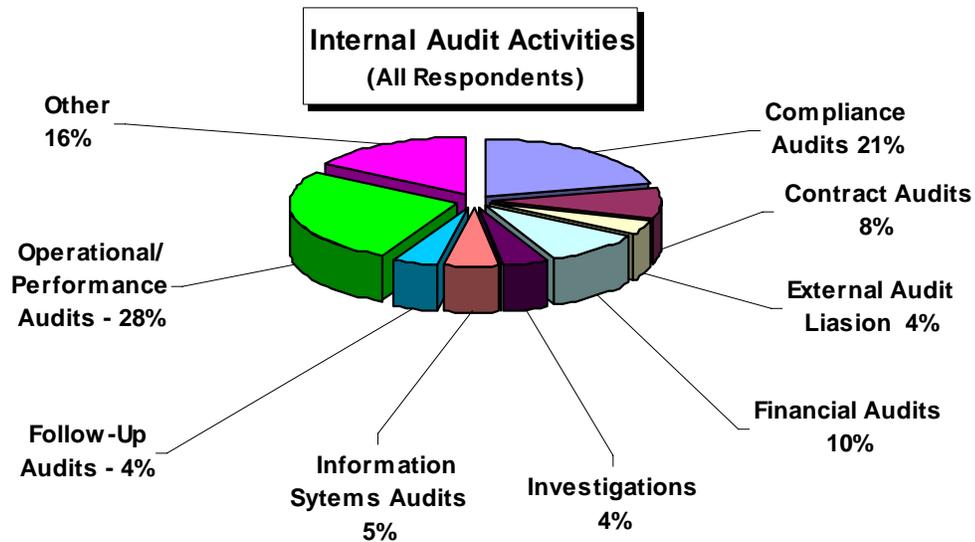
Respondents to our survey identified incompatible duties as the most prevalent barrier to internal audit independence. Of the 34 internal audit organizations that responded to our survey, 22 reported that their units have responsibilities that are not directly related to internal audit tasks, including:

- Eleven internal audit units that have responsibilities as the agency’s internal control officer (ICO);
- Eight internal audit units with responsibilities as the agency’s information security officer (ISO); and
- Sixteen internal audit units that have programmatic responsibilities in addition to internal audit duties.

Some agencies may congregate activities that contain an element of internal control (i.e., internal audit, internal controls, information security) — and the amount of time dedicated to these activities can be significant for some internal audit units. On average, the 22 organizations referred to above reported that they expend 20 percent of available staff time on activities unrelated to the internal audit function. That average rose to over 25 percent for smaller internal audit organizations (staff size of 1 - 4 people)."

¹⁹ Internal Audit Standard 1130.A1-A2; IIA Auditor Practice Advisory 1130.A1-1

We also asked each audit organization to describe the types of audit engagements and other responsibilities they undertake annually. The chart below reflects averages for all agencies reporting:



The 35 agencies that responded to the direction and staffing portion of the Task Force survey²⁰ reported that they used most of their resources on operational/performance and compliance audits. On *average*, internal audit organizations expended a significant portion (16 percent) on “other” types of activities (discussed below), including ICO and ISO responsibilities.

Internal Control Officer (ICO) Duties

Eleven internal audit units responding to our survey told us they were also responsible for the duties of the ICO.

The Internal Control Act requires that the head of each agency designate an ICO who is responsible for both implementing and reviewing the organization’s internal control efforts. While the Act does not preclude the internal audit director from acting as the ICO, New York State’s Internal Control Standards, issued by the Office of the State Comptroller, expresses the viewpoint that, “*in most instances* (emphasis added), the internal auditor cannot properly perform the role of internal control officer.” This is because the organization’s internal auditor must be independent of the activities that are audited, including the internal control function.

BPRM Item B-350 defines the ICO’s duties as working with appropriate agency personnel to coordinate the internal control activities, and to ensure that the agency’s internal control program meets the requirements established in that policy. Although the ICO is not an operational role as

²⁰ Note: One additional agency responded to the direction and staffing portion of the Task Force survey than the oversight, guidance and reporting section.

described in internal auditing standard 1130.A1 (i.e., duties directly related to the agency's mission); the ICO role is a management function as defined in government auditing standard 3.14 and will require management decisions as to the overall design and implementation of the internal control system. As such, the role of the internal auditor is generally incompatible with the role of the ICO.

As a practical matter, it is important to recognize that, in smaller agencies, there may be an overlap between the internal audit and internal control functions. In these situations, the internal audit director should limit his/her role to assembling information (i.e., "coordinate the internal control activities of the agency..." per BPRM Item B-350), being careful to avoid decision-making as to the type of controls needed, or an opinion on the quality of controls that have been formally evaluated. If the internal auditor undertakes any internal control responsibilities, it should be clearly communicated, as part of that process, that agency managers are responsible for maintaining an appropriate system of internal controls. Audits of the internal control system and the agency's annual internal control certification should fully disclose the internal auditor's role in the internal control process.

Separation of the internal control and internal audit functions should not preclude a strong working relationship that can create synergies between the two activities. Creating a sense of unanimity between the internal control and internal audit functions will improve the overall internal control culture of an agency. The internal control and internal audit functions reinforce one another when:

- The internal auditor uses internal control reports when planning audits;
- The auditor consistently evaluates and reports on compliance with internal control requirements in audit reports, as part of the auditor's assessment of internal controls;²¹
- The internal control officer reviews internal audit reports on a regular basis to ensure that agency managers incorporate significant risks, findings and recommendations identified in the report into the internal control system; and
- Follow-up audits address whether significant risks, findings and recommendations of the audit have been addressed and incorporated into the agency's internal control system.

²¹ Government Auditing Standard 7.16: "Internal auditing is an important part of internal control. When an assessment of internal control is called for, the work of the internal auditors can be used to help provide reasonable assurance that internal controls are effectively designed and functioning properly...."

Adopting these steps will provide the internal auditor and ICO with continuous feedback on the quality of the internal control system and, therefore, lower the risk (control risk) that the system may be ineffective, or lose its effectiveness over time.

Information Security Duties

Of the internal audit organizations responding to our survey, eight told us they were also responsible for ISO duties.

In January 1997, the New York State Office for Technology (OFT) issued policy 97-1 to provide agencies with guidance on minimum security policies for protection of assets inclusive of information, computers, and networks. In September 1999, OFT issued technology policy 99-2, stating that it is the responsibility of each agency to appoint an ISO that is *well versed* (emphasis added) in all areas of information security and be able to understand the technology being used at his or her agency.”²²

The ISO “has overall responsibility for ensuring the implementation, enhancement, monitoring and enforcement of information security policies and standards .”²³ These duties may include the development, or facilitating the development, of an information security policy and facilitating (evaluating) compliance with that policy. As such, the Workgroup believes that the ISO role (as described by CSCIC policy P03-002), *in its totality*, is incompatible with the internal audit role because the internal auditor would be required to perform a management function and make management-level decisions. The Workgroup believes that *limited* ISO duties *are compatible* with the internal audit activity provided the internal audit is qualified to perform those tasks. That is, when the internal auditor’s involvement is limited to:

- Working with other agency employees *to develop* (not to approve) information security policies *provided* the internal auditor does not assume management responsibilities. Such activity is consistent with the definition of internal auditing (i.e., “Internal auditing is an independent, objective assurance and *consulting* activity...”);²⁴ or
- Evaluating compliance with the security policy (Compliance testing is within the purview of both the internal auditor and the ISO); and
- All parties are aware of the extent of the internal auditor’s role; and

²² These policies are now within the domain of the New York State Office of Cyber Security and Critical Infrastructure Coordination (CSCIC).

²³ Page 7 of (CSCIC) Policy P03-002

²⁴ Definition of internal auditing per the IIA (http://www.theiia.org/?doc_id=1499)

- The internal audit unit, collectively, has the requisite knowledge and experience in technology and information security to meet the intent of OFT policy 99-2²⁵. Use of other agency personnel outside of the internal audit unit, or private consultants, is an acceptable means of acquiring this knowledge and experience, provided they are independent of the information technology/security processes being reviewed.

The eight internal audit units that told us they had ISO responsibilities *may* have difficulty in meeting the experience requirements described in OFT policy. While the Task Force did not request access to resumes for each member of the internal audit units in our survey; we did request information regarding professional certifications as *an indicator* of their collective education and experience to serve in that role. Of the eight units with ISO responsibilities, only one reported they had a certified information systems auditor (CISA), certified information security manager (CISM)²⁶, or Certified Information Security Professional (CISSP) on staff²⁷.

Programmatic Responsibilities

Sixteen internal audit organizations, 47 percent of respondents, told us that they had programmatic responsibilities in addition to internal audit duties. As stated above, professional standards preclude internal auditors from assuming operating responsibilities or making management decisions. Examples of these additional responsibilities described in the responses to our survey include:

- Routine auditing of agency contracts;
- Employee drug testing;
- Fleet management;
- Personnel investigations; and
- Auditing agency-regulated businesses, including third parties (i.e., not-for-profits) supervised by the agency.

These duties are operating responsibilities that include management-level decision making. In some instances, programmatic responsibilities comprised a major portion of the internal audit unit's activities, indicating that agency may not be maintaining an emphasis on the internal audit function. Per the professional standards, the auditor should refrain from these types of activities.

²⁵ Internal Attribute Standard 1210 and Government Auditing Standard 3.42 also emphasize the need for the internal unit to, collectively, obtain the knowledge, skills, and other competencies needed to perform its responsibilities. These standards specifically address the need for skills related to information technology.

²⁶ The CISA and CISM certifications are offered by the Information Systems Audit and Control Association <http://www.isaca.org>

²⁷ the CISSP is offered by The International Information Systems Security Certification Consortium <https://www.isc2.org>

Government auditing standards²⁸ provide examples of non-audit services that are prohibited, stating that audit organization should not:

- Perform management functions or make management decisions.
- Serve as members of an entity’s management committee or board of directors.
- Make policy decisions that affect future direction and operation of an entity’s programs.
- Supervise entity employees.
- Develop programmatic policy.
- Authorize an entity’s transactions, or maintain custody of an entity’s assets.
- Maintain or prepare the audited entity’s basic accounting records or maintain or take responsibility for basic financial or other records that the audit organization will audit.
- Post transactions (whether coded or not coded) to the entity’s financial records or to other records that subsequently provide data to the entity’s financial records.
- Process the entity’s entire payroll if payroll was a material amount to the subject matter of the audit.

When the internal auditor does assume operational responsibilities, he/she must fully disclose those impairments in the audit documents related to those areas.

Other Matters Related to Auditor Independence

Auditor objectivity is a personal trait that is fundamental to the internal audit organization’s actual and perceived level of independence.

Independence and Objectivity of the Internal Audit Director

The GAO recognizes the need for internal auditors to be appointed in a manner that will remove them from political pressures as a means to help ensure the auditor’s independence and objectivity. Government auditing standard 3.29 states that:

“Auditors need to be sufficiently removed from political pressures to ensure that they can conduct their audits objectively and report their findings, opinions, and conclusions objectively without fear of political repercussions. Whenever feasible, auditors within internal audit organizations should be under a personnel

²⁸ Government Auditing Standard 3.14, 3.17(f), 3,18(a),(b)

system in which compensation, training, job tenure, and advancement are based on merit.”

Agency executive managers are, generally, members of the exempt class and are responsible for setting agency policy. Internal audit directors may also be members of the exempt class:

- The Act, as reflected in Article 45 of New York State Executive Law, states: “The position of internal audit director shall be an exempt position.....”
- BPRM Item B-350²⁹ provides for the appointment of the internal audit director to “either an exempt or classified position.”

In an exempt position, the director of the internal audit unit serves at the pleasure of the head of the agency and has no tenure protection. This situation could impact the director's ability to report findings, opinions, and conclusions objectively. To be effective in their role as evaluators of policy, and to comply with government auditing standard 3.29, it is important that all internal auditors, including the internal audit director, be assigned to classified (competitive) service, thereby formalizing their independence from executive management and enhancing their ability to conduct audits in an objective manner.

Independence and Objectivity of Internal Audit Staff

Maintenance of auditor objectivity requires a continuing assessment of the auditor’s relationship with the audited entities:

- IIA practice advisory 1130-1 states that the chief audit executive should periodically obtain from the internal audit staff information concerning potential conflicts of interest and bias.
- Government auditing standard 3.08(a) states that audit organizations “should establish policies and procedures that will enable the identification of personal impairments to independence...”

The Workgroup recommends that all internal audit staff members be required to complete independence certifications on an annual basis, consistent with internal audit standard 1130-1 and government auditing standard 3.08(a). Those certifications should identify actual and potential impairments to independence, and require internal auditors to report any new impairment to the internal audit director as they arise. Information on the collection of independence statements should be included in each agency’s annual internal control certification. Review of independence statements should be part of the peer review process.

²⁹ See Section V of BPRM Item B-350 - "Internal Audit Responsibilities."

RECOMMENDATIONS

1. The Division of the Budget should expand BPRM Item B-350 to:
 - a. Require the internal audit director to report the *results* of the unit's work to the head of the agency, and (if applicable) to the audit committee/board of directors (or other governing body).
 - b. Require that the internal audit director report *administratively* to the Agency Head or the designated executive deputy (or equivalent position). If the executive deputy (or equivalent position) individual has line or staff duties, the internal audit director should report directly to the Agency Head.
 - c. Establish a goal of quarterly meetings between the internal auditor and agency executive management/audit committee.
 - d. Require the internal audit director to distribute final reports to the Agency Head/executive deputy, audit committee, auditee and Internal Control Officer. Any further distribution of audit reports should be made only with the knowledge and permission of Agency Head or (if applicable) to the audit committee/board of directors or other governing body that oversees the Internal Audit unit.
 - e. Emphasize the relevance and importance of audit committees.
 - f. Endorse the independence of the internal audit and Internal Control Officer (ICO) functions. Establish limitations on internal control activities where those duties overlap. Require agencies to identify any impairment to the independence of an internal auditor who also serves as the ICO as part of the agency's internal control certification.
 - g. Provide guidance to internal audit functions regarding the assumption of operating responsibilities, performance of management functions or decision-making, or assumption of other monitoring roles (e.g., ICO or Information Security Officer (ISO)).
 - h. Require internal auditors to complete an annual independence statement that identifies actual and potential impairments to independence and requires they notify the internal audit director whenever a new actual or potential impairment arises. Similar direction should be included in any other guidance developed for internal auditing in New York State government.

2. The Division of the Budget should expand the annual internal control certification process to require information that:
 - a. Provides a current agency organizational chart that identifies the placement of the internal audit unit, the individual that has responsibility for overseeing the internal audit activity, and any other organizations or activities that may be under the purview of the internal audit director.
 - b. Describes the existence and composition of an audit committee.
 - c. Identifies any overlap between the duties of internal audit director and other management or monitoring responsibilities.
 - d. Indicates when the last independent review of the agency's internal control certification process was completed and, if applicable, the results of that review.
 - e. Discloses whether internal auditors are required to complete an annual independence statement and, if so, the date those statements were last collected.
 - f. The frequency of meetings held between the internal auditor and agency executive management and the audit committee (if applicable).
 - g. Agency protocols for the distribution of internal audit reports.

3. The Office of the State Comptroller should provide guidance related to the concepts in the above recommendations in its Internal Control Standards or any other publications developed for internal controls or internal auditing in New York State government.

4. The ICTF should work with the Department of Civil Service to review the classification of Internal Audit positions to ensure all internal auditors are sufficiently removed from political pressures and are under a personnel system in which compensation, training, job tenure, and advancement are based on merit.

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Internal Audit Director Qualifications

ACKNOWLEDGEMENTS

About the Report

This is one of nine reports that were issued by the New York State Internal Control Task Force (ICTF) in the summer of 2006.

The ICTF, led by a Steering Committee, was comprised of six Work Groups coordinated by Task Force Liaisons from the Division of the Budget (DOB), the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA).

About the Authors

The research for this study was conducted by Michael Abbott, Thomas Howe, and James Nellegar and with input from Phillip Maher, Theresa Vottis, William Gritsavage, Bradley Moses, David Koshnick, Joel Biederman, and Kevin O'Donoghue.

The report was written by Michael Abbott and James Nellegar.

Research Groups

The contents of this study were developed by the ICTF from its original research, professional guidance, and literature. It builds upon earlier reports by the New York State Assembly, audit reports by the OSC, and DOB budget bulletins.

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Stakeholders in this study include State Agencies, Public Authorities, the Division of the Budget, and the Office of the State Comptroller.

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BACKGROUND

The public demands that government agencies be held accountable for resources under their control. Internal auditors can assist management of those agencies in ensuring their controls and operations are efficient, effective, economical, and comply with laws and regulations. To carry out this important work, the internal audit unit must be directed by an individual with the necessary knowledge, skills, and other competencies.

Periodically, there have been reports (from both the legislature and the Comptroller's Office) that have noted that some New York State (State) agency internal audit directors do not have the necessary qualifications for the position. Most recently, the Office of the State Comptroller's Audit Report 2003-S-14, State Agency Internal Audit Units' Compliance with Internal Control Act, found that 11 out of 34 agencies did not fully comply with the requirement for the Director of Internal Audit (DIA) to have both internal auditing education and experience.

Without the necessary education and experience, the directors may not have the knowledge, skills, and competencies to accomplish the important responsibilities of the internal audit units.

OBJECTIVES AND METHODOLOGY

The Workgroup's objective was to define both the minimum qualifications, including education and experience requirements, along with preferred qualifications for the position of DIA. To accomplish our objective, we reviewed the New York State Governmental Accountability, Audit and Internal Control Act (Internal Control Act); Budget Policy and Reporting Manual (BPRM Item B-350); the Institute of Internal Auditors' Standards (IIA Standards) and supporting Practice Advisories; the U.S. Government Accountability Office's (GAO) Government Auditing Standards; recommended practices published by the Government Finance Officers Association (GFOA); job specifications issued by the Department of Civil Service; and job announcements for directors of internal audits from various public and private sector organizations. We also surveyed State internal audit units to obtain information on directors of internal audit including experience, education, and certifications.

RESULTS IN SUMMARY

Based on our research and survey results, it is clear that *some* State agencies have not historically placed a strong emphasis on relevant education and experience in making appointments to the position of DIA. In addition, there has been little or no oversight to ensure only qualified individuals are appointed. The role of the Division of Budget (DOB) in approving the appointments is not clearly defined and there are no established minimum qualifications for the position of

DIA. These conditions can have a detrimental effect on the effectiveness of internal audit and could be viewed as not establishing the proper “tone at the top” regarding the importance of internal audit activities. For this reason, minimum education and experience requirements should be established.

RESEARCH AND SURVEY RESULTS

The Workgroup reviewed requirements and guidance, current practices, and survey results to obtain an understanding of the environment. Our review showed there was inconsistency in the education and experience qualifications for the position of director of internal audit across agencies, governments, and the private sector. However, the qualifications most frequently mentioned were experience, college degree, knowledge of auditing standards, and communication skills. For this reason, they are the core of the required qualifications.

Requirements and Guidance

The Internal Control Act and BPRM Item B-350 do not provide specific guidance on the qualifications for the position of DIA. The Internal Control Act states the internal audit director shall “have appropriate internal auditing credentials.... including internal auditing education and experience.” BPRM Item B-350 states the DIA “shall reflect the qualifications of the Standards for the Professional Practice of Internal Auditing.” While the Internal Control Act required internal auditing education, there are very few colleges that provide educational programs in internal auditing. In addition, some individuals conducting performance audits³⁰ would not meet these requirements even though they would have similar experience as those conducting internal audits.

The IIA Standards do not specifically address the director’s qualifications, but state that the DIA should possess “the knowledge, skills, and other competencies needed to perform their individual responsibilities.”

³⁰ Government Auditing Standards, 2003 Revision, Chapter 2, Paragraph 2.09 – “Performance audits encompass a wide variety of objectives, including objectives related to assessing program effectiveness and results; economy and efficiency; internal control; compliance with legal or other requirements; and objectives related to providing prospective analyses, guidance, or summary information.”

The IIA's *Model Internal Audit Legislation for State Governments* states the chief audit executive shall possess one or more of the following qualifications:

- A bachelor's degree and five³¹ years of progressively responsible professional auditing experience as an internal auditor or external auditor, information technology auditor, or any combination thereof; or
- A master's degree and four years of progressively responsible professional auditing experience as an internal auditor, external auditor, information technology, or any combination thereof; or
- A certificate as a Certified Internal Auditor (CIA) or Certified Government Auditing Professional (CGAP) and four years of progressively responsible professional auditing experience as an internal auditor, external auditor, information technology auditor, or any combination thereof. In the absence of a CIA certificate or CGAP certificate, consideration should be given to require a CPA license or CISA credential.

The GAO Audit Standards do not specifically address the DIA's qualifications, but state staff collectively should have the necessary "technical knowledge, skills, and experience." They provide some specificity by requiring audit staff members to have knowledge of GAO Audit Standards, the audited entity's specialized areas or industry, and the subject matter under review; along with oral and written communication skills.

The AICPA has guidelines for hiring the chief audit executive and recommends the individual should have a CPA or CIA credential and have significant experience (10 years or more) in a management role, along with strong technical skills in accounting and auditing. In addition, the preferred qualifications include an advanced business degree such as an MBA.

The GFOA recommends, at a minimum, the head of the internal audit function should possess a college degree and appropriate relevant experience. It also states it is highly desirable that the head of the internal audit function hold some appropriate form of professional certification such as CIA, CPA, or CISA.

The Department of Civil Service has issued a job specification for the internal auditor series, which includes education and experience qualifications for senior, associate, and principal internal auditors. For example, the qualifications for a principal internal auditor are: bachelor's degree with a major in accounting, business or public administration, economics or industrial management, or a closely related field; and five years of progressively responsible experience

³¹ Where specific years of experience are referenced in the IIA qualifications, the number of years is provided as an example and it is up to the organization to specify the amount.

conducting internal audits or program research, review and appraisal, including two years in a supervisory capacity. A master's degree in one of the specified fields may be substituted for one year of the required non-supervisory experience.

Current Practices

Our review of job announcements for the DIA for two State agencies, the federal government, and the private sector shows a wide variation in education and experience requirements. Further, there is a significant variation in the minimum qualifications that have been established.

State Agencies

The records of the Department of Civil Service show, as of March 31, 2005, 28 of the 34 positions of director of internal audit in the State are in the exempt jurisdictional class and there is no one set of established minimum qualifications for the positions. Rather, each agency is responsible for establishing the qualifications for the position. This point was further confirmed by our survey where 18 out of the 29 agencies responding indicated that they have not developed education and experience requirements for the DIA.

A review of job announcements for DIA positions at two State agencies noted the following.

- One State agency required a bachelor's degree and a minimum of five years of progressively responsible management experience with an organization that monitors, reviews, or audits program or fiscal operations. Two of these years should include supervisory experience. The candidate should have knowledge of governmental operations, an ability to identify management organizational and operating problems and be able to assess their implications, and effective communication skills to articulate audit objectives and findings.
- Another State agency required that the successful candidate exhibit executive management level skill, education, and employment history that meets the criteria for certification by the IIA or a similarly recognized professional organization. Three years of this experience must have been that of a managerial role in an auditing function for a large organization or recognized auditing or accounting firm. The preferred qualifications were for higher level auditing or accounting educational credentials, full certification by a recognized body as noted above, experience focusing on the agency's service sector, and experience in a governmental setting or with governmental relationships.

Federal Government

We noted the following after reviewing job announcements for the position of assistant inspector general,³² a job which has some similarities to the DIA:

- One position for an assistant inspector general for audit and evaluation required a bachelor's degree in accounting or business administration and a minimum of five years of professional experience in auditing. A strong knowledge and in-depth experience in auditing standards and practices is required along with one of the following licenses or certifications: Certified Defense Financial Manager, Certified Financial Manager, Certified Government Financial Manager, Certified Internal Auditor, Certified Information Systems Auditor, Certified Management Accountant, Certified Public Accountant. The individuals must also have skills and knowledge related to networking, non-technical writing, leadership, process improvement, GAO audit techniques, and quality control principles.
- Another position of assistant inspector general had mandatory technical and executive core qualifications. The technical qualifications were a thorough knowledge of generally accepted auditing practices and Government Auditing Standards as applied to financial and compliance audits (evaluations and reviews), economy and efficiency audits (evaluations and reviews), and program audits (evaluations and reviews); and demonstrated experience in designing, managing, coordinating, and directing audits or evaluations of highly complex and diverse subjects. The executive core qualifications were in five key areas including leading change, leading people, results driven, business acumen, and building coalitions/communication. Under each of these areas, there was an explanation of the abilities needed. For example, under leading people, the qualification was the ability to design and implement strategies which maximize employee potential and foster high ethical standards in meeting the organization's vision, mission, and goals. The position also required the ability to explain, advocate, and express facts and ideas in a convincing manner, and negotiate with individuals and groups internally and externally. It also involved the ability to develop an expansive professional network with other organizations and to identify the internal and external politics that impact the work of the organization.

It is interesting to note the qualifications for the latter federal position do not mention any educational degree requirements or certification. That may be due, in part, to the fact that the federal government uses program evaluators with various backgrounds, in addition to auditors, to conduct its audits, reviews, and studies. If the qualifications required accounting, auditing, or

³² Job announcements for the position of inspector general, as opposed to the assistant inspector general, were not readily available.

business education, it could discriminate against those otherwise qualified individuals. Therefore, we did not specify as a requirement that the bachelor's degree needed to be accounting or a closely related field.

Private Sector

A review of the qualifications for the position of DIA at several Fortune 500 companies found the requirements also varied. One company required a bachelor's degree in accounting, finance, or a related field; certification such as CPA, CISA, and/or CIA; and 10 to 15 years of relevant experience. Another company required a bachelor's degree in accounting or auditing, knowledge of internal audit practices, and a certification, such as a CPA, CIA, CISA, or certified management accountant (CMA).

Survey Results

The survey results show that 18 out of 29 agencies did not develop education and experience qualifications for the DIA. Without established qualifications, there is a wide variation in the education and experience levels, as well as certifications of directors of internal audit in State agencies.

The results show that:

- 2 out of 29 directors of internal audit do not have a bachelor's degree.
- Of those with a bachelor's degree, only 17 reported being an accounting major.
- 8 individuals reported earning a master's degree.
- The number of years of experience as an internal auditor ranged from none to 33, with 15 being the average number of years.
- 6 out of the 29 directors did not have 5 or more years experience in conducting internal audits.

It is questionable whether an individual with little or no experience as an internal auditor could effectively oversee the responsibilities of the internal audit unit. Using the proposed minimum education and experience qualifications, 8 of the 29, or 27.6 percent, of the directors of internal audit do not have the necessary qualifications.

The survey results show that the number of professional certifications per director ranged from none to four. Collectively, 12 out of the 29 individuals earned one or more certifications such as CPA or CIA. Surprisingly, only three individuals reported being certified as a CIA.

CONCLUSION

The research and survey results show the need to implement minimal qualifications for the position of DIA and procedures to ensure only qualified individuals are appointed to the position. Internal audit units led by qualified individuals can help ensure accountability is established over the State's resources.

RECOMMENDATIONS

Based on our research and survey results we recommend the following which, if implemented, will provide a defined set of qualifications for the position of DIA and ensure those qualifications are consistently met.

1. The Division of the Budget should adopt the following minimum and preferred qualifications in BPRM Item B-350 for DIA positions.

Required Minimum Qualifications

- Bachelor's degree.
- Five years progressively responsible experience conducting or managing one or more of the following: audits, examinations, or program reviews, and, in addition, two years in a supervisory capacity.
- Extensive knowledge of professional audit standards.
- Demonstrated oral and written communication skills.

Preferred Qualifications – Must Also Meet the Required Minimum Qualifications

- Professional certification such as Certified Internal Auditor (CIA), Certified Public Accountant (CPA), or Certified Information Systems Auditor (CISA).
- Master's degree in accounting, business, public administration, economics, management, or a closely related field to the agency's service sector.
- Experience focusing on the activities of the agency's service sector.
- Extensive knowledge of public sector operations.

2. DOB should clarify its role in approving individuals as Directors of Internal Audit.

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Internal Audit Staffing

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BACKGROUND

The New York State Governmental Accountability, Audit and Internal Control Act (Internal Control Act) requires the Director of the Division of the Budget (DOB) to develop, and periodically revise, a schedule of Executive Branch agencies that are required to establish and maintain an internal audit function. DOB requires approximately thirty-three agencies to maintain an internal audit unit due to potential operational vulnerability and exposure to risk per the Budget Policy and Reporting Manual (BPRM) Item B-350.

Staffing of the internal audit function has been a concern in the past. In October 1997, the New York State Assembly (“*Who’s Minding the Store*”) reported that most internal audit units were understaffed. In August 2004, the New York State Office of the State Comptroller (Report 2003-S-14, “*State Agency Internal Audit Units’ Compliance with Internal Control Act*”) cited two agencies listed in BPRM Item B-350 for not implementing an internal audit function.

In October 2004, DOB – in conjunction with the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA) – formed an interagency internal control task force (ICTF) to address the internal audit issues identified in the OSC’s report, as well as to provide guidance on the broader internal control requirements of the Internal Control Act. The ICTF created six work groups, and assigned the organization and staffing workgroup (Workgroup) issue of establishing minimum staffing guidelines for internal audit units.

RESULTS IN SUMMARY

In an era of increasing emphasis on organizational accountability, efforts to improve internal controls, risk management and corporate governance bring an unprecedented focus on internal audit organizations. Given the stakes (New York State’s budget for fiscal year 2006-07 is more than \$112 billion), staffing of those organizations is an important consideration for internal audit units. To be successful in their charge, it is important that they have access to adequate levels of human resources that possess the necessary skills – and be able to compete in a dynamic marketplace for the services of talented and qualified audit professionals.

While we identified no standard methodology for determining staffing levels for internal audit units, our survey data indicates that some BPRM Item B-350 agencies are staffed well below averages for reporting agencies as a whole, and as compared to other agencies in the same service sector and to government industry data provided by the Institute of Internal Auditors. We also noted that many Executive Branch agencies are not required to maintain an internal audit function (i.e., non-B-350 agencies). As a group, we estimated those agencies had over \$2.3 billion in expenditures in fiscal 2004-2005. This figure is an indicator of the *potential* risk associated with agency expenditures; it does not address programmatic or compliance risks that are inherent to those agencies’ business and operational processes. The Workgroup believes a

collective approach may be an ideal way of providing internal audit coverage and mitigating risk in these relatively smaller State agencies.

Substantial work is needed to develop and improve the job market for internal auditing in New York State. Internal audit units that responded to our survey reported a marginal ability to recruit and retain qualified professionals. This situation is likely due to the job market for internal auditors in New York State being relatively small, little use of the internal audit titles series, and the fact that the career ladder for internal auditors is more limited than for some other accounting and auditing careers in New York State government.

We also noted that opportunities exist to improve the efficiency and effectiveness of the internal audit workforce by: coordinating the efforts of internal audit units, encouraging internal auditors to pursue professional certifications, and assisting agencies in the procurement, deployment and use of data-based audit management tools and Computer Assisted Audit Techniques (CAATs).

OBJECTIVES AND METHODOLOGY

Our objectives were to: 1) Develop guidance to help agencies determine necessary staffing levels for internal audit units; and 2) Review relevant recruiting, retention classification, and compensation issues that may impact internal audit staffing.

To accomplish our objectives, the Workgroup reviewed applicable laws and professional research related to internal audit staffing and surveyed Executive Branch agencies regarding organization and staffing issues. After completing our research and obtaining survey information, the Workgroup:

- Analyzed internal audit staffing levels among agencies and within service sectors;
- Compared internal audit staffing data to benchmark government sector data from the Institute of Internal Auditors' (IIA) Global Audit Information Network (GAIN);
- Summarized recruitment/retention and classification/compensation issues identified from our survey and research; and
- Summarized other information from our survey and research that related to the internal audit workforce, including demographic information and technology profiles for internal audit units.

Thirty-five agencies responded to the Task Force surveys on staffing and recruiting and retention. Of the 35 responses, 30 were agencies required to comply with BPRM Item B-350.

RESULTS OF REVIEW

This Workgroup report focuses on permanent staffing of internal audit units. It includes:

- Analysis of current internal audit staffing levels (focusing on Executive Branch agencies);
- Guidance on using risk assessments to evaluate human resource needs; and
- Other matters related to the internal audit staffing including:
 - a. Coordination of the efforts of internal audit units;
 - b. The demographic profiles for internal audit units responding to our survey; and
 - c. Technology profiles for those units.

Internal Audit Staffing Levels

The passage of the Sarbanes-Oxley Act on the national level has placed an increased emphasis on the need for internal auditing, as well as an increased demand among executives for the audit and consulting services that internal audit organizations can deliver. That increase in demand requires that New York State internal audit units have the ability to compete in a dynamic marketplace for the services of talented and qualified audit professionals.

Internal audit units provide a variety of services. Agency management needs to assess its internal audit needs and the required level of staff to meet those needs. The Workgroup could not identify a standard method for calculating the appropriate level of staff size for internal audit organizations in professional literature. Subsequent sections of this report discuss consideration of industry averages, risk assessments and identification of recurring projects when assessing the appropriateness of internal audit staffing levels.

Internal Audit Staffing Levels at BPRM Item B-350 Agencies

The Internal Control Act requires Agency Heads, as identified in BPRM Item B-350, to appoint a Director of Internal Audit. Although BPRM Item B-350 states that the internal audit director is responsible for ensuring that the size of the audit staff is adequate to complete the annual work plan, it does not provide a standard process for determining staffing levels. Thus, the Act and BPRM Item B-350, considered together, require only that the position of DIA be filled – and only at the 33 agencies identified in BPRM Item B-350. Internal auditing is an activity that relies on a vibrant exchange of ideas among those studying a process or problem. As such, the Workgroup believes an internal audit unit that consists of only one full-time internal auditor to be less than the ideal. Eight agencies that responded to our survey had only one person assigned

to the internal audit function. Of the eight, two of those individuals worked less than 50 percent of the time on internal audit matters.

Our analysis of survey data³³ shows a wide variation in staffing levels. Some agency's internal audit units are staffed well below averages for reporting agencies as a whole and within their service sector.

While it's helpful to have empirical data on which to base an evaluation of each agency's own staffing, it is important to keep in mind that survey data details only what agencies are doing; not what they should do. The average, high and low data can be used to help agencies assess the adequacy of the size of the internal audit unit on a comparative basis; but it is also critical to acknowledge that averages are only one consideration in the complex task of assessing the adequacy of internal audit staffing – a starting point. After making comparisons, agency managers need to consider other factors that impact the staffing needs. For example, business model and program complexity; the number of agency locations and degree of decentralization; availability of qualified candidates for internal audit positions; and executive management's expectations and risk tolerance.

We evaluated agency internal audit staffing by comparing: 1) Internal audit staffing to agency funding;³⁴ and 2) Internal Audit staffing to total agency staffing. For each analysis, we compared internal audit staffing to statewide averages and within service sectors as defined by the Office of the State Comptroller.

We found a wide variance in the ratios between internal audit staffing to agency appropriations, both on a statewide basis and within service sectors. On a statewide basis, the variance among B-350 agencies was 0.00 to 0.02 internal audit staff per \$1M in agency appropriations. We noted that wide ranges in internal auditing to staffing exist within some sectors. For example, in the public health segment the Department of Health was at .00005 while the Office of Mental Health was .00385. The chart below includes agencies that had internal audit staffing ratios that were lower than both the statewide average *and* within their respective service sector.

³³ Survey data includes information for three agencies, which are not required to comply with BPRM Item B-350. Data for those agencies did not have a significant effect on Statewide or service sector averages.

³⁴ Although most State agencies are funded through the appropriations process, some derive their funding from independent revenue streams that should be considered when evaluating overall risk. For example, the State Insurance Fund reported revenues from insurance premiums of over \$1.5 billion in fiscal 2004-05 — and an investment portfolio of over \$9.5 billion.

B-350 AGENCY³⁵	IA STAFF PER \$1M IN AGENCY APPROPRIATIONS		
	AGENCY RATIO	STATEWIDE RATIO	SECTOR RATIO
Department of Correctional Services	0.00000	0.001171	0.00328
Department of Health	0.00005	0.001171	0.00027
Education Department	0.00010	0.001171	0.00054
Temporary and Disability Assistance	0.00057	0.001171	0.00115
Department of Labor	0.00056	0.001171	0.00115
Division of Criminal Justice Services	0.00066	0.001171	0.00328

We found a similar variance in the ratios between internal audit staffing to total agency staffing. Among B-350 agencies the variance was 0.00 to 0.005 internal audit staff per agency employee. We noted wide variance within sectors for this analysis as well. For example, in the transportation sector the Department of Transportation was at .0009 while the Department of Motor Vehicles was at .0038. The GAIN benchmark for internal audit staff to total number of employees was 0.00150. The chart below includes agencies that had staffing ratios lower than both the statewide *and* within the respective service sector.

B-350 AGENCY	IA STAFF PER TOTAL NUMBER OF AGENCY STAFF		
	AGENCY RATIO	STATEWIDE RATIO	SECTOR RATIO
Department of Correctional Services	0.00000	0.00046	0.00031
Office of Mental Retardation	0.00005	0.00046	0.00027
Department of Agriculture and Markets	0.00010	0.00046	0.00061
State University of New York	0.00011	0.00046	0.00013
City University of New York	0.00012	0.00046	0.00013
Department of Civil Service	0.00036	0.00046	0.00091

We also noted that one agency listed in the tables above reported having significant operations statewide and a decentralized administrative structure. In a decentralized agency, the risks may be greater and internal auditors can provide senior management and the audit committee with continuous feedback on relatively autonomous components of agency operations. The internal auditor is also in a position to identify and recommend best practices among regional operations.

³⁵ While an agency's total appropriations and FTEs are a starting point for conducting a study of internal audit staffing needs, other indicators such as organizational and program size and structure, relative risk, and corresponding controls, among other factors would also have to be taken into consideration. A summary of analytical data for all BPRM Item B-350 agencies, and other agencies that responded to the Task Force surveys, is included as Appendix 1 to this report. Sector averages are included as Appendix 2.

Internal Audit Coverage at Non- BPRM Item B-350 Agencies

Agencies not subject to BPRM Item B-350 should be provided with an economical means of obtaining internal audit coverage.

As part of our research, we quantified appropriation data for Executive Branch agencies that are not required to maintain an internal audit function (i.e., non-B-350 agencies). Appropriation information provides *an indicator* of the level of potential risk associated with operations for those agencies. These statistics do not address programmatic or compliance risks that are inherent to these agencies' business processes. We developed our estimate by removing appropriations attributable to the State Legislature, the State Comptroller's Office, the Attorney General's Office, the Judiciary, public authorities and other miscellaneous items.³⁶ We estimate Executive Branch agencies that are not required to have an internal audit function had over \$2.3 billion in appropriations for fiscal 2004-05.

Every agency should have the opportunity to obtain internal audit coverage. While providing dedicated, full-time staff may not be financially feasible at every agency, a practical approach would be to cover those agencies through shared services or outsourcing. The Workgroup believes a collective audit approach may be an ideal way to provide audit coverage for these agencies, as it would:

- Allow costs to be shared among agencies;
- Provide a mechanism for sharing audit expertise on common business processes; and
- Provide a means for identifying and sharing best practices among covered agencies.

Using Risk Assessments to Assess Human Resource Needs

In most New York State agencies, managers are responsible for assessing risks and controls for their functional areas. The agency Internal Control Officer (ICO) oversees the internal control process and provides an annual internal control certification to DOB. Internal audit units may also perform independent risk assessments of agency operations as part of their planning process.³⁷

³⁶ These branches of government are covered by separate legislation and were not within the scope of our review. Costs for the State University of New York and City University of New York campuses were included in our estimates.

³⁷ When developing independent risk assessments of agency operations, the internal auditor can refer to two risk models provided by the IIA. These approaches are detailed in "Internal Auditing Manual on CD-ROM," second edition. Copyright © 2002, The Institute of Internal Auditors.

Internal control certification and risk assessment data that results in a ranking of risks (i.e., quantitative or categorized by level or risk) can help the DIA define the audit population and prioritize projects based on the relative risk. Using these rankings as a guide, the DIA can then develop an audit plan and a corresponding estimate of the staff needed to complete the requirements of the plan.

First Things First

Before analyzing existing risk assessment data and preparing an audit plan, the DIA should:

- **Clarify Expectations with Agency Management and the Audit Committee:** It is the DIA's responsibility to formally discuss the results of risk assessments with agency management and the audit committee prior to development of the annual audit plan. These discussions should result in a clear understanding of the expectations and priorities of all parties.
- **Consider the Quality of the Internal Control System and Risk Assessments:** The DIA should be satisfied as to the sufficiency of the internal control system, and the quality of risk assessments encompassed therein, before relying on that data. For example, the auditor should feel comfortable that:
 - a. Risk assessment data is current;
 - b. All functional and risk areas have been adequately defined;
 - c. All functional units are reporting as required;
 - d. All significant risks have been inventoried;
 - e. All significant risks have been assessed and scored or categorized.

Prioritizing Projects

After ranking potential projects by relative risk, the DIA needs to consider other, non-quantitative, items which may affect decisions relative to the proposed audit plan. For example:

- How potential projects will address the agency's needs and compare to the agency's overall objectives;
- How potential projects will impact financial results, compliance, agency productivity and service delivery;
- Whether recurring items are included in the plan;
- Whether risks unique to the agency or its industry are reflected in the plan;
- The number of agency locations and degree of decentralization; and
- Executive management's risk tolerance.

Consideration of qualitative factors could change the overall priority of individual projects on the internal audit unit's proposed audit plan.

Identifying Resource Needs and Staffing Gaps

After developing a proposed audit plan built on ranking of risks, management and audit committee priorities and qualitative factors, the DIA can begin developing resource estimates. For each proposed project, the DIA should assess the amount of staff days needed and any specialized knowledge or skills necessary to handle the total workload. For example, the project may require program expertise or a strong knowledge in engineering or information technology.

Projects that are recurring in nature are predictable in terms of the amount of human resources that must be committed to meet the project objectives. Recurring projects may be required by law, regulation or rule. Requirements may also arise from management or audit committee direction as to the level of emphasis to be placed on an issue or topic.

OSC Bulletin No. G-212, for example, requires an audit of procurement no less than every three years. If a procurement audit at a decentralized agency requires 40 days to perform, on average, and the agency has 12 locations, the annualized impact on the human resource budget for internal auditing would be 160 days:

Procurement Cycle Example

A	B	C	D
Number of Days	Number of Locations	Cycle	Annualized Resource Intensity ((AxB)/C)
40	12	3 Years	160

Of the 34 agencies responding to the Task Force survey on baseline resource needs, 18 were able to describe a list of recurring projects that included (annualized) resource estimates. These projects included, for example, audits of procurement, equipment, travel and Internet use.

For the 34 agencies:

- The number of recurring projects ranged from 1 to 13 projects.
- Resource estimates for recurring projects ranged from 13.50 days per year to 3,722 days per year.

Maintaining an inventory of recurring projects can ease the task of estimating human resource needs, as well as facilitate discussion and a mutual understanding between the DIA, executive management and the audit committee as to which areas are, or should be, reviewed on a periodic basis.

Filling the Resource Gap

Prior to discussing the proposed audit plan with agency management and the audit committee, the internal audit director should develop a set of alternatives to address any gaps that may exist, along with a rationalized course of action. A cost/benefit analysis for each alternative, for example, would be useful in this regard. The DIA should seek clear direction from agency management and the audit committee as to which alternatives should be pursued.

If it is necessary to augment audit staff — a likelihood given the variety of new demands placed on internal auditors — the DIA will need to borrow staff, purchase services or hire staff to meet those demands, or choose some combination thereof.

- **Insourcing:** One option for meeting temporary increases in demand or the need for specialized skills is to borrow qualified staff from other offices within the agency. In these situations, the DIA needs to specifically define the skills that are required, the tasks that will be performed and the anticipated time frames for the project. The DIA should be comfortable that the individuals assisting in the project have the requisite skills and abilities to complete the assignment.
- **Outsourcing/Shared Services:** Where borrowing staff or adding full-time employees is impractical, the internal audit organization may want to consider augmenting core staff with outside expertise. Outsourcing and Shared Services (partnering with internal audit professionals from another State agency) provide internal audit units with the ability to meet temporary demands without taking on the cost of adding permanent staff. By bringing in professionals from other organizations, the internal audit unit can benefit from fresh perspectives and objective insights. Using outside personnel presents challenges too. For example, outsourcing a project can be a time consuming effort and personnel from an outside firm or a partner may not be able to assimilate into the team as quickly as an experienced internal auditor.

- **Adding Full-time Staff:** When internal audit units want to expand or acquire new expertise, the traditional approach is to hire full-time professionals. Hiring full-time staff is a costly approach that must be matched to a long-term need. Benefits of adding full-time staff include:
 - Building a strong and permanent base of skills.
 - Creating stability by adding staff that understand the agency structure, practices and culture.
 - Building relationships with other offices in the agency.

Each internal audit unit's particular needs and compliance deadlines will dictate whether borrowing staff, purchasing services or hiring staff – or using a combination of these options – is right for the agency. Each comes with its own benefits and risks.

Personnel Matters

With the advent of Sarbanes-Oxley, demand for internal auditors is increasing. It is imperative that New York State maximizes its ability to attract talented professionals to a logistically and organizationally dispersed workforce by providing for a fair and effective classification and compensation system for internal auditors.

As part of our review, we surveyed internal audit organizations regarding their ability to recruit and retain qualified internal audit professionals. We also:

- Collected data on the title series used by agencies to staff internal audit units; and
- Evaluated the compensation plan for internal auditors as compared to other accounting and audit titles used in New York State government.

Further information on the internal audit workforce is presented on page 88 of this report.

Recruiting

Ability to Recruit

We asked agency internal audit units to respond to statements (shown in the charts that follow) related to their ability to recruit qualified professional to internal audit positions. We scored responses from a -2 (strongly disagree) to a + 2 (strongly agree). The statements are positive in nature and, thusly, average responses of 1.0 or more (agree → strongly agree) are favorable.

Ability to Recruit

Statement	Average Score
“When we are authorized to hire, our Internal Audit Group <i>has</i> an ability to recruit new employees <i>that is equal to</i> that of other accounting, audit and financial organizations <i>in our agency.</i> ”	.80
“When we are authorized to hire, our Internal Audit Group <i>has</i> an ability to recruit new employees <i>that is equal to</i> that of other accounting, audit and financial organizations <i>in New York State government.</i> ”	.54

The 35 agencies that responded to our recruiting survey, collectively, reported marginally favorable views as to their ability to recruit. Comments provided in the recruiting portion of our survey did describe some challenges that internal audit units were experiencing. Those comments addressed:

- The need for a traineeship in the internal auditor series.
- Intermingling of the internal auditor and auditor title series.
- Lack of ability to hire based on qualitative factors (e.g., resume, interview and a writing sample).

Desired Education, Skills and Job Titles for the Future Workforce

We also asked agencies about education, audit skills, and the job titles they would be most interested in if they could add new staff. For the 35 groups responding, we accumulated the information that follows.

Desired Level of Education and Coursework

<u>#</u>	<u>Topic</u>
34	Agencies Preferring a Bachelor’s Degree
19	Average # of Accounting Credits Preferred
3.94	Average # of Auditing Credits Preferred
1.62	Average # of Years of Auditing Experience Preferred

Ranking of Skills Desired

<u>Average Ranking</u>	<u>Skills</u>
6.94	Knowledge of the agency and its processes.
6.49	Proficiency in computer-assisted audit tools.
6.11	Knowledge of information technology auditing.
6.00	Proficiency in basic business software.
4.23	Demonstrated ability to develop written communications.
4.03	Ability to assess internal controls.
3.94	Demonstrated ability to communicate verbally.
3.34	General analytical skills.
2.94	Knowledge of accounting/auditing/finance.

Retention

We also surveyed internal audit units regarding their perceptions of their ability to retain qualified internal audit professionals.

Ability to Retain Qualified Internal Audit Professionals

Statement	Average Score
"Our organization <i>has</i> the ability to retain our employees in a manner <i>equal to</i> that of other accounting, audit and financial organizations <i>in our agency</i> ."	.40
"Our organization <i>has</i> the ability to retain our employees in a manner <i>equal to</i> that of other accounting, audit and financial organizations in <i>New York State Government</i> ."	.46

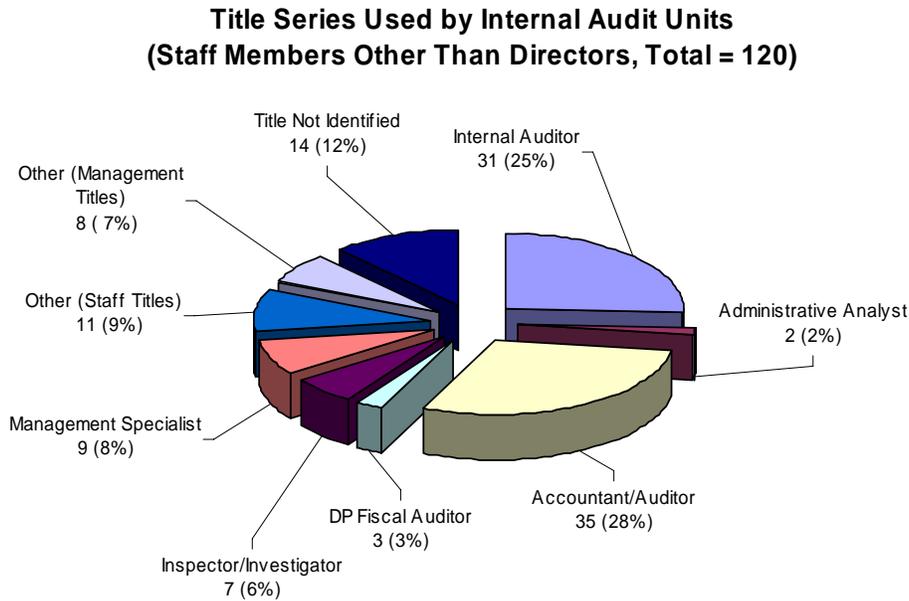
The overall average scores were only marginally positive. Comments provided in the retention portion of our survey also described some of the challenges that internal audit units were experiencing in retaining staff. Those comments addressed:

- Few promotion and career opportunities.
- Lack of ability to retain staff with information technology skills (move to technology-oriented organizations).

Classification and Compensation

Classification

We assembled survey information regarding how State agencies classify internal audit positions (i.e., title series used). Internal audit units responding to our survey use a wide array of title series to staff the internal audit activity.



Although there is a title series for internal auditors, many agencies have not elected to use it. As a result, the opportunities for internal auditors in New York State are not robust as other title series and do not offer the opportunities needed to attract and retain talented individuals to the profession.

Internal Audit Career Ladder

Internal auditing, as an industry within New York State government is at a competitive disadvantage. The career ladder in the internal audit title series ranges from a salary grade 18 (Senior Internal Auditor) to salary grade 27 (Principal Internal Auditor). Internal audit positions beyond the Principal Internal Auditor level are generally exempt positions that are not part of competitive internal audit career ladder. By comparison, the competitive career ladder for some other accounting and audit titles in New York State range from salary grade 14 (trainees) to salary grade 35 (equivalent to an M-6). As a result, internal auditing careers are not as financially attractive as other accounting and audit careers in New York State government.

Director of Internal Audit Compensation

In reviewing our survey results, we noted that DIA's compensation varies widely. The reported salary grades for these positions ranged from an M-2 through M-6. While the workgroup recognizes the need for differing compensation due to the size of the agency or complexity of its operations, there does not appear to be a system to ensure compensation is commensurate with responsibilities.

Other Matters Related To The Internal Audit Workforce

The Workgroup also considered workforce issues that present opportunities to increase the efficiency and/or effectiveness of internal audit units, or were presented to us by respondents to our survey.

Coordinating Internal Audit Units

Sharing resources and expertise to the extent possible will maximize the efficiency and effectiveness of internal audit units. The Institute of Internal Auditors slogan, "*Progress Through Sharing*", reflects this philosophy.

In New York State, the internal audit workforce is dispersed across all branches of government and is comprised of relatively small workgroups, organized by agency. Although many of these organizations may belong to local chapters of the IIA, no mechanism exists that encourages these units to communicate and coordinate efforts horizontally. Issues internal audit units could coordinate on include:

- Sharing best practices for assessing and prioritizing risk in government operations;
- Sharing audit programs and template reports for common business processes;
- Promoting agency best practices identified by audit or review;
- Assessing business needs, including frequency and content of civil service examinations;³⁸
- Sharing technology; and
- Developing the internal audit workforce and promoting professional certifications.

³⁸ For those agencies whose auditors are in classified service.

The Workgroup recommends that a coordinating body be formed to identify and address issues of common interest to internal audit organizations. We also recommend the development of an internal audit website to facilitate communication on key and emerging issues. A website would also be useful for:

- Maintaining a directory of internal audit organizations statewide;
- Posting internal audit policies and procedures;
- Sharing technology expertise;
- Maintaining information on continuing professional education (tracking CPEs and course offerings); and
- Communicating the requirements and review programs for external assessments (Peer Review).

Demographic Profiles of Internal Audit Units

When assessing the abilities of the internal audit workforce, it is useful to have an understanding of how that workforce's level of experience compares to industry norms. As part of our survey, we obtained demographic information from internal audit units regarding the experience and certifications of internal audit directors and their staff, and compared that information to GAIN data.

a. Internal Audit Experience

Internal audit units responding to our survey reported a level of internal auditing experience for the director (15 years) that was generally consistent with director experience for government organizations reporting to the GAIN survey (13 years). The range of internal auditing experience for internal audit directors in State agencies, however, ranged from *no experience* to 33 years. Five of the 22 directors (23 percent) have less than three years of internal auditing experience.

Average internal audit experience for staff members in State agencies was lower than that for GAIN data. For the agencies responding to our survey, the average internal audit experience for staff members was 8.8 years. Respondents to the GAIN survey reported an average of 10 years of experience for internal audit staff.

b. Professional Certifications

Professional certifications are becoming increasingly important for internal auditors due to increased visibility, credibility, and competency concerns. Professional certifications also provide senior managers with valuable insight regarding the skills of staff members. For these reasons, the Workgroup recommends that the State encourage professional certifications.

Professional certifications were not as prevalent in the internal audit units responding to our survey (28 percent of staff³⁹ had at least one professional designation) as compared to government organizations responding to the GAIN survey (44 percent of staff). Professional designations among internal audit units responding to our survey were as follows:

Professional Certifications

	CIA	CCSA	CFE	CGAP	CGFM	CISA	CPA	At Least one Certification
Directors (29)	3	0	2	0	6	1	8	14 (48%)
Staff (120)	13	1	4	0	10	10	10	34 (28%)

One survey respondent suggested that the State incorporate professional certifications, such as the Certified Internal Auditor and Certified Information Systems Auditor, into the minimum qualifications for both the promotional and open competitive process. Providing additional credit in the examination process for professional designations would provide an additional incentive for internal auditors, but not a requirement, to pursue professional certifications. Another option to promote certifications would be for the State to obtain, or subsidize the purchase of, review materials for professional examinations.

c. Negotiating Unit

Our survey results show that some internal audit positions are union-represented while others are management confidential. Eighty-nine (74 percent) of 120 internal audit staff described in the responses to our survey were classified as members of negotiating units other than the management-confidential group.

³⁹ GAIN data did not isolate certifications for internal audit directors.

Internal Auditors routinely have access to executive management information and, as such, should be considered to be part of the management team. Accordingly, they should be classified as part of the management-confidential negotiating group.

Technology Profiles of Internal Audit Units

Staff's ability to use technology is an important aspect of any analysis of staffing needs. Using the appropriate types of technology can help internal audit organizations increase their efficiency. Technology can also enhance the effectiveness of internal audit staff by increasing the overall capabilities of the team.

We obtained technology profiles from internal audit units as part of our survey. We found that opportunities do exist to improve the efficiency and effectiveness of internal audit units by increasing the use of technology. Of the 34 agencies responding:

- Ten (29 percent) respondents told us they use data-based audit management systems for automating the audit process (e.g., risk assessments, planning, scheduling, work papers, reporting, issue tracking, time reporting, expenses, training records, etc.).
- Nineteen (56 percent) told us they use a data analysis tools such as ACL or IDEA. This type of software are commonly categorized as "Computer Assisted Audit Techniques (CAATs) and enables the auditor to perform more complicated analyses on a larger number of audit records than possible when using spreadsheet or database type software. Evaluation and use of electronic audit packages is addressed in the report from the Internal Audit Process Workgroup.

RECOMMENDATIONS

1. The ICTF should:
 - a. Work with agencies identified in the table in this section to assess their internal audit staffing needs and identify plans to meet those needs.
 - b. Publish guidance on using risk assessments to estimate total staffing needs.
 - c. Identify methods for providing audit coverage at other agencies, including:
 - Coordinate the efforts of internal audit units statewide;
 - Host an internal audit website; and

- Help agencies improve staff productivity by providing assistance in the procurement, deployment and use of data-based audit management tools and Computer Assisted Audit Techniques (CAATs).
- d. Encourage professional certifications by:
- Working with the Department of Civil Service to recognize in examination processes; and
 - Obtaining/subsidizing review materials/courses.
- e. Work with the Department of Civil Service to:
- Classify internal audit as management confidential positions statewide;
 - Create a traineeship for the internal audit title series. Consider establishing an internship program for internal auditing;
 - Evaluate the potential for transferability between accounting/audit series positions and the internal audit title series.
 - Develop a compensation classification and career ladder that is competitive with other accounting and auditing careers in New York State; and
 - Encourage internal audit units to use the internal audit title series.
2. Agencies should:
- a. Maintain an inventory of recurring audit projects.
 - b. Report on internal audit staffing as part of an annual internal audit report to agency management (discussed in the independence section of this report).
 - c. Review internal audit staffing levels annually and discuss with agency management the need for any additional internal audit staff.

Summary of Ratio Analysis for BPRM Item B-350 Agencies and Other Respondents ⁴⁰

AGENCY	Internal Audit FTE's	Agency Service Sector	Agency Appropriation 2004-05*, ** (Millions)	Number of Agency Staff	Internal Audit Staffing Per \$1M Expenses			Internal Audit Staffing Per Agency Staff		
					Agency	All Respondents	Service Sector	Agency	All Respondents	Service Sector
Agriculture and Markets	0.41	Economic Development	\$147.00	4,152	0.00279	0.00117	0.00642	0.0001	0.000464	0.000610
Alcohol & Substance Abuse Services.	1.50	Public Health	513.65	970	0.00292	0.00117	0.00027	0.0015	0.000464	0.000272
Alcoholic Beverage Control	0.25	Regulatory Agencies	13.86	147	0.01804	0.00117	0.00801	0.0017	0.000464	0.002402
Banking Department	2.00	Regulatory Agencies	84.64	576	0.02363	0.00117	0.00801	0.0035	0.000464	0.002402
Children and Family Services	10.25	Public Welfare	3,178.05	3,957	0.00323	0.00117	0.00115	0.0026	0.000464	0.001531
City University of New York	6.00	Cultural and Educational	3,289.17	47,657	0.00182	0.00117	0.00054	0.0001	0.000464	0.000132
Civil Service, Department of	1.00	Operating Government	58.52	2,817	0.01709	0.00117	0.00569	0.0004	0.000464	0.000907
Correctional Services	0.00	Public Safety	2,417.96	31,660	0.00000	0.00117	0.00328	0.0000	0.000464	0.000305
Criminal Justice Services	0.40	Public Safety	604.31	745	0.00066	0.00117	0.00328	0.0005	0.000464	0.000305
Economic Development	1.00	Economic Development	43.93	215	0.02276	0.00117	0.00642	0.0047	0.000464	0.000610
Education Department	2.46	Cultural and Educational	23,535.88	2,946	0.00010	0.00117	0.00054	0.0008	0.000464	0.000132
Environmental Conservation	4.00	Operating Government	970.38	3,986	0.00412	0.00117	0.00569	0.0010	0.000464	0.000907
General Services, Office of	3.00	Operating Government	377.66	2,014	0.00794	0.00117	0.00569	0.0015	0.000464	0.000907
Health, Department of	2.00	Public Health	42,121.35	6,509	0.00005	0.00117	0.00027	0.0003	0.000464	0.000272
Housing and Community Renewal	2.75	Housing Programs	311.21	940	0.00884	0.00117	0.01124	0.0029	0.000464	0.005870
Housing Finance Agency/SONYMA [@]	4.00	Housing Programs	289.49	210	0.01382	0.00117	0.01124	0.0190	0.000464	0.005870
Hudson River Valley Greenway [@] **	0.25	Regulatory Agencies	0.70	4	0.35714	0.00117	0.00801	0.0625	0.000464	0.002402
Insurance Department	0.90	Regulatory Agencies	165.27	930	0.00545	0.00117	0.00801	0.0010	0.000464	0.002402
Insurance Fund, State [*]	12.00	Regulatory Agencies	1,715.86	2,680	0.00699	0.00117	0.00801	0.0045	0.000464	0.002402
Investigation, Temp. State Com. [@] **	0.15	Regulatory Agencies	3.27	30	0.04586	0.00117	0.00801	0.0050	0.000464	0.002402
Labor	3.30	Public Welfare	5,911.57	4,564	0.00056	0.00117	0.00115	0.0007	0.000464	0.001531
Lottery	1.75	Revenue Agencies	124.40	336	0.01407	0.00117	0.01953	0.0052	0.000464	0.001918
Mental Health	8.35	Public Health	2,166.50	17,162	0.00385	0.00117	0.00027	0.0005	0.000464	0.000272
Mental Retardation	1.25	Public Health	2,940.60	23,580	0.00043	0.00117	0.00027	0.0001	0.000464	0.000272

⁴⁰ While an agency's total appropriations and FTEs are a starting point for conducting a study of internal audit staffing needs, other indicators such as organizational and program size and structure, relative risk, and corresponding controls, among other factors would also have to be taken into consideration.

Appendix 1 (Continued)

Summary of Ratio Analysis for BPRM Item B-350 Agencies and Other Respondents

AGENCY	Internal Audit FTE's	Agency Service Sector	Agency Appropriation 2004-05*, ** (Millions)	Number of Agency Staff	Internal Audit Staffing Per \$1M Expenses			Internal Audit Staffing Per Agency Staff		
					Agency	All Respondents	Service Sector	Agency	All Respondents	Service Sector
Motor Vehicles	11.30	Transportation	251.76	2,973	0.04488	0.00117	0.00403	0.0038	0.000464	0.001625
Niagara Frontier Trans. Auth. @ **	3.00	Transportation	182.49	1,500	0.01644	0.00117	0.00403	0.0020	0.000464	0.001625
Parks, Recreation & Historic Pres.	0.75	Economic Development	229.20	236	0.00327	0.00117	0.00642	0.0032	0.000464	0.000610
Parole @	1.50	Public Safety	192.75	2,008	0.00778	0.00117	0.00328	0.0007	0.000464	0.000305
Public Service	1.00	Economic Development	71.87	579	0.01391	0.00117	0.00642	0.0017	0.000464	0.000610
Real Property Services @	0.00	Regulatory Agencies	64.41	391	0.00000	0.00117	0.00801	0.0000	0.000464	0.002402
State Police	10.35	Public Safety	514.78	5,764	0.02011	0.00117	0.00328	0.0018	0.000464	0.000305
State University of New York	10.00	Cultural and Educational	7,660.61	88,684	0.00131	0.00117	0.00054	0.0001	0.000464	0.000132
State, Department of	1.00	Regulatory Agencies	140.07	1,411	0.00714	0.00117	0.00801	0.0007	0.000464	0.002402
Tax Appeals @	0.00	Revenue Agencies	3.18	31	0.00000	0.00117	0.01953	0.0000	0.000464	0.001918
Taxation & Finance	8.90	Revenue Agencies	417.70	5,186	0.02131	0.00117	0.01953	0.0017	0.000464	0.001918
Temporary and Disability Assist.	3.00	Public Welfare	5,275.06	2,286	0.00057	0.00117	0.00115	0.0013	0.000464	0.001531
Transportation	8.60	Transportation	5,245.94	9,618	0.00164	0.00117	0.00403	0.0009	0.000464	0.001625
Worker's Compensation**	2.00	Regulatory Agencies	126.68	1,555	0.01579	0.00117	0.00801	0.0013	0.000464	0.002402
	130.37		\$111,362	281,009						

@ = Non- BPRM Item B-350 Agency

* = Non-Appropriated Revenue per Agency

** = Expenses Per OSC /Agency (Appropriation/Non-Appropriated Revenue Not Readily Available)

⁴⁰ While an agency's total appropriations and FTEs are a starting point for conducting a study of internal audit staffing needs, other indicators such as organizational and program size and structure, relative risk, and corresponding controls, among other factors would also have to be taken into consideration.

SECTOR TOTALS FOR BPRM ITEM B-350 AGENCIES AND OTHER RESPONDENTS ⁴¹

AGENCY	Internal Audit FTE's	Agency Service Sector	Agency Appropriation 2004-05*, **	Number of Agency Staff	I/A FTE's per \$1M in Expenses	Internal Auditors Per Agency Staff
City University of New York	6.00	Cultural and Educational	3,289,171,000	47,657	0.00182416785	0.000126
Education Department	2.46	Cultural and Educational	23,535,880,400	2,946	0.00010430882	0.000833
State University of New York, Central Administration	10.00	Cultural and Educational	7,660,609,900	88,684	0.00130537909	0.000113
CULTURAL AND EDUCATION SECTOR	18.46		34,485,661,300	139,287	0.00053514995	0.000132
Agriculture and Markets, Department of	0.41	Economic Development	146,998,700	4,152	0.00278914031	0.000099
Economic Development, Department of	1.00	Economic Development	43,931,900	215	0.02276250287	0.004651
Parks, Recreation and Historic Preservation, Office of	0.75	Economic Development	229,201,000	236	0.00327223703	0.003178
Public Service, Department of	1.00	Economic Development	71,868,000	579	0.01391439862	0.001727
ECONOMIC DEVELOPMENT SECTOR	3.16		491,999,600	5,182	0.00642276945	0.000610
Housing and Community Renewal, Division of [@]	2.75	Housing Programs	311,207,000	940	0.00883656216	0.002926
Housing Finance Agency/SONYMA [@]	4.00	Housing Programs	289,494,000	210	0.01381721210	0.019048
HOUSING PROGRAMS SECTOR	6.75		600,701,000	1,150	0.01123687159	0.005870
Civil Service, Department of	1.00	Operating Government	58,516,500	2,817	0.01708919706	0.000355
Environmental Conservation, Department of	4.00	Operating Government	970,383,800	3,986	0.00412208036	0.001004
General Services, Office of	3.00	Operating Government	377,655,200	2,014	0.00000000794	0.001490
OPERATING GOVERNMENT SECTOR	8.00		1,406,555,500	8,817	0.00568765328	0.000907
Alcohol & Substance Abuse Services	1.50	Public Health	513,650,000	970	0.00292027645	0.001546
Health, Department of	2.00	Public Health	42,121,352,500	6,509	0.00004748186	0.000307
Mental Health, Office of	8.35	Public Health	2,166,496,300	17,162	0.00385414921	0.000487
Mental Retardation, Office of	1.25	Public Health	2,940,598,700	23,580	0.00042508350	0.000053
PUBLIC HEALTH SECTOR	13.10		47,742,097,500	48,221	0.00027439096	0.000272

⁴¹ While an agency's total appropriations and FTEs are a starting point for conducting a study of internal audit staffing needs, other indicators such as organizational and program size and structure, relative risk, and corresponding controls, among other factors would also have to be taken into consideration.

SECTOR TOTALS FOR BPRM ITEM B-350 AGENCIES AND OTHER RESPONDENTS

AGENCY	Internal Audit FTE's	Agency Service Sector	Agency Appropriation 2004-05*, **	Number of Agency Staff	I/A FTE's per \$1M in Expenses	Internal Auditors Per Agency Staff
Correctional Services	0.00	Public Safety	2,417,955,600	31,660	0.00000000000	0.000000
Criminal Justice Services, Division of	0.40	Public Safety	604,311,200	745	0.00066191062	0.000537
State Police, Division of	10.35	Public Safety	514,783,000	5,764	0.02010555904	0.001796
PUBLIC SAFETY	12.25		3,729,802,800	40,177	0.00328435595	0.000305
Children and Family Services, Office of	10.25	Public Welfare	3,178,050,500	3,957	0.00322524768	0.002590
Labor, Department of	3.30	Public Welfare	5,911,567,100	4,564	0.00055822761	0.000723
Temporary and Disability Assistance, Office of	3.00	Public Welfare	5,275,057,900	2,286	0.00056871414	0.001312
PUBLIC WELFARE SECTOR	16.55		14,364,675,500	10,807	0.00115213184	0.001531
Alcoholic Beverage Control, Division of	0.25	Regulatory Agencies	13,856,000	147	0.01804272517	0.001701
Banking Department	2.00	Regulatory Agencies	84,640,000	576	0.02362948960	0.003472
Hudson River Valley Greenway Council @ **	0.25	Regulatory Agencies	700,000	4	0.35714285714	0.062500
Insurance Department	0.90	Regulatory Agencies	165,266,500	930	0.00544574974	0.000968
Insurance Fund, State	12.00	Regulatory Agencies	1,715,857,000	2,680	0.00699358979	0.004478
Investigation, Temporary State Commission of @ **	0.15	Regulatory Agencies	3,270,666	30	0.04586221889	0.005000
Real Property Services, Office of @	0.00	Regulatory Agencies	64,411,200	391	0.00000000000	0.000000
State, Department of	1.00	Regulatory Agencies	140,072,100	1,411	0.00713918046	0.000709
Worker's Compensation Board	2.00	Regulatory Agencies	126,681,299	1,555	0.01578764992	0.001286
REGULATORY AGENCIES SECTOR	18.55		2,314,754,765	7,724	0.00801380789	0.002402
Lottery, Division of	1.75	Revenue Agencies	124,400,800	336	0.01406743365	0.005208
Tax Appeals, Division of @	0.00	Revenue Agencies	3,179,000	31	0.00000000000	0.000000
Taxation & Finance, Department of	8.90	Revenue Agencies	417,700,000	5,186	0.02130715825	0.001716
REVENUE AGENCIES SECTOR	10.65		545,279,800	5,553	0.01953125716	0.001918

⁴¹ While an agency's total appropriations and FTEs are a starting point for conducting a study of internal audit staffing needs, other indicators such as organizational and program size and structure, relative risk, and corresponding controls, among other factors would also have to be taken into consideration.

SECTOR TOTALS FOR BPRM ITEM B-350 AGENCIES AND OTHER RESPONDENTS

AGENCY	Internal Audit FTE's	Agency Service Sector	Agency Appropriation 2004-05*, **	Number of Agency Staff	I/A FTE's per \$1M in Expenses	Internal Auditors Per Agency Staff
Motor Vehicles, Department of	11.30	Transportation	251,759,800	2,973	0.04488405218	0.003801
Niagara Frontier Transportation Authority @ **	3.00	Transportation	182,493,000	1,500	0.01643898670	0.002000
Transportation, Department of	8.60	Transportation	5,245,939,500	9,618	0.00163936317	0.000894
TRANSPORTATION SECTOR	22.90		5,680,192,300	14,091	0.00403155365	0.001625
	130.37		\$111,361,720,065	281,009		

@ = Non- BPRM Item B-350 Agency * = Non-Appropriated Revenue per Agency ** = Expenses Per OSC /Agency (Appropriation/Non-Appropriated Revenue Not Readily Available)

⁴¹ While an agency's total appropriations and FTEs are a starting point for conducting a study of internal audit staffing needs, other indicators such as organizational and program size and structure, relative risk, and corresponding controls, among other factors would also have to be taken into consideration.

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Internal Audit Outsourcing, Insourcing and Shared Services

ACKNOWLEDGEMENTS

About the Report

This is one of nine reports that were issued by the New York State Internal Control Task Force (ICTF) in the summer of 2006.

The ICTF, led by a Steering Committee, was comprised of six Work Groups coordinated by Task Force Liaisons from the Division of the Budget (DOB), the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA).

About the Authors

The research for this study was conducted by Theresa Vottis and James Nellegar with input from Michael Abbott, Thomas Howe, Phillip Maher, William Gritsavage, Bradley Moses, David Koshnick, Joel Biederman, and Kevin O'Donoghue.

The report was written by Theresa Vottis, Michael Abbott, and James Nellegar.

Research Groups

The contents of this study were developed by the ICTF from its original research, professional guidance, and literature. It builds upon earlier reports by the New York State Assembly, audit reports by the OSC, and DOB budget bulletins.

Stakeholder Groups

Stakeholders in this study include State Agencies, Public Authorities, the Division of the Budget, and the Office of the State Comptroller.

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BACKGROUND

The Institute of Internal Auditors (IIA) believes that internal audit is best performed by an independent entity that is an integral part of the organization and which functions under the policies established by senior management.⁴² Internal auditors engaged full-time in an agency readily understand the organizational structure, practices and culture. Leveraging this knowledge, they help streamline processes and assess impacts on controls. In addition, they can better understand the organizational risk and potential strategic outcomes. However, some agencies may not be large enough to warrant an internal audit function, but nevertheless may benefit from internal audit services. One of the challenges is providing those services in a cost effective manner.

Agencies with internal auditors are also facing challenges with today's changing demands in operating environments, evolving technologies, new regulations, and fraud detection. These challenges require a larger and deeper pool of internal audit talent to identify and assess risks and thus adequately serve management. Contracting, partnering or working with outside organizations as well as using in-house, non-audit staff improves the agency's ability to address these risks and meet customer expectations. These types of arrangements can be called outsourcing, insourcing, or shared services.

Outsourcing is defined as an agency hiring an independent contractor to provide a specific service. Insourcing can be defined as using agency staff, from an office other than internal audit, to work on a project or audit. The staff may be selected for their expertise on a particular assignment. Shared services can be generally defined as one agency providing audit services to another. Besides providing additional audit coverage, these arrangements may assist in transferring knowledge to in-house staff, thus raising staff's level of proficiency for future engagements.

OBJECTIVE AND METHODOLOGY

The Organization and Staffing Workgroup's (Workgroup) objective was to identify alternatives that agencies with and without internal audit units can use to ensure appropriate internal audit coverage. To accomplish our objective, the Workgroup surveyed internal audit organizations regarding their experience with and interest in outsourcing or shared services. The Workgroup also identified best practices and opportunities for increasing efficiency and coverage; studied professional articles and other material; identified information on the potential cost, quality and extent of the coverage that may be available; and considered the use of the OGS Statewide contract for audit services.

⁴² *A Perspective on Outsourcing of the Internal Auditing Function*, Institute of Internal Auditors Professional Practices Pamphlet 98-1.

RESULTS IN SUMMARY

Based on our research and survey results, outsourcing, insourcing, and shared services arrangements are appropriate when staff is insufficient in number or lacks specialized expertise to conduct the audit engagement. These arrangements come with a cost in terms of contract dollars, staff time to manage a contract, or staff time away from their home agency or office. Agencies using these options have been satisfied with the quality and timeliness of the results. Audit coverage may be enhanced by having agencies in similar service sectors work cooperatively to provide audit coverage across agencies. Further, a variety of other options, such as the statewide audit services contract, requests for proposals, and insourcing, have been identified as other means for providing the necessary audit coverage.

The State Comptroller's audit of State agencies' compliance with the Internal Control Act found that more than half of the Budget Policy and Reporting Manual (BPRM) Item B-350 agencies did not have adequate audit coverage of their systems of internal controls. Despite this inadequate coverage, shared services and outsourcing are not widely used among the agencies responding to the Workgroup's survey. Although agencies have an opportunity to expand the use of both shared services and outsourcing, they appear to lack any catalyst or incentive to move in that direction.

RESEARCH AND SURVEY RESULTS

The Workgroup reviewed current practices and survey results to obtain an understanding of the use of outsourcing, insourcing, and shared services.

Outsourcing

Only three (10%) of the thirty-one agencies⁴³ responding to the Workgroup's survey had any experience with outsourcing internal audit services. For the three agencies that used outsourcing, they cited lack of an adequate number of staff and lack of staff with special expertise as the reasons for outsourcing. These results are consistent with the 11 percent of state government audit groups surveyed⁴⁴ in October 2003 that reported outsourcing some portion of their work.

Of the three agencies from the Workgroup's survey that outsourced internal audit services, one used outsourcing rarely and only for financial audits. The other two agencies had more extensive experience using third party providers for information technology, performance and contract audits, as well as financial management practices reviews and activity based costing assessments.

⁴³ Twenty-seven were B-350 agencies.

⁴⁴ IIA/NASACT/NALGA State Government Auditing Survey. The Institute of Internal Auditors' Global Auditing Information Network (www.gain2.org), October 2003.

Although this is a limited sample, the agencies reported average or better results in terms of value, time, and costs. In addition, the three agencies rated the quality of the audit products as very good.

The means for procuring the outside services also varied between the two agencies with the most experience. One contracted on a project-by-project basis while the other had an open-ended contract with one vendor. As part of this open-ended agreement, the agency identified a project for outsourcing by providing a scope and the vendor then submitted an estimated fee schedule along with the proposal to accomplish the work. When accepted, the fee schedule became the maximum payable under the contract.

Insourcing

The Workgroup is only aware of a few agencies that used insourcing to complement their audit staff. The agencies generally found that insourced staff provided specific program and institutional knowledge and a different perspective on the audit. The additional staff also resulted in the agency being able to accomplish more internal audits.

Shared Services

The Workgroup asked agencies about the extent that services were being shared and whether agencies were interested in providing services to or receiving services from another agency. As the table below illustrates, 26 agencies felt their resources were insufficient to provide coverage to another agency. In contrast, 13 agencies expressed an interest in obtaining audit services.

Shared Internal Audit Services

Interested in Obtaining Services	# of Agencies	Willing to Provide Services	# of Agencies
No Need/Not Interested	18	On a limited or ongoing basis	5
Interested	13	Resources insufficient to provide coverage	26

This imbalance in interest in obtaining services and willingness to provide services does not make this option viable with current staffing levels. Of the 31 agencies responding to the Workgroup’s survey, 4 had provided services to another agency. They cited advantages of gaining experience, sharing best practices, and addressing the immediate need for a review. Conversely, the disadvantages included taking time away from their own duties (thus reducing the home agency’s audit coverage) and a lack of detailed knowledge of the audited agency’s business.

Our research found that the State of Illinois consolidated the internal audit functions from 26 agencies into a single statewide function covering the State's 46 agencies, boards, and commissions. Some of the benefits cited by the consolidation included:

- Increased objectivity and independence
- Development of a statewide risk assessment
- Identification of patterns of risks across multiple agencies
- Greater flexibility in scheduling audits
- Better ability to match auditor expertise and assignments
- Better ability to establish specialized audit teams such as information technology teams

Some of the drawbacks included:

- Difficulty in melding various agency cultures
- Agencies lose their internal audit units
- Agency management may be less likely to request internal audit services
- Staff may be less likely to develop expertise in a specific area or establish an on-going working relationship with agency management.

While there are benefits to a consolidation of all internal audit units, it may be beneficial to use a hybrid model where internal audit units for smaller agencies are consolidated and larger agencies such as the BPRM Item B-350 agencies retain their own internal audit units. However, this option needs to be further studied.

Factors to Consider With Outsourcing, Insourcing, and Shared Services

When considering the use of outsourcing, insourcing, and shared services, agencies must consider the appropriateness, cost-effectiveness and availability of such services.

Appropriateness

Outsourcing, insourcing, and shared services can be a useful addition to an internal audit function's toolkit, particularly for acquiring expertise which may not be available or cost-effective to maintain in-house. Further, these arrangements can augment audit resources resulting from insufficient staffing or demands created by peak workloads. Insourcing may be appropriate for audits that require a subject specialist, but there may be concerns with independence and availability or willingness to loan staff. Shared services may be particularly appropriate for small agencies, but only five agencies surveyed were willing to offer such services.

Whatever solution is chosen, both IIA and GAO standards⁴⁵ require that the persons assigned to the engagement possess the knowledge, skills and other competencies to conduct the engagement properly. Further, the auditors overseeing the work must have sufficient knowledge, either in-house or through an alternative source, to communicate the audit objectives, evaluate whether the work meets the objectives, and assess the results of the procedures used.

Agencies should be careful that no conflict of interest or independence impairment is created when using these arrangements.

Cost-Effectiveness

The Workgroup did not identify any studies or other data that would allow it to assess the cost effectiveness of outsourcing, insourcing, or shared services. However, as part of its research, the Workgroup recognized that these arrangements require a commitment by management. This commitment includes the contracted cost, if any, and the time and effort: to scope the engagement; to find and procure the firm or agency to do the work; to oversee the contract or agreement; to provide agency-related information and context to facilitate a successful project; and to ensure that the work product satisfactorily addresses the scope in accordance with internal audit standards.

The Workgroup spoke with one agency that has used outsourcing fairly regularly over the last three years. The appendix of this report includes a list of lessons learned from this agency's experience. Although the list may seem daunting, the audit products resulting from this agency's outsourcing arrangements were well-received by agency management and provided expertise and turnaround times not available internally.

Availability

There are several options for outsourcing and they are presented in this section. The availability of insourcing is primarily dependent on an agency's management being willing to loan staff to the internal audit unit. Similarly, the availability of shared services is dependent on an agency's management being willing to loan staff to another agency.

One source of outsourcing opportunities can be found in the Office of General Services (OGS) contract for *Audit Services – Statewide* (Group: 79037, Award: 00939), to facilitate the procurement of audit services. The contract makes use of the bid process which may shorten the contract process through pre-qualifying and continuously recruiting contractors for particular service areas. At the time of the Workgroup's research, 24 contractors qualified for one or more of the three audit lots – Financial and Financial Related Audits, Performance Audits, and Operational and Claims Audits. Only one agency in the Work Group's survey had used this

⁴⁵ IIA Standards 1200 and 1210; IIA Practice Advisory 1200-1; and GAO Standards 7.37 and 7.38.

contract. The bid/proposal process was shorter, but the lack of responsiveness to the projects being offered rendered the contract ineffective and the agency had to pursue other contracting options.

Other traditional contracting options, such as requests for proposals, may also be used. While a request for proposal typically takes longer, it may provide more flexibility than the OGS contract. One agency has a contract where a large auditing firm is essentially on retainer, thus providing coverage for multiple projects but needing only one contracting effort. Another option may be to combine the efforts and/or needs of multiple agencies by contracting with a firm(s) to provide similar audit services across agencies. One area frequently referred to in the Workgroup's survey as a good candidate for this combined effort is the State Comptroller's Bulletin G-212 requirement to audit procurement on a regular basis.

Depending on the size and complexity of the work needed, agencies may also procure small, easily defined projects via a purchase order. The payment terms and deliverables are simply included as part of the purchase order. Moreover, temporary services contracts have been used with limited success to augment audit staff.

RECOMMENDATIONS

The Workgroup has included three recommendations to further explore the use of outsourcing, insourcing, and shared services.

1. Agency management should consider outsourcing, insourcing, or shared services as a means of providing audit coverage or securing specialized expertise.
2. The ICTF should further study agency use of outsourcing to identify opportunities for improving the options currently available, minimizing contract management overhead costs, and developing multi-agency contracts for commonly needed audits.
3. The ICTF should further study the feasibility of establishing a collective audit approach to provide internal audit coverage for smaller agencies that do not maintain an internal audit unit.

CONCLUSION

Outsourcing, insourcing, and shared services are viable options to ensure agencies have adequate internal audit coverage, but these arrangements need to be more carefully studied. The ICTF should explore these issues further and then communicate their findings to state agencies for their consideration.

Outsourcing Lessons Learned

- Know why the agency outsourced the project
- Use clear audit objectives and a comprehensive list of audit activities
- Detail the agency's needs in the request for proposal
- Be firm and precise in defining your expectations of the outsourcing firm
- Consultant auditors are expensive but want to do a good job, so work with them
- Use safe budget estimates
- Anticipate the out-of-scope argument
- Maintain good relationships to ensure the firm's continued interest in the agency's audits
- Manage the risk that the firm could assign or substitute inexperienced staff
- Select a procurement method which meets the agency's business needs
- Use selection committees that include stakeholders
- Include both qualitative and quantitative (cost comparison) elements in the firm selection criteria
- Link approval of deliverables to payments
- Be aware that legal issues, such as indemnification clauses, may impede award of contract
- Recognize that procurement overheads are high
- Recognize that procurement time (in terms of duration) can be a significant
- Educate the vendor about institutional issues
- Actively oversee the contract, because oversight is crucial to project success
- Use detailed audit plans and periodic reports
- Use senior/experienced people to manage consultant projects
- Be aware of quality dipping near the end of the contract
- Clarify expectations for working papers – e.g., content, ownership, etc.
- Perform quality assurance on results
- Make the firm aware that the agency wants to actively participate with report edits
- Edit reports when necessary to bridge external/internal perspectives

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Internal Audit Process

ACKNOWLEDGEMENTS

About the Report

This is one of nine reports that were issued by the New York State Internal Control Task Force (ICTF) in the summer of 2006.

The ICTF, led by a Steering Committee, was comprised of six Work Groups coordinated by Task Force Liaisons from the Division of the Budget (DOB), the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA).

Research Groups

The contents of this study were developed by the ICTF from its original research, professional guidance, and literature. It builds upon earlier reports by the New York State Assembly, audit reports by the OSC, and DOB budget bulletins.

Stakeholder Groups

Stakeholders in this study include State Agencies, Public Authorities, the Division of the Budget, and the Office of the State Comptroller.

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BACKGROUND

The Internal Audit Process Workgroup recommends that the Office of the State Comptroller (OSC) revise its Standards for Internal Control in New York State to specifically recognize the internal audit process as a supporting activity to agency management. The revised standards should set forth minimum requirements for the operation of an internal audit function within a New York State government entity and should, at a minimum, provide guidance in the four areas outlined in the following pages.

OBJECTIVES AND METHODOLOGY

The Internal Audit Process workgroup was charged to develop guidance and identify best practices in four areas: risk-based audit planning, reviewing internal controls, monitoring audit findings, and maintaining audit work papers. To accomplish these objectives, the workgroup analyzed the operational requirements imposed by the Internal Control Act, the Standards for Internal Control in New York State Government issued by the OSC and professional audit standards as they each relate to the four areas. The group also surveyed current internal audit practices within New York State and conducted follow-up discussions with audit staff from several agencies.

RESEARCH AND SURVEY RESULTS

Risk-Based Audit Planning

The workgroup's first objective was to provide internal audit units with tools to assist them both in assessing risk within their organizations and in developing an audit plan that focuses on the areas of highest risk. The group was also asked to identify best practices currently in place at individual agencies and to provide guidance on specific approaches to increase efficiency.

The Work Group found that some State agencies do not have a risk-based audit planning process, while others do not update their assessments of organizational risk at least annually. The group believes that these two elements are essential for the professional practice of internal auditing consistent with the Internal Control Act. The Work Group also agreed that all the practices itemized below are necessary for effective audit planning and should be part of each internal audit unit's planning process.

Reviewing Internal Controls

The workgroup's second objective was to provide internal audit units with guidance and tools to assist them in evaluating and monitoring the internal control systems within their entities. The group addressed this objective from two perspectives: the extent to which internal audit units should devote resources to examining internal control systems within their organizations, and the

extent to which internal controls need to be examined during the course of individual audit engagements.

The workgroup has concluded that the Standards for Internal Control in New York State Government issued by the OSC serve as the basis for evaluation of internal controls in State agencies and public authorities. Further, in making the Internal Control Act permanent in 1999, the Legislature highlighted the need for agency management to promote good internal controls and accountability in government in part by mandating that certain agencies maintain internal audit units while permitting others to evaluate the need for such units annually. In this context, the issue of whether internal audit units should devote some of their resources to examining control issues inside the organization or whether it is acceptable to only audit outside groups that conduct business with the organization (e.g. contractors, grantees, service providers) seems clear.

Internal audit units exist in major part in New York State due to the provisions of the Act, which focuses largely on control systems internal to the entity. In addition, the Act specifically requires that the internal audit function shall evaluate the agency's internal controls and operations. To fulfill this responsibility, the internal audit units created by the Act must devote resources to examining the internal activities.

However, it is important to note that the Act provides no criteria to evaluate the minimum level of resources that must be devoted to internal activities. In addition, we note that the Act also provides no expectation that all internal audit resources must be directed to internal activities. As such, the group concludes that this allocation is best determined as part of a larger analysis of risks facing the particular entity (i.e. the risk-based audit planning process).

Regarding the more focused issue of how internal controls should be addressed during an individual audit, Generally Accepted Government Audit Standards (GAGAS), which require auditors to have a sufficient understanding of relevant internal controls to plan an audit and determine what kinds of tests to perform in the audit. Auditing standards also require that sufficient, competent, relevant evidence is obtained to support the basis of their judgment about internal controls. In general, the group concluded that for routine audits of programs or operations, generally accepted audit standards (GAAS, GAGAS, and IIA Standards) already provide adequate direction and the auditor should refer to these authoritative sources.⁴⁶ For audits of internal control systems, once the internal audit unit has decided to examine the subject, it should then identify the specific objectives of that examination. It should consider examining the five elements of internal control: control environment, communication, assessing and

⁴⁶ GAGAS refers to the standards and guidance contained in the G.A.O. Yellow Book, promulgated by the U.S. Comptroller General of the United States. GAAS is a set of 10 standards established by the AICPA. GAGAS incorporate, but go beyond GAAS. The Institute of Internal Auditors provides guidance in the form of Standards, which they refer to as *The International Standards for the Professional Practice of Internal Auditing*.

managing risk, control activities and monitoring. And, depending on the needs of the agency, the audit unit may need to expand the scope.

In addition, as part of its periodic assessment of organizational risk, the internal audit unit should review and test documentation, including management control self assessments, maintained by the agency's Internal Control Officer in support of the entity's annual certification. Depending on the test results, the internal audit unit can form a basis to either rely on the certification or set it aside and conduct its own separate review of internal controls.

Control Self Assessment

With regard to the objective of obtaining evidence from agency staff, the group concludes that Control Self Assessment process of the Institute of Internal Auditors' is a "best practice" that can provide the auditors with the best evidence from which to draw a conclusion about the control environment and preliminary indicators of how adequate the agency's risk assessment, control activities, information and communication systems, and monitoring processes are. However, it should also be understood that auditors should perform other tests and evaluations to draw conclusions about these four other components of internal controls, as well as being constantly aware of other control environment evidence gained by the auditors' interaction with management.

Once the decision has been made to conduct a Control Self Assessment survey, the audit director should contact management to discuss the following items:

- The auditors will be collecting evidence on the five elements of internal controls, with particular emphasis on assessing the control environment.
- Using the organization chart, and other input from management as necessary, the auditors will schedule meetings with all staff involved in the area under audit to get their input about internal controls. When scheduling the meetings with staff, the auditors should ensure that their supervisors are not in the same meetings.
- Once the survey is complete, the auditors will analyze the results and meet with area management to discuss the preliminary results.
- After discussing results with area management, the auditors will prepare a preliminary report for internal audit review and approval. Once approved internally, the preliminary report should be forwarded to area management for their review prior to the meeting with them.

A sample Control Self Assessment survey questionnaire is being provided as a best practice and should be tailored by the auditor to the area under review as necessary. The auditor should

identify manager(s) by name and title in the survey since the instrument makes specific statements about management's ethics and integrity. This is necessary to avoid any confusion for the employees filling out the survey. Alternatively, the auditor may decide that the survey should be anonymous, in which case they can eliminate the identifying information from the survey, or still collect the information but keep it confidential. This document is intended as a guide and therefore, the auditor may decide to also consider integrating its content with all or parts of other best practices available to them.

Monitoring Audit Findings

The workgroup's third objective was to provide agencies with guidance for establishing a system to monitor the implementation of their audit recommendations through a formal system of follow-up. The group's conclusions are based upon analysis of the Act and applicable audit standards, as well as information provided by State agencies in response to our survey.

As previously noted, the Act specifies that the internal audit function shall evaluate the agency's internal controls and operations. Further, the internal audit function is also directed to identify internal control weaknesses that have not been corrected and make recommendations to correct those weaknesses. The Work Group concludes that each internal audit unit must therefore have a process to follow up on audit findings if it is to identify weaknesses that remain uncorrected. This interpretation is supported by an analysis of IIA standards, which require in part that:

- The chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management
- 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 internal audit activity should monitor the disposition of results of consulting engagements to the extent agreed upon with the client

Our survey showed that most State agency internal audit units do have a system in place to monitor audit findings. In most cases, audit units reported using a manual system. The following survey responses indicate that State agencies follow-up on audit recommendations based on various circumstances, such as:

- Every six months on internal audits, as needed on external audits;
- 90 days - similar to OSC's process for final reports;
- Significant outstanding findings reviewed annually;
- Depends on audit;
- Based on significance of the issues;

- Depends on recommendation.

The survey responses also highlighted how internal audit units use different criteria to determine which audits to follow up on, including:

- Follow up on major recommendations;
- Impact on operation audited;
- High priorities main concern, too much control activities can cause resistance;
- Formal follow up on material issues, informal follow up on others;
- Corrective action taken immediately; and
- Based on materiality and relative risk, not all audits warrant a follow up.

Maintaining Audit Documentation

This workgroup's final objective was to identify best practices and establish minimum standards for audit documentation to be retained in support of internal audit activities. As part of this effort, the group also addressed issues related to electronic work papers and other non-traditional forms of work paper documentation. Thirty-two agencies responded to our survey. The overall results indicated that internal audit units are successful in managing the following:

- Maintaining work papers for each audit engagement;
- Using an electronic format such as Word and/or Excel;
- Including standard elements in the work papers such as source, purpose, conclusion and scope; and
- Utilizing proper work paper techniques such as cross referencing and work paper review.

Although many of the agencies' internal audit units seem to have some good procedures established, we found that there are a small percentage of agencies that are lacking in these procedures. Therefore, our recommendation for baseline requirements are intended to reach those internal audit units that are showing a need for improvement, as well as to focus on creating some standardization among the units and address improving automation and efficiency.

The recommendations included in this report will provide all State agencies a better understanding of the requirements under the New York State Internal Control Act, as well as the Internal Auditing Standards defined by the Institute of Internal Auditors as they pertain to audit documentation. In addition, they serve to highlight some methodologies that can be classified as a "best practice" within the internal audit function.

RECOMMENDATIONS

The following baseline practices this Work Group is recommending were modified slightly from the International Standards for the Professional Practice of Internal Auditing (IIA Standards) to make them more applicable to State agencies.

1. The DIA in each State agency should periodically develop a risk-based audit plan to determine the priorities of the internal audit activity, consistent with the organization's goals.
2. The internal audit activity's plan of engagements should be primarily based on a risk assessment, updated at least annually. The input of senior management and the board (if applicable) should be considered in the process.
3. In developing the audit plan, the DIA 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.
4. The DIA 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 DIA should also communicate the impact of resource limitations.
5. The DIA should ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan.
6. The DIA should establish policies and procedures to guide the internal audit activity.
7. The DIA should establish and maintain a system to monitor the disposition of audit recommendations communicated timely to management.
8. The DIA should document the rationale in deciding which audit recommendations should be followed up on and when, as opposed to recommendations where no follow-up is needed.
9. The DIA should follow up with management to document that either audit recommendations have been effectively implemented, or that senior management has accepted the risk of not implementing the recommendations.
10. The DIA should monitor the disposition of recommendations of consulting engagements to the extent agreed upon with the client.
11. The DIA should establish a written policy for security and control of audit work papers. Work paper policies should address four areas:

Physical Control: Work papers are the auditors' property and should be kept under their control. The auditors should know exactly where manual work papers and supporting documents are during the conduct of the audit. When

not in use, they should be kept in a locked file or otherwise secured so they are not readily available to persons unauthorized to use them. Access to electronic work papers should be controlled via electronic data processing security controls (passwords, shared file controls, etc.).

Storage: The most recent set of work papers for each project should be kept in the Department's *secured* central files. The current electronic work paper files should be maintained in a directory of active audits. Prior work papers may be filed in a centralized record retention. A designated individual should be assigned to maintain a list of work papers sent to record storage. A destruction date should be placed on each carton sent to storage.

Retention: Work papers should be retained for a minimum of seven years (depending on industry, regulatory constraints, etc.) after the date of the report.

Release to Internal and External Parties: Approval from senior management and/or legal counsel should be obtained prior to releasing work papers and reports to external parties, as appropriate.

12. Internal audit units should maintain work paper documentation for each audit and follow-up. The IIA Standards require internal auditors to record relevant information to support the conclusions and engagement results under IIA Practice Standard 2330. In addition, Government Auditing Standards, Section 4.22 require that each Internal Audit function maintain documentation related to planning, conducting and reporting on the audit. This documentation should contain sufficient information to enable an experienced auditor who has no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions.
13. Internal audit units should establish a written policy governing work paper review and approval. Our survey revealed that 7 out of the 32 respondents (22 percent) are currently not having their work papers reviewed by someone other than the auditor who prepared them. The policy should clearly delineate who is responsible for reviewing audit work papers prepared by various staff levels and when that review should occur. Audit units should also consider adopting a standard work paper review checklist as a best practice for managing this important quality assurance function.
14. The ICTF should develop a mechanism for internal audit units to create and share standard work paper elements to meet minimum requirements and incorporate best practices. This is needed to address our initiative of establishing consistency and efficiency. A total of 38 percent of the internal audit units responding to our survey

indicate that they do not currently utilize standard templates or checklists while creating work papers. Examples of what should be included in the guide are explanations of the qualities of good work papers (e.g., relevance and completeness), descriptions of good work paper techniques (e.g., tick-marks, cross-referencing and standard templates), and examples of standardized work papers that could be utilized by others (e.g., planning documents, schedules and analyses).

15. The ICTF should explore licensing an electronic work paper package (such as TeamMate®) on a statewide basis for use by all agencies. Our survey revealed that 78 percent of the internal audit units would be interested in learning more about electronic audit packages. Our workgroup participated in a demonstration of one such product (TeamMate®) which is licensed and utilized by the Office of the State Comptroller for all of its audit assignments. We found this product directly addresses many of the issues presented in our recommendations. However, the group concluded that this product would be cost prohibitive for most organizations given the small size of their audit units. The ICTF should investigate the possibility of licensing this product on a broader, statewide basis so that smaller agencies could take advantage of the product at a more affordable incremental cost.

ADDITIONAL OBSERVATIONS

As the Internal Audit Process Work Group compiled our recommendations for the Task Force, we realized that additional information is needed in several areas to assist Internal Audit Units, Internal Control Officers and management in fulfilling their responsibilities. Many of these areas will likely be addressed by the Task Force. The Group recommends that the Task Force establish a process for developing and maintaining a resource repository that can be accessed by internal audit personnel, Internal Control Officers and management as a principal place of reference. This resource repository might include such items as a standardized internal audit manual, standard audit programs, internal control programs and examples of other documents that promote best practices in these areas of responsibility.



Internal Audit Continuing Professional Education

ACKNOWLEDGEMENTS

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The research for this study was conducted by the members of the New York State Internal Control Task Force (NYS ICTF) Continuing Professional Education Workgroup. Each member of the Workgroup contributed to the written report.

Research Groups

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For More Information

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BACKGROUND

The Standards for the Professional Practice of Internal Auditing (internal audit standards) issued by the Institute of Internal Auditors' (IIA) require that internal audits be performed with proficiency and due professional care. To maintain this level of proficiency Part 270 of the Professional Proficiency Standard further requires that Internal Auditors maintain their technical competence through continuing professional education (CPE). The internal audit standards address (in general terms): who is covered by CPE requirements, what areas the internal auditor should be trained in, how such training should be obtained, and what documentation is required to support continuing education.

Continuing education is important for many reasons and provides benefits to both the individual auditor and organization. Besides enabling auditors to keep current with professional and Industry practices, well trained auditors tend to be more productive. Many organizations recognize the importance of continuing education through education leave and reimbursement programs.

In 2004, the Office of the State Comptroller (OSC) issued an audit report 2003-S-14, entitled "State Agency Internal Audit Units' Compliance with Internal Control Act." The audit cited a need for some agencies to provide internal audit staff with sufficient continuing professional education.

In response to OSC's audit, the Internal Control Task Force (ICTF) was established to assist agencies in strengthening compliance with the Internal Control Act. The ICTF is a joint effort of the Division of the Budget (DOB), OSC and New York State Internal Control Association (NYSICA). To address items raised in the report, six working groups were established. The ICTF assigned responsibility for training issues to the Continuing Professional Education (CPE) Workgroup.

RESULTS IN SUMMARY

The CPE Work Group identified three primary areas of focus: (1) Defining minimum CPE requirements for internal audit staff; (2) Identifying best practices, shared training, and external training opportunities; and (3) Developing an ongoing plan to meet CPE requirements. Based upon survey data and research conducted by our workgroup, we drafted the "New York State Internal Auditor Continuing Education Guidance Document" and recommend that it be adopted by the ICTF and distributed to all NYS agencies as the official guidance document for CPEs. We recommend establishing a New York State Internal Auditor website to provide access to available training programs and resources. A formalized training function would facilitate the planning and implementation of CPEs to NYS Internal Auditors.

OBJECTIVES AND METHODOLOGY

Our objective was to provide recommendations regarding Continuing Professional Education for New York State internal auditors. We were also charged with documenting best practices in tracking auditor CPEs; determining what CPE resources are available; and providing recommendations on a continuing process for providing CPEs in the future.

To accomplish our objectives, we reviewed applicable laws, budget bulletins, and professional guidance from the IIA and the Government Accountability Office (GAO). We also sent a survey to ninety-seven executive branch agencies regarding their CPE programs and practices. Thirty-three executive branch agencies are required to maintain internal audit functions per Budget Policy and Reporting Manual (BPRM) Item B-350.

Thirty-six State agencies responded to our CPE survey. Of the thirty-six responses, thirty-one were BPRM Item B-350 agencies. We also received responses from four Federal agencies, one local government agency, and one private sector employer.

RESULTS OF REVIEW

Define Minimum CPE Requirements for Internal Audit Staff

The Internal Audit CPE Work Group was charged with determining the number of CPEs required for Internal Auditors (Auditors) and the time period over which those CPEs can be acquired and credited to each auditor's requirement.

The CPE Work Group explored alternatives for establishing minimum CPE requirements. We conducted a survey of State agencies and Federal and private entities to determine if their internal audit units were required to obtain CPEs and to determine an acceptable benchmark of CPEs to recommend to our Task Force. We found that 22 of the 36 State Agencies responding to our survey already recommend or require a total of 80 CPEs each two-year period.

We also reviewed the CPE requirements for Certified Public Accountants, Certified Fraud Examiners, Certified Internal Auditors and other professional certifications. In addition, we reviewed the CPE requirements established by GAO. We concluded that a hybrid of GAO standards and the internal audit standards were best suited for our State government environment. The GAO's CPE requirement of 80 CPEs every two years and the requirements of the above-mentioned professional certifications were essentially the same, but varied in their implementation.

Based upon the information evaluated above, the Work Group developed the "New York State Internal Auditor Continuing Education Guidance Document" (See Appendix 1). This document includes guidance and recommendations on establishing and maintaining a CPE program.

Identify Best Practices and Shared and/or External Training Opportunities

Internal Auditors within New York State (NYS) possess unique skills and areas of expertise developed through years of internal audit practice. These skills and expertise represent a wealth of knowledge waiting to be shared with other internal audit units. Coordinating the sharing of knowledge on internal audit techniques and internally developed resources would enable auditors to keep current with professional and industry practices and be more productive in a cost effective manner. The Work Group has identified several opportunities where such coordination of training programs, communication and tracking of CPEs would increase the efficiency and effectiveness of managing and monitoring internal auditors' CPEs.

To facilitate the coordination among the internal audit units, the Work Group recommends establishing an internal audit training function (IATF). The IATF would be responsible for administering cost effective training programs coordinated between the State's internal audit units. The IATF would work with Directors of Internal Audit to identify training needs. These training needs would then be developed into training programs and be presented in the most cost effective means. Whether the program is presented by State internal auditors, professional organizations or through outside vendors, the IATF would be responsible for maximizing resources to meet the needs of the State's internal auditors while keeping per seat costs to a minimum.

The Work Group also identified an opportunity to improve communication between internal audit units. Sharing information concerning the training programs being offered by State agencies and professional organizations would help increase the efficiency and effectiveness of obtaining CPEs for auditors. There are numerous organizations providing training programs throughout the State. Sharing information and best practices will assist internal audit units in maintaining the professional competency of the auditors. The Work Group has determined a need for the establishment of a NYS Internal Auditor web page. The web page would provide a cost effective means for sharing valuable information to the internal audit units on timely and on-going basis. The Work Group has compiled a listing of training organizations, along with links to their websites, to be included on the recommended website. (See Appendix 2)

Training hours for all auditors should be tracked. Our survey results identified differences in the methods internal audit units use to track CPEs. The results showed that 22 internal audit units track CPEs using "in-house" developed systems, such as spreadsheets, databases or word processing. Seven units track CPEs manually and six units do not track CPEs. One unit uses commercially purchased software to track CPEs

The Work Group has identified two options for tracking CPEs. These options would be available to internal audit units that do not have an existing system, or are interested in upgrading their current system. The two options are as follows:

1. Share CPE tracking systems developed “in-house” by NYS internal audit units. Examples of these tracking systems could be shared via the internal auditor web page.
2. DOB and OSC should help facilitate agencies' tracking of CPEs.

Develop an Ongoing Plan to Meet CPE Requirements

Implementation of the recommendations in this report requires a commitment of resources. Resources are needed to fund training programs for auditors to obtain the 80 CPEs, develop and implement an ongoing training plan, and monitor compliance with the CPE recommendation.

CPE costs can vary from courses that require very low or no cost, to those that cost up to thousands of dollars per day, depending on the type and location of the training programs attended. The Work Group identified several existing sources of low-cost training programs. Many of these programs provide 1-2 CPEs at monthly or quarterly programs offered by professional organizations. Although the dollars needed to attend these programs is relatively low, the program content does not always meet the auditor’s needs. Therefore, the objective of obtaining CPEs, to maintain the internal auditor’s professional competency, may not be achieved through attendance at only existing low-cost programs.

As mentioned in the previous section of this report, we recommend an IATF be created. The IATF would coordinate with the Internal Audit Directors to identify relevant training needs common to NYS internal audit units. The identification of relevant training needs may be obtained through Internal Audit Director Roundtable discussions or through surveys of the internal audit units. In-house training programs may be developed using NYS internal auditors knowledgeable in the respective subject area. Our survey results found that almost half of the internal audit units surveyed expressed a willingness to present at a best practices seminar. If in-house resources are not available, then the IATF can work with the professional organizations or a private vendor to develop a program relevant to the needs of the NYS internal auditors.

Working in a cooperative arrangement between internal audit units can reduce the cost of obtaining CPEs by as much as 50 percent per person. In addition, responses to our survey indicated that 33 of the 36 internal audit units would be interested in participating in cooperative training programs. The Work Group has estimated the cost of obtaining 40 CPEs per year at \$700 per

Auditor. (See Appendix 3 for details.) This estimate does not consider travel costs or specialized training needs specific to an agency.

Resources needed to develop and implement an ongoing training plan will vary depending upon the method chosen to carry out this responsibility. The following are three alternatives that we would like the Steering Committee to consider.

Creation of New Unit

A new unit would be created within an existing agency to develop and implement an ongoing training plan, maintain the NYS website, and monitor internal audit units' compliance with recommended CPEs. This unit would also provide the optional CPE tracking service to those agencies requesting the service. The unit could perform other functions as well, such as coordinating internal audit peer reviews and the internal audit director's roundtable discussions.

Loaned Staff to Coordinate CPE Oversight

This alternative calls for internal audit offices to loan staff on a rotating basis, preferably annually, to an existing agency. The loaned staff would be responsible for the development and implementation of an ongoing training plan based on needs expressed by the Internal Audit Directors. They would also monitor internal audit units' compliance with recommended CPEs and provide optional CPE tracking service if requested. The designated agency would be the repository for institutional knowledge about internal audit units throughout New York State government and a staff person from the designated agency would work with loaned staff as a collateral duty. Administrative support would also be provided by the designated agency. In contrast to our first option, this one does not address website maintenance or coordination of internal audit peer reviews.

Under this scenario, the tasks would be less labor intensive for the designated agency. However, it requires a commitment by State Agencies to support this concept. Our survey did not include this component; therefore willingness to participate in this program is unknown. Given the limited resources available in the State's internal audit units, agencies may be unwilling to provide the resources needed to implement this option.

Build Upon Existing Training Program

Under this scenario, an existing training program, such as the OSC's Professional Development Unit, would be expanded to accommodate the needs of the State's internal auditors. The existing program would be responsible for the development and implementation of an ongoing training plan based on needs expressed by the Internal Audit Directors. This unit would also provide the

optional CPE tracking service to those agencies requesting the service. This would facilitate monitoring of internal audit units' compliance with recommended CPEs.

RECOMMENDATIONS

1. Agencies should implement a continuing education program which includes all the elements of the New York State Internal Auditor Continuing Education Guidance document.
2. DOB and OSC should help facilitate continuing education and CPE tracking services for NYS Internal Audit Units.
3. DOB should facilitate a NYS Internal Auditor web page to share information.
4. Agencies should share best practices for in-house systems for tracking CPEs using a NYS Internal Auditor web page.

**GUIDANCE ON
CONTINUING PROFESSIONAL EDUCATION FOR
NEW YORK STATE INTERNAL AUDITORS**

INTRODUCTION

The New York State Governmental Accountability, Audit and Internal Control Act (The Internal Control Act) require agencies having internal audit functions to operate in accordance with generally accepted professional standards for internal auditing. Initially enacted in 1987, the Act was made permanent in 1999. DOB's Budget Policy and Reporting Manual (BPRM) Item B-350 provides implementation guidance to agencies and further defines the standards cited in the Act to be the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors (IIA). Compliance with these standards is the responsibility of each agency covered under the Act.

Part 270 of the IIA's Professional Proficiency Standards requires that internal auditors maintain their technical competence through continuing professional education (CPE). The IIA Standards address, in general terms, what is covered by CPE recommendations; what areas the internal auditor should be trained in; how such training should be obtained; and what documentation is recommended for supporting continuing education.

This document is designed to provide additional guidance to agencies in complying with the IIA's CPE recommendations. Our recommendations are based upon guidance provided by United States Government Accountability Office (GAO) and IIA. Agencies choosing to adopt and comply with Generally Accepted Government Auditing Standards (GAGAS) issued by GAO will be deemed to be in compliance with the Act. Internal auditors holding professional certifications (i.e. CIA, CPA, CISA, etc.) may be subject to additional CPE recommendations. Individual internal auditors are responsible for complying with these recommendations.

RESPONSIBILITIES OF THE AGENCY AND AUDIT DIRECTOR

Internal audit units in New York State (NYS) should ensure that internal auditors meet the biennial CPE recommendations. Each agency's internal audit policies and procedures for CPE hours should address the following:

- Identifying all internal auditors and other employees who conduct internal audit functions, and ensuring that they meet the CPE recommendations of this guidance document;
- Soliciting training information from others and assisting internal auditors in determining which programs, activities, subjects, and topics qualify for CPE;
- Making information on CPE programs available to internal auditors and other employees who perform audit activities;
- Providing funding and opportunities for internal auditors to attend internal or external CPE audit related programs;
- Ensuring that audit staff will be granted the appropriate number of CPE hours for each CPE program the audit organization approves and staff attends;
- Establishing policies and procedures to determine the number of CPE hours to be allowed for external training programs and other professional activities;
- Documenting the number of CPE hours completed by each auditor;
- Monitoring auditor compliance with the CPE recommendations; and
- Advising internal audit candidates during the interview process of the biennial CPE recommendations.

RESPONSIBILITIES OF THE INDIVIDUAL INTERNAL AUDITOR

Individual internal auditors are responsible, in conjunction with the audit organization, for seeking opportunities for CPE, for successfully completing CPE programs and activities, and for providing and or maintaining documentation of the CPE hours completed. In addition, individual internal auditors are responsible for monitoring their own progress towards meeting the CPE recommendations and maintaining evidence of their attendance at or completion of external CPE programs. Internal auditors should also contact each appropriate entity to which they report their CPE (e.g., state licensing bodies, professional organizations) to determine what are the entity's specific CPE recommendations and/or guidelines.

CPE Recommendation

It is recommended that internal auditors working in NYS internal audit units obtain 80 hours of CPEs every two years. At least 20 of the 80 hours should be completed in each year of the two-year period.

Auditors Subject To CPE Recommendations

The CPE recommendations stated under the qualifications standard apply to NYS internal auditors who perform internal audits in accordance with the Institute of Internal Auditors Standards. The CPE recommendations set forth the minimum number of CPE hours that internal auditors should complete, whether they are employed full-time or part-time by NYS government internal audit organizations. Agencies that contract out for internal audit services should ensure these contractors meet the CPE recommendations of this guidance document.

It is recommended that internal auditors who are assigned to either planning, directing, performing fieldwork for or reporting on internal audits meet the 80-hour CPE recommendation.

Exemptions

The following individuals should be qualified to perform their assigned tasks and should maintain their professional competence in their areas of specialization, but are not required to meet the CPE hours recommended within this document:

- External consultants and internal specialists, such as actuaries, appraisers, attorneys, engineers, geologists, information technology specialists, medical doctors, and statisticians who are assigned to the job in the role of a specialist do not need to meet the CPE requirement. Internal auditors who use their work should take appropriate steps to determine whether such specialists are qualified in their areas of specialization and should document their conclusions.
- Staff performing support services within the audit organization, such as individuals assigned to staff positions in budgeting, personnel, training and administrative functions are exempt from the requirement.
- Employees who assist in the internal audit engagement by performing support services, such as background research, report writing/editing, production, and distribution are not required to meet the recommended CPE hours.
- College and university students employed on a temporary basis for a limited period of time (for example, an internship of limited duration) or enrolled in a formal program sponsored by the college or university for a specific period of employment, such as a term or semester, are also exempt from the requirement.

Exceptions

The internal audit organization, at its discretion, may grant exceptions from a portion of the CPE recommendations if extended absences or other extenuating circumstances such as the following prevent an auditor from fulfilling those recommendations. Exceptions may arise for a variety of reasons, including the following:

- Ill health;
- Extended family leave;
- Sabbaticals;
- Leave without pay absences;
- Foreign residency;
- Military service; or
- Natural disaster.

The internal audit unit should document its policies and the reasons for any exceptions granted and retain that documentation for an appropriate period of time. The internal audit organization should not grant exceptions for reasons such as workload, budget, or travel constraints.

MEASURING COMPLIANCE WITH CPE RECOMMENDATIONS

The NYS internal auditor CPE recommendations should be satisfied every two years. To simplify administration of the CPE recommendations, an internal audit department should establish a standard two-year reporting period for all its internal auditors.

- **Measurement of Compliance after Beginning of Two-Year Period**

Internal auditors hired or assigned to an internal audit unit after the beginning of a two-year CPE period should complete a pro rata number of CPE hours. An audit organization may define a “pro rata number of hours” based on the percentage of time an auditor worked on internal audits.

- **CPE Carryover**

Internal auditors may not carry over CPE hours earned in excess of the 80-hour recommendations from one two-year period to the next.

- **Deficiency Make-up**

At its discretion, an internal audit organization may give internal auditors who have not completed the recommended number of CPE hours for any two-year period up to two months immediately following the period to make up the deficiency. Any CPE hours completed to make up a deficiency in one period should be documented in the CPE records and may not be counted toward the recommendations for the next two-year period, including the 20-hour annual minimum recommendation. Internal audit organizations that grant the 2-month grace period should evaluate whether internal

auditors who have not satisfied the CPE recommendations after the grace period should be allowed to participate in internal audits until those recommendations are satisfied.

Acceptable CPE Programs

CPE programs are structured educational activities with learning objectives designed to maintain or enhance participants' knowledge and skills in areas applicable to performing internal audit engagements. CPE programs may include subjects that are directly applicable to government auditing, the government environment, or the specific or unique environment in which the entity operates. It is anticipated that internal auditors will maintain the high standards of the profession in selecting quality educational programs to fulfill the CPE recommendations. The overriding consideration in determining whether a specific program is acceptable is that it be a formal program of learning which contributes directly to the professional competence of an internal auditor.

More specifically, acceptable formal programs should:

1. Contribute to the professional competence of participants;
2. State program objectives that specify the level of knowledge the participants should have attained, or the level of competence to be demonstrated upon completing the program;
3. State education or experience prerequisites, if appropriate for the program;
4. Be developed by individuals qualified in the subject matter and instructional design;
5. Provide program content which is current; and
6. Be on a professional level and related to the internal auditing discipline.

The following general areas are acceptable as subjects for CPE programs as long as they meet other CPE program criteria:

- Auditing and accounting;
- Management and communication (oral and written);
- Computer science;
- Mathematics, statistics, and quantitative applications in business;
- Economics;
- Business law;

- Specific business topics such as finance, production, marketing, and personnel; and
- Specialized industry areas such as government, banking, utilities, or oil and gas.

Activities other than those listed in this guidance may be deemed acceptable if the DIA can demonstrate that they contribute to professional competence. Substantiating that a particular activity qualifies as acceptable and meets the requirements is the responsibility of the agency's Internal Audit Director.

Programs, Activities, Subjects, and Topics That Do Not Qualify

Examples of programs and activities or subjects and topics that do not qualify for CPE hours include, but are not limited to, the following:

1. On-the-job training;
2. Basic or elementary courses in subjects and topics in which the auditor already has the knowledge and skills being taught;
3. Programs that do not maintain or enhance internal auditors' professional proficiency, but are designed for general personal development (such as resume writing, improving parent-child relations, personal investments and money management, and retirement planning).
4. Programs that demonstrate the operation of office equipment or software that are not used in conducting internal audits;
5. Programs that provide training on the audit organization's administrative operations;
6. Business sessions at professional organization conferences, conventions, and meetings; and
7. Preparation time for repeated presentations on the same subject matter within the two-year period.

Some tax services that are not related to the subject matter of internal audits performed under IIA Standards would not qualify as CPE for purposes of NYS Internal Audit recommended CPEs. However, if taxation topics relate to an objective of an internal audit conducted under IIA Standards, training in those related tax topics could qualify as CPE.

Other Activities Qualifying For CPE

CIA Examination

Eighty CPE hours are awarded for successful completion of the CIA examination (40 hours in the year the examination is passed and 40 hours in the subsequent year).

Education

A maximum of 80 CPE hours may be awarded in the education category for each two-year period reported. Educational activities include:

1. Professional education and development programs, such as seminars and conferences, provided by national or state and local auditing and accounting organizations;
2. Technical sessions at meetings of national or state and local auditing and accounting organizations and chapters;
3. Formal in-house training programs;
4. Programs of other sponsors (industrial, professional societies, etc.);
5. College or university courses passed (credit and non-credit courses), except for those courses an internal auditor must take in order to meet the requirement of a bachelor's degree or its equivalent;
 - Fifteen hours of CPE credit are awarded for each semester hour of college/university credit earned;
 - Ten hours of CPE credit are awarded for each quarter hour of college/university credit earned;
6. A maximum of 80 CPE hours may be awarded for certification examinations passed other than the CIA in the year the exam is passed. Twenty CPE hours are awarded for passing each part of another accounting or auditing examination (for example, the CPA, or CISA examination); and
7. Formal correspondence and self-study programs relevant to internal auditing that include evidence of completion.

Publications

A maximum of 50 hours may be awarded in the publications category for each two-year period. Generally, one full journal page of single-spaced print is equal to two hours of CPE credit, with the following limits on one publication:

- Books - 50 hours
- Articles - 25 hours
- Research papers - 25 hours

Contributions to publications should pertain to the internal auditing discipline. Published articles or books not related directly to internal auditing are acceptable if the internal auditor is able to demonstrate that these activities contribute to his or her professional audit proficiency.

Oral Presentations

A maximum of 50 CPE hours may be awarded in the oral presentations category for each two-year period. The hours reported for the first presentation will be based on the length of presentation time, plus credit for preparation time equivalent to three times the presentation time. Subsequent presentations of the same material may be reported as presentation time only up to a maximum of 10 CPE hours in each two-year period.

Participation

A maximum of 25 CPE hours may be awarded in the participation category in each two-year period for:

- a) Participation as an officer or committee member in a professional industry organization related to internal auditing; one CPE hour for each hour of qualifying participation will be awarded; and
- b) Participation in a quality assurance review; one CPE hour for each hour spent on-site will be awarded, but no CPE hours will be awarded for activities such as preparation time and writing the report.

Measuring CPE Hours

A CPE hour may be granted for each 50 minutes of participation in group programs and activities that qualify. One-half CPE hour increments (equal to 25 minutes) may also be granted after the first CPE hour has been earned in a given program or activity. At conferences and training classes where the length of individual presentation or session are other than 50 minutes, the sum of the presentations or session should be considered as one total program; for example, two 90 minute, two 50 minute, and three 40 minute presentations equal 400 minutes or 8 CPE hours. When the total minutes of a presentation are more than 50, but not equally divisible by 50, the CPE hours should be rounded down to the nearest one-half hour.

Providers of CPE programs should monitor their programs to accurately assign the appropriate number of hours. Participants should receive CPE hours only for the actual time they attend the program. Preparation time for students participating in a CPE program should be counted only if the CPE provider has designated that a portion of the CPE program be individual study, and that portion meets the recommendations for individual study programs.

Participants in individual-study programs should be granted CPE hours when they satisfactorily complete the programs. These programs should be pre-tested by the vendor or provider to determine the average completion time, and CPE hours should be granted in an amount equal to the average completion time. For example, an individual-study course that takes an average of 600 minutes to complete should be granted 12 CPE hours.

Maintaining Documentation

1. The internal audit unit is responsible for maintaining documentation of the CPE hours completed by each auditor, subject to the CPE recommendations. The audit organization's records, which may be kept electronically, should include the following information for each CPE program or activity attended or completed by an auditor:
 - a. Name of the organization providing the CPE;
 - b. Title of the training program, including the subject matter or field of study;
 - c. Dates attended (for group programs) or dates completed (for individual study programs); and
 - d. Number of CPE hours each auditor earned toward the 80-hour recommendation.
2. The internal audit unit should also maintain the following CPE documentation or have appropriate policies and procedures in place requiring the auditor to maintain this documentation, which may be kept electronically:
 - a. Certificate, or other evidence of completion, from the CPE provider (if provided);

- b. Documentation of CPE courses presented and/or copies of course materials developed by or for speakers, instructors, or discussion leaders, along with a written statement supporting the number of CPE hours claimed, and
 - c. A copy of the published book, article, or material that names the writer as author or contributor; a written statement from the writer supporting the number of CPE hours claimed; and the name and contact information of the publisher, if applicable.
 3. If the audit organization elects to delegate the responsibility to the auditor for maintaining the above documentation, the audit organization should have adequate procedures in place to ensure that its records of CPE hours earned by auditors are supported by the documentation maintained by auditors. Examples of such procedures could include periodic distribution of CPE reports to auditors for verification against their records, periodic review of records for a random sample of auditors, etc.

Retaining Records

All CPE records should be maintained for a minimum of five years to coincide with peer review requirements.

Monitoring Compliance

Compliance with the CPE recommendations should be evaluated during the performance of a peer review and or other quality assurance monitoring activity that results in the annual Internal Control Certification.

TRAINING ORGANIZATIONS, WEBSITES AND LINKS

Organization	Chapter	Website	Training Info Page
Association of Government Accountants http://www.agacgfm.org/membership/localchapters/chapterlist.aspx	NY Capital Chapter	http://www.aganycap.org/	http://www.aganycap.org/education/main.htm
	NYC	http://members.aol.com/blumenie/nycaga.htm	http://members.aol.com/blumenie/moreinfo.htm
Institute of Internal Auditors http://www.theiia.org/chapters/index.cfm?act=all.list&selected=United%20States	Albany Chapter	http://www.theiia.org/chapters/index.cfm?act=home.page&cid=87	http://www.theiia.org/index.cfm?doc_id=883 (Includes on-line training)
	Buffalo	http://www.theiia.org/chapters/index.cfm?act=home.page&cid=24	See posted newsletters
	Central NY	http://www.theiia.org/chapters/index.cfm?act=home.page&cid=58	http://www.theiia.org/chapters/index.cfm/view.events/cid/58
	Westchester	http://www.theiia.org/chapters/index.cfm?act=home.page&cid=86	http://www.theiia.org/chapters/index.cfm/view.events/cid/86 (no events currently listed)

TRAINING ORGANIZATIONS, WEBSITES AND LINKS

	Long Island	http://www.theiia.org/chapters/index.cfm?act=home.page&cid=241	http://www.theiia.org/chapters/index.cfm/view.events/cid/241
Institute of Internal Auditors	NYC	http://www.nyiia.org/	http://www.theiia.org/index.cfm?doc_id=883 (Includes on-line training) http://www.nyiia.org/calendar.htm
Information Systems Audit and Control Association http://www.isaca.org/Content/NavigationMenu/About_ISACA/Chapters/ISACA_Chapters_in_North_America.htm-newyork	Hudson Valley Chapter	http://www.isacahv.org/	http://www.isacahv.org/events.htm
	Western NY	http://www.isacawny.org/	http://www.isacawny.org/index.php?option=com_weblinks&catid=82&Itemid=4 http://www.isacawny.org/index.php?option=com_events&Itemid=45
	Central NY	http://www.cnyisaca.org/	http://www.cnyisaca.org/events.html

TRAINING ORGANIZATIONS, WEBSITES AND LINKS

	NY	http://www.isacany.org/	http://www.isacany.org/Web_Site/Education/Workshops and Seminars.htm
Association of Certified Fraud Examiners http://www.cfenet.com/chapters/ChapterList.asp	Albany Chapter	http://www.albanyacfe.org/	http://www.albanyacfe.org/ACF Etrainingevents.htm
Association of Certified Fraud Examiners	Western NY	http://www.cfenet.com/chapters/ChapterDetail.asp?Page=Contact&ChapterID=86	http://www.cfenet.com/chapters/ChapterDetail.asp?Page=Training&ChapterID=86 Training events empty
	Syracuse	http://www.cfenet.com/chapters/ChapterDetail.asp?Page=Contact&ChapterID=49	http://www.cfenet.com/chapters/ChapterDetail.asp?Page=Training&ChapterID=49
	Long Island	http://www.licfe.org/	'Events' link not active
	NY	http://www.nycfe.org/	http://www.nycfe.org/seminars/index.htm
American Institute of Certified Public Accountants	National	https://www.aicpa.org/	http://ceae.aicpa.org/
	New York State Chapter	http://www.nysscpa.org/	http://www.nysscpa.org/continuingeducationa.htm
American Women's Society of Certified Public Accountants		http://www.awscpa.org/	http://www.awscpa.org/frameset.php?cf=meetings.htm

TRAINING ORGANIZATIONS, WEBSITES AND LINKS

Institute of Management Accountants		http://www.imanet.org/ima/index.asp	http://www.imanet.org/ima/sec.asp?TRACKID=&CID=787&DID=998
National Association of State Auditors, Comptrollers and Treasurers		http://www.nasact.org/	http://www.nasact.org/conferences/index.html
National Association of Local Government Auditors		http://www.nalga.org/	
Governor's Office of Employee Relations			http://www.goer.state.ny.us/train/index.html http://www.ric.goer.state.ny.us/training.shtml
NYS Training Council			http://www.nystc.org/
NYS Office for Technology			http://www.oft.state.ny.us/academy/index.htm
Public Employees Federation		http://www.pef.org/	Select "education and training" link

TRAINING ORGANIZATIONS, WEBSITES AND LINKS

Management/Confidential Tuition Reimbursement			http://www.goer.state.ny.us/mc/mctuition.html
Civil Service Employees Association			http://www.nyscseapartnership.org/
MIS Training Institute			http://www.misti.com/
US Department of Agriculture Graduate School		http://www.grad.usda.gov/	http://www.grad.usda.gov/cgi-bin/sb/nav.cgi/aip=e71e80w3M6Z,00WGzwOI,K8tTShom8f4-EJ-.?nav=100455

Internal Audit CPE Work Group
Estimated Cost Implementing 80 CPEs Every Two Years

Low Cost Training Already Available:	Estimated CPE's	Cost of Program
Leadership and Accountability	6	Free
Internal Controls Association	10	Free
GOER Leadership Programs	6	Free
NASACT Audio Conferences	8	\$33
OSC Fall Conference	15	\$65
OSC Outreach Programs	Various	Free
Available CPEs	45	\$98
Professional Organizations Programs		Non-Member Prices
AGA: Full-Day Programs	8	\$200
IIA: Full-Day Programs	7	\$100
ISACA: Full-Day Programs	7	\$120
TCTC	21	\$475
NYCHIA Subscription Program	35	\$750
Programs to be Developed with Coordinated Effort:		
Best Practices	7	Free
1-2 Day Technical Program:		
Using State Employees	7	Free
Using Hired Consultants	7	\$150
New Internal Auditor Training Program	21	Free
Other CPE Options:		
On-line Learning:		
OFT's Soft Skills	40	\$60
Smart Pros-Technical	40	\$250
Estimated cost for 40 CPEs per year, if, on average, an auditor obtained:		
10-20 CPEs from Low-Cost Program		\$100
10-20 CPEs from Coordinated Efforts		\$300
10-20 CPEs from Professional Organizations		\$300
		<u>\$700</u> per auditor



Internal Audit Peer Review

ACKNOWLEDGEMENTS

About the Report

This is one of nine reports that were issued by the New York State Internal Control Task Force (ICTF) in the summer of 2006.

The ICTF, led by a Steering Committee, was comprised of six Work Groups coordinated by Task Force Liaisons from the Division of the Budget (DOB), the Office of the State Comptroller (OSC) and the New York State Internal Control Association (NYSICA).

About the Authors

The research for this study was a collaborative effort conducted by a group of volunteers from the internal audit departments of several large and small New York State agencies. This work group consisted of internal audit officials who each possess many years of experience in the practice of professional internal auditing.

Research Groups

The contents of this study were developed by the ICTF from its original research, professional guidance, and literature. It builds upon earlier reports by the New York State Assembly, audit reports by the OSC, and DOB budget bulletins.

Stakeholder Groups

Stakeholders in this study include State Agencies, Public Authorities, the Division of the Budget, and the Office of the State Comptroller.

For More Information

Feel free to contact the following individuals should you require additional information:

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Peer Review Workgroup

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BACKGROUND

The Governmental Accountability Audit and Internal Control Act (The Internal Control Act) requires agencies to operate in accordance with generally accepted professional standards for internal auditing. In order to be in compliance with the *Standards for the Professional Practice of Internal Auditing (Standards)* adopted by the Institute of Internal Auditors (IIA), agency internal audit units in existence as of January 2002 must have an external quality assessment (QA) completed by January 1, 2007. Thereafter, such external assessments should be conducted at least once every five years. Similarly, the Government Accountability Office (GAO) has issued Government Auditing Standards (Yellow Book) which require that peer reviews be performed at least once every three years.

The Peer Review Work Group was charged with establishing a cost-effective approach that would enable agency internal audit units to comply with this requirement. In addition to complying with the Act and the *Standards*, there are “real world,” everyday reasons for obtaining an external quality assessment including reinforcing management’s confidence in relying on the work of the internal audit unit. External assessments can also help ensure more effective and efficient internal auditing operations by identifying better practices and making recommendations intended to improve performance.

RESULTS IN SUMMARY

The Work Group identified several approaches that agencies could take to comply with the *Standards*. There is not a one-size fits-all approach to this issue. Some agencies may benefit from obtaining their reviews from a national association that deals with issues specific to their industry. Some agencies may elect to self-assess their compliance with an independent quality validation of the self-assessment. Other agencies may prefer to participate in a reciprocal peer review arrangement between three or more organizations. Still others may choose to contract with an outside party to conduct the review.

The Work Group believes that the best approach is for agencies to participate in a sharing of resources whereby agencies lend internal audit managers and staff to a cooperative effort; and teams from these resources are formed to conduct assessments at participating agencies. This cooperative approach will help share best practices among internal audit units statewide and individual participants will benefit by seeing how other internal audit units approach common issues.

RESULTS OF REVIEW

Cost Comparison of Various Approaches

The Peer Review Work Group explored the potential costs and benefits associated with the various alternatives described above. External quality assessment services can be obtained from independent outside providers such as public accounting firms and the Institute of Internal Auditors. We estimated the cost of contracting for an external assessment could range from a low of approximately \$11,000 to a high of approximately \$55,000. Some CPA firms indicated that it is often appropriate to include more partner time on such projects because of the nature of the work. Doing so could increase the costs beyond these estimates.

We surveyed firms on the Office of General Services' (OGS) Statewide Audit Services Mini-bid Contract for Lot II – performance audits. Most firms said that they would be willing to perform an external assessment despite indications that they had not performed this type of an engagement to date.

Self-assessment with independent validation is another option to meet the requirement for an external assessment. It addresses concerns that an external assessment by an independent individual or team may be too costly for smaller internal audit units. The primary focus would be on compliance with the *Standards*. Attention to other areas such as benchmarking, analysis of best practices, governance and consulting services may be reduced or omitted.

Self-assessment with independent verification by a contractor should cost less than the estimates above due to agencies performing the majority of the work themselves. However, agencies should also consider the cost of the staff time spent performing the review when deciding how to comply with the external assessment requirement. The time invested in a self-assessment would likely be similar to time spent preparing for an external assessment by an independent party.

Participation in a national association peer review program involves a commitment of in-kind services plus related travel costs. Generally, such programs operate reciprocally with an internal audit unit becoming eligible to acquire a peer review after earning sufficient credits by volunteering staff resources for the performance of such reviews at other agencies.

Similarly, a New York State cooperative approach would also involve the commitment of staff resources. Based on the Work Group's estimate of 27 total staff days to complete an external assessment, the cost of salary and fringe benefits for State employees conducting an assessment would be approximately \$11,000.

Develop a Plan to Assist Agencies In Obtaining External Assessments

For Agencies Contracting Out

The Work Group prepared a mini-bid template and evaluation spreadsheet that agencies could use to obtain an external assessment by bidding off of the OGS's statewide Audit Services Contract. This template will be posted on related websites so that agencies may copy and customize it to their needs.

For Agencies Opting to Participate in a Cooperative Effort

Twenty agencies responding to the ICTF survey regarding peer review indicated that they are planning to participate in the State cooperative approach and two other agencies indicated that they might want to participate. To determine the amount of resources available to undertake these 22 peer reviews, the ICTF Steering Committee sent a letter to Agency Heads that encouraged them to loan staff for this undertaking.

Staff volunteers received three days of training on how to conduct an external assessment that was provided by the Institute of Internal Auditors (IIA). The training will ensure a common basis of understanding for the auditors who will be leading and participating on peer review teams.

We have identified three categories of staff necessary for this project:

External Assessment Reviewers - Reviewers should be internal auditors who have a good understanding of the current *Standards* and have experience managing an internal audit function. Preference would be for individuals who also have earned a professional certification (e.g., Certified Internal Auditor, Certified Public Accountant and Certified Information System Auditor).

Engagement Supervisors - Experienced peer review team leaders who have led internal audit projects and have an understanding of the *Standards*. Preference would be for individuals with professional certifications.

Staff Auditor – For external assessments at larger agencies, engagement supervisors will need staff assistance. Our model is based on having two staff auditors per project.

Monitoring

The Work Group believes that agencies should report the status of their required external quality assurance assessment as part of their Internal Control certification pursuant to BPRM Item B-350. Agencies choosing to participate in the State cooperative approach will also be tracked on the plan/schedule developed to coordinate this cooperative effort.

Need for a Resource to Coordinate External Assessments

To sustain the State cooperative effort, the Division of the Budget should coordinate the external assessment process. The coordinator's duties would include: scheduling the assessments with agencies, arranging for staffing of each peer review assignment, sending out the questionnaires in advance of the scheduled review, receiving questionnaires back from agencies and providing results to the engagement supervisor.

The external assessment requirement is continuous and agencies will need a review either every three to five years depending on whether they follow GAO or IIA auditing standards.

Action Items

- ICTF Steering Committee issued a letter to Agency Heads calling for qualified volunteers to staff the State cooperative peer review effort.
- An IIA training course was held in 2005 for individuals who will be conducting, reviewing or working on external assessments.
- A template for agencies to use to mini-bid off of the statewide audit services back drop contract should be placed on the ICTF website.
- Responsibility for coordinating the peer process in future years should be determined.

RECOMMENDATIONS

We believe a State cooperative external assessment approach, conducted by the Division of the Budget, is the best way for most agencies to obtain a peer review because it is cost-effective, offers training and learning opportunities for individual participants and will result in a sharing of best practices. We recognize that this approach might not work for every agency. However, we believe that a self-assessment with an independent validation would not add as much value, since the self-assessment would be limited to evaluating compliance with the *Standards* and would not likely lead to improvements. Also, contracting-out for external assessments is not as attractive an option because it may be more costly, and offers less long-term value because of the lost opportunity for staff members' professional development.