

*A REPORT BY THE NEW YORK STATE
OFFICE OF THE STATE COMPTROLLER*

**Alan G. Hevesi
COMPTROLLER**



**NEW YORK STATE
DIVISION OF THE BUDGET**

**STATE AGENCY INTERNAL AUDIT UNITS'
COMPLIANCE WITH INTERNAL CONTROL
ACT**

2003-S-14

DIVISION OF STATE SERVICES

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Report 2003-S-14

Ms. Carole E. Stone
Director
New York State Division of the Budget
The State Capital
Albany, New York 12224

Dear Ms. Stone:

The following is our report on New York State Agency Internal Audit Units' compliance with the New York State Governmental Accountability, Audit, and Internal Control Act for the period April 1, 2001 through May 31, 2003.

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law. Major contributors to this report are listed in Appendix C.

Office of the State Comptroller
Division of State Services

August 17, 2004

EXECUTIVE SUMMARY

NEW YORK STATE DIVISION OF THE BUDGET STATE AGENCY INTERNAL AUDIT UNITS' COMPLIANCE WITH INTERNAL CONTROL ACT

SCOPE OF AUDIT

The New York State Governmental Accountability, Audit, and Internal Control Act (Act), originally passed in 1987, required State agencies to establish systems of internal controls and mandated internal audits of funds, materials, and workforce performance. In 1993, the Legislature extended the Act until January 1, 1999. When the Act was made a permanent law in 1999, it defined internal audit as “an appraisal activity established by the management of an organization for the review of operations as a means of assuring conformance with management policies and the effectiveness of the internal control, and conducted in conformance with generally accepted standards for internal auditing.” The Act made the Division of the Budget (DOB) responsible for designating the State agencies that must have an internal audit function. DOB complied by identifying 34 such agencies (listed agencies). The Act also set forth criteria for the qualifications of each audit unit director, the establishment of organizational independence, and the performance of audits and reviews of each agency’s internal controls. It further specified that each internal audit unit is to operate in conformance with professional standards for internal audit, which are the generally accepted Standards for the Professional Practice of Internal Auditing (Standards) that are published by the Institute of Internal Auditors (IIA).

Our audit addressed the 34 listed agencies’ internal audit units’ compliance with the Act and the Standards. We considered the following questions for the period April 1, 2001 through May 31, 2003:

- Did the 34 listed agencies have internal audit functions, headed by appropriately qualified directors, that conform with the Standards?
- Did these internal audit units appropriately fulfill their roles of evaluating internal controls and operations, identifying control weaknesses, and making recommendations for corrective actions, in accordance with the Act and the Standards?

AUDIT OBSERVATIONS AND CONCLUSIONS

The State Assembly Oversight, Analysis and Investigation Committee performed a study in 1997 of all State agencies and authorities covered by the Act's provisions. Titled *Who's Minding the Store?*, the study concluded that "non-compliance with critical or essential provisions of the Act was pervasive" and that "because internal control practices were not implemented according to the Act, professional standards and Division of Budget guidelines, many agencies were not proving themselves accountable to the citizens of New York State, thus setting the stage for unethical behavior, inefficiency, fraud, and abuse."

Our audit disclosed that the conditions identified by the Assembly in their report are still prevalent today. We found that more than 50 percent of the 34 listed agencies' internal audit units have serious problems in complying with the Act and/or the Standards. Two of the listed agencies, the Department of Health and the Division of Military and Naval Affairs, have neither internal audit units nor internal audit functions. The Division of Probation and Correctional Alternatives (DPCA) also has no internal audit unit. To compensate, the internal audit unit of the Division of Criminal Justice Services provides internal audit services to DPCA. However, during our 26-month audit period, this unit performed only one internal audit for DPCA - an examination of the DPCA Quick Pay process. This audit alone does not provide DPCA with enough feedback on the adequacy of its systems of internal control and does not indicate whether the systems are working as intended. In addition, the Department of Civil Service had an internal audit unit in name only; its one-person shop performed no internal audit services during our audit period. (See pp.15-17)

We audited each internal audit unit against five audit organization criteria from the Act and the Standards. These criteria included the director's qualifications, staff qualifications, continuing professional education, and organizational and individual independence. We found that eight agencies either have not hired an internal audit director or have hired a director who does not have the qualifications required by the Act. In addition, 12 agencies' internal audit staffs received little or no continuing education during our audit period. (See pp.18-19)

We identified 11 agencies whose internal audit units lacked organizational independence because they did not report to a level high enough in the organization and 16 agencies whose internal auditors did not have individual independence because they were assigned other duties within their agencies that were incompatible with their internal audit responsibilities. At 12 of the 16 agencies, the director of internal audit was also the agency's Internal Control Officer (ICO). This arrangement creates a conflict of interest because these individuals are responsible for providing an independent analysis of the same internal control operations over which they have implementation responsibility. (See pp.19-20)

We also audited against six criteria related to the internal audit processes at the listed agencies. We determined whether each unit performed periodic risk assessments; developed risk-based audit plans; performed audits and reviews of the agency's internal controls; established a system to monitor the disposition of audit results communicated to management; adopted a quality assurance process for monitoring the overall effectiveness of its operations; and maintained sufficient documentation to support its findings and conclusions. We found that just four agencies were in compliance with all six of these requirements. In contrast, we identified 16 agencies whose internal audit units were not in full compliance with at least four of the six requirements. In many of these cases, the units were not performing risk assessments, were not preparing risk-based audit plans and/or were not conducting sufficient internal audits of agency functions and operations. As a result, these units are not providing the proper oversight of their agencies' internal control frameworks and processes, and the agencies' managements have no assurance that their systems are operating as intended. (See pp. 23-28)

We recommend that agencies comply with both the audit organization and the audit process requirements of the Act and the Standards.

COMMENTS OF DOB AND AGENCY OFFICIALS

A draft copy of this report was provided to DOB officials for their review and comment. DOB also solicited comments from the 34 agencies covered by this report. Their comments have been considered in preparing this report, and are included as Appendix D. Officials generally agreed with most of our findings. They reported measures underway to correct deficiencies and proposed a cooperative effort to assist internal audit units with ongoing compliance. Appendix E contains State Comptroller's Notes, which address instances where agencies disagreed with some of the findings.

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INTRODUCTION

Background

The Institute of Internal Auditors (IIA), an internationally recognized member organization consisting of internal auditors from both the public and private sectors, defines internal auditing as:

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

Internal auditors assist the organization in the effective discharge of responsibilities, promote the establishment of cost-effective controls, assess risks, and recommend measures to mitigate those risks. An integral part of the management team, internal auditors furnish top management with analyses, appraisals, counsel, and information on the activities they review; they also monitor organizational ethics.

The State Legislature found that the scope, size and complexity of State government necessitated that the State’s systems of internal control provide a reasonable assurance to the public, the governor, the Legislature, the Judiciary and the heads of State agencies and authorities that State assets and resources are used consistent with their intended purposes and in an effective, economical and efficient manner. The New York State Governmental Accountability, Audit, and Internal Control Act (Act), originally passed in 1987, required State agencies to establish systems of internal controls and mandated internal audits of funds, materials, and workforce performance. In 1993, the Legislature extended the Act until January 1, 1999.

The State Assembly Oversight, Analysis and Investigation Committee performed a study in 1997 of all State agencies and authorities covered by the Act’s provisions. Titled *Who’s Minding the Store?*, the study concluded that “non-compliance with critical or essential provisions of the Act was pervasive” and

“because internal control practices were not implemented according to the Act, professional standards and Division of Budget guidelines, many agencies were not proving themselves accountable to the citizens of New York State, thus setting the stage for unethical behavior, inefficiency, fraud, and abuse.”

The Legislature made the Act permanent in 1999, and strengthened some of its requirements. The 1999 law defined internal audit as “an appraisal activity established by the management of an organization for the review of operations as a means of assuring conformance with management policies and the effectiveness of the internal control, and conducted in conformance with generally accepted standards for internal auditing.” The Act made the Division of the Budget (DOB) responsible for designating the State agencies that must have an internal audit function. In its Budget Bulletin B-350, DOB assigned 34 State agencies (listed agencies) with that obligation (see Appendix A).

The Act specifies that each of the 34 listed agencies’ commissioners is to appoint a director of internal audit with appropriate internal auditing credentials, including internal auditing education and experience. In addition, the Act requires the director to report directly to the head of the agency. It also requires the internal audit function to identify internal control weaknesses that have not been corrected and make recommendations for correcting these weaknesses. Finally, the Act requires each internal audit unit to operate in accordance with professional standards for internal auditing, the generally accepted Standards for the Professional Practice of Internal Auditing (Standards) that are published by the IIA.

In addition to the specific requirements of the Act, we selected the following Standards to measure the performance of the 34 listed agencies’ internal audit units:

Staff Qualifications - Internal auditors should possess the knowledge, skills and other competencies needed to meet their individual responsibilities. Collectively, the internal audit unit should possess or obtain the knowledge, skills and other competencies needed to perform its duties.

Independence - Internal auditors should have an impartial, unbiased attitude and avoid conflicts of interest. They should

refrain from assessing operations for which they were or are responsible.

Training - Internal auditors should enhance their knowledge, skills and other competencies through continuing professional education.

Risk Assessments - The internal audit unit's plan of engagements should be based on a risk assessment, undertaken at least annually. The input of senior management and the Board should be considered in this process.

Audit Plans - The chief audit executive should establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.

Monitoring Results - The chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management.

Quality Assurance - The internal audit unit should adopt a process to monitor and assess the overall effectiveness of the unit's operations. Every audit should receive supervisory review and, periodically, an assurance process should occur either through a self-assessment or an assessment performed by a third party independent from the original audit.

Work Papers - Internal auditors should identify, analyze, evaluate, and record sufficient information to achieve the engagement's objectives.

We have addressed this report, and the recommendations contained herein, to the Division of the Budget, because it is in a unique position to coordinate and assist the individual agencies' efforts to comply with the Act. Although DOB is not directly responsible for internal audit activities at State agencies, its role in determining which agencies must establish internal audit units, coupled with its past efforts to coordinate implementation of other important provisions (such as those related to internal control systems), makes it a critical focal point in the process.

Audit Scope, Objectives and Methodology

We audited the internal audit operations of the 34 listed agencies for the period April 1, 2001 through May 31,

2003. The objectives of this performance audit were to determine whether the listed agencies had established internal audit functions, headed by appropriately qualified directors, in accordance with professional standards and to determine whether the listed agencies' internal audit units are appropriately fulfilling their role of evaluating internal controls and operations, identifying control weaknesses and making recommendations for corrective action. To accomplish these objectives, we reviewed the Act and the Standards; we spoke with officials from DOB, as well as each agency's director of internal audit and his/her staff, where appropriate; and we reviewed pertinent documents at each agency and conducted tests as necessary.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations of each agency that are within our audit scope. Further, these standards require that we understand each agency's internal control structure and its compliance with those laws, rules and regulations that are relevant to the operations included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

Response of DOB and Agency Officials to Audit

We provided a draft copy of this report to DOB officials for their review and comment. DOB also solicited comments from each of the 34 agencies covered by this report. Their comments have been considered in preparing this report and are included as Appendix D. Agencies generally agree with most of our findings and indicate that they either have already taken action to correct deficiencies or have identified measures to bring their internal audit units into compliance with the Act. Appendix E contains State Comptroller's Notes, which address instances where agencies disagreed with some of the findings. DOB has proposed establishing an Internal Audit Best Practices Group, consisting of staff from DOB, OSC and agencies, to develop practical approaches for internal audit units to meet ongoing requirements.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, each listed agency shall report to the Governor, the State Comptroller and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

AUDIT RESULTS

Despite the report issued by the Assembly in 1997 and the Legislature making the Act permanent in 1999, we found that many of the listed agencies are not in compliance with the organizational and/or the operational requirements of the Act. Three agencies - the Department of Health (DOH), the Division of Military and Naval Affairs (DMNA), and the Division of Probation and Correctional Alternatives (DPCA) - did not have internal audit units as required by the Act and DOB. Neither DOH nor DMNA has a way to obtain internal audit services for its organization. Thus, their managements have no independent appraisal function that can assure them that their agencies' systems of internal controls are either adequate or operating as intended. The Division of Criminal Justice Services (DCJS) provides internal audit services to DPCA. However, during our audit period, DCJS performed just one audit at DPCA, addressing their Quick Pay program. This one audit does not provide an adequate appraisal of DPCA's systems of internal controls.

We audited the 31 agencies with internal audit units. We reviewed their operations for five categories pertaining to their audit organizations (director and staff qualifications, individual and organizational independence, and training) and six categories pertaining to their audit processes (risk assessments, audit plans, audits and reviews, monitoring of results, quality assurance, and work papers) to determine each unit's compliance with these requirements of the Act and the applicable Standards. See Appendix B for a chart showing the results of our audits of these operations.

In addition to the three agencies without an internal audit function, we identified one agency that had a function in name only. The Department of Civil Service (DCS) had hired an internal audit director who possessed neither education nor experience in internal auditing. DCS management then assigned the director a wide variety of other managerial functions within the organization that were not related to internal audit. In addition, since it hired no additional internal audit staff, DCS had no real internal audit function. During our audit period, this unit performed no risk assessments, prepared no risk-based

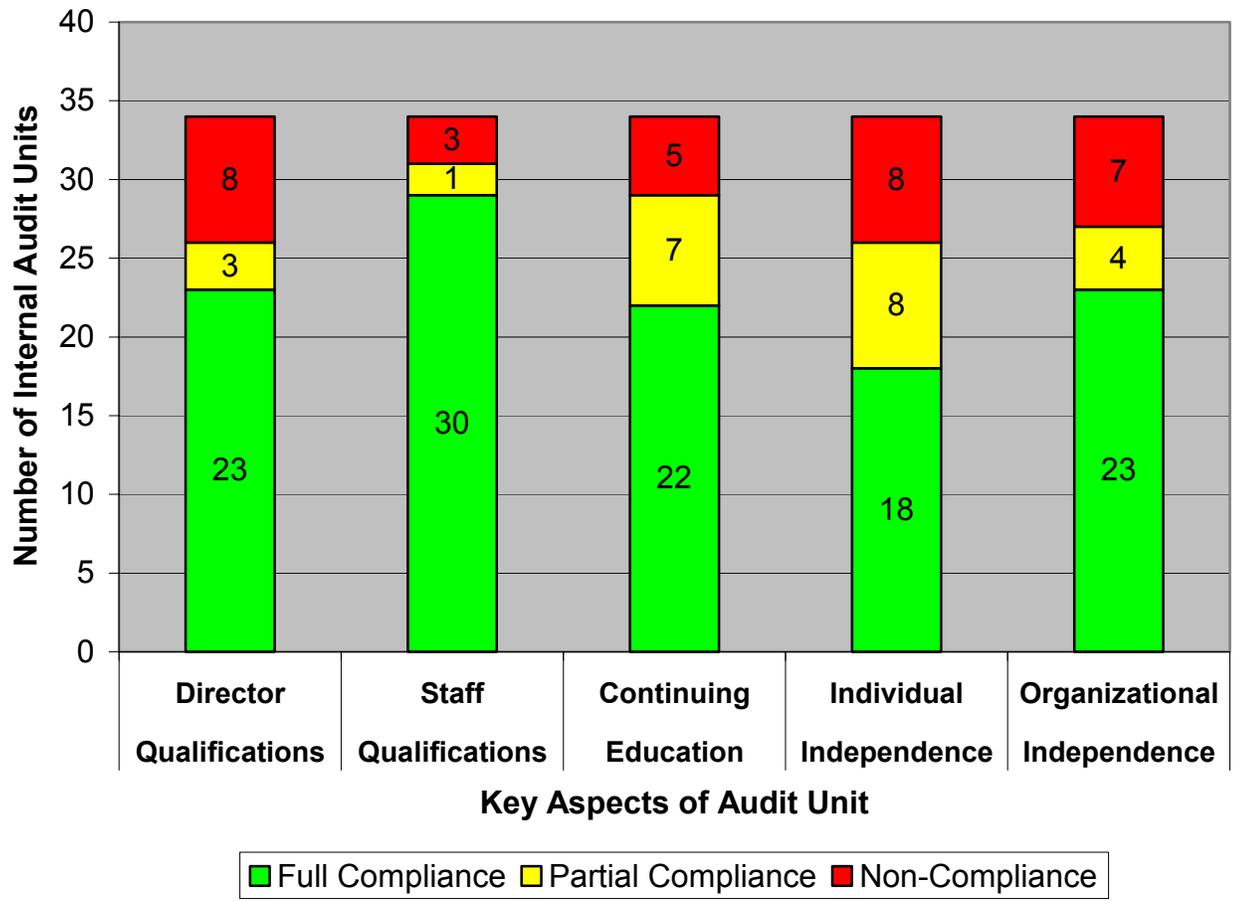
audit plans, and performed no audits or reviews. Thus, DCS had no independent appraisal of its internal control activities and its management had no assurance that the internal control systems in place were either adequate or working as intended. After our audit concluded, DCS hired a new director of internal audit after promoting the existing director to a management function within the organization.

Of the 34 listed agencies, 8 either have not hired an internal audit director or have hired a director who did not possess the qualifications required by the Act. In addition, 21 of the agencies' internal audit units have independence problems and the audit processes of 13 agencies have serious deficiencies (e.g., the audit units do not perform risk assessments, develop audit plans, or perform actual audits). Overall, only four agencies fully complied with each of the 11 requirements of the Act and/or the Standards for which we tested. More than half of the listed agencies (19) were not in compliance with more than one of the requirements and another ten agencies only partially complied with at least two provisions. As a result, we conclude that the internal audit function at many agencies is not functioning as intended.

AUDIT ORGANIZATION

The structure of the internal audit organization is addressed in both the Act and the Standards, which stipulate that organizations should have qualified directors and staff auditors who maintain and upgrade their skills and abilities through proper training. Auditors should have both organizational and individual independence so they can provide management with an objective appraisal of the agency's internal control structure and activities. We identified the following nine agencies whose internal audit units were in compliance with the requirements in all five key aspects: the Department of Agriculture and Markets (A and M); the State Insurance Department (SID); the Division of Housing and Community Renewal (DHCR); the Office of Parks, Recreation and Historical Preservation (OPRHP); the Department of State (DOS); the Department of Labor (DOL); the Office of Temporary and Disability Assistance (OTDA); the Department of Transportation (DOT); and the State University of New York (SUNY). The following chart depicts the results of our reviews of the internal audit unit organizations at the 34 listed agencies.

Summary of Audit Unit Organization



Director Qualifications

The Act requires each of the 34 listed agencies to hire a qualified director who has both education and experience in auditing. As stated previously, DOH, DMNA, and DPCA have no internal audit function and, therefore, they have no directors of internal audit. The Division of State Police (DSP) and the Division of Parole (Parole) had not hired a director or appointed a person as the acting director to head their internal audit operations. Three agencies, DCS, DCJS, and the Office of Mental Retardation and Developmental Disabilities (OMRDD) had hired directors of internal audit who had neither accounting and auditing education nor experience. Three other agencies, the Division of Alcoholic Beverage Control (ABC), the Department of Correctional Services (DOCS), and the

Department of Environmental Conservation (DEC), had hired directors who met only one of the two Act requirements (internal audit education or experience). Thus, 11 agencies were not in full compliance with this requirement of the Act.

Staff Qualifications and Training

The Standards require internal audit units to have staff who are qualified and who receive continuing professional education (CPE) to ensure they maintain and enhance their auditing skills and knowledge. We identified four agencies - DOH, DMNA, DCS, and ABC that did not have qualified staffs for their internal audit units. DOH and DMNA have no internal audit units, and DCS does not have a functioning internal audit unit. As such, these agencies are not in compliance with this standard. At ABC, the director, who did not have adequate accounting or auditing education when he was hired, was the sole staff member.

Employing staff auditors who lack proper internal auditing credentials and/or CPE can compromise the effectiveness of the internal audit function. We identified 12 agencies whose internal auditing staffs had received little or no CPE during the period April 1, 2001 through May 31, 2003. In addition to DOH and DMNA, which had no internal audit units and, therefore, no CPE, we found that the Workers' Compensation Board's (WCB) lone internal auditor had received no CPE since May 2001. We also found that ABC's lone internal auditor had received less than 10 hours of CPE since 2001, and that the last time the internal auditor at Parole received CPE was January 2002. We found significant problems with the audit process at WCB which had deficiencies in four of the six audit process categories we examined, and at Parole, which had deficiencies in five of the six categories.

Independence

Internal auditors add value by being effective independent assessors of the quality of the internal control framework and processes. Independence is a function not only of being separate and distinct from operating responsibilities, but also of reporting directly to an organizational level above that being audited. To this end, the Act requires the directors of internal audit to report directly to their agency heads. At each agency,

we considered reporting to the commissioner, or a person who works directly under the commissioner and is effectively responsible for the daily activities of the agency, as meeting the intent of the Act. We identified 11 agencies whose internal auditors lacked organizational independence because they did not report to a level high enough in the organization and/or they reported to someone who had direct responsibility over potential audit areas. Seven of these agencies met both these conditions, while four met one or the other. For example, at the State Insurance Fund (SIF) and the Division of the Lottery (Lottery), the directors of internal audit report to the people at their respective agencies who are responsible for most of the financial areas that the units will be auditing. This reporting arrangement impairs the independence of these units, because their direct supervisors can influence their choices of areas to audit, as well as the audit results. As a result, these units may not provide independent appraisals of the operations their immediate supervisors oversee.

We also identified 16 agencies whose internal auditors did not have individual independence because of incompatible duties. For example, at ABC and Parole, the directors of internal audit were also assigned responsibility over various financial and/or managerial functions that created conflicts with their ability to appraise these operations independently. Twelve internal audit directors acted as their agencies' Internal Control Officers (ICO). As defined by the Act, the ICO provides the day-to-day oversight of an agency's internal controls and aids his/her agency in developing and implementing strong systems of internal controls. The internal auditor is required by the Act to provide an independent appraisal of the adequacy of his/her agency's systems of internal controls and a determination of the level of implementation of these systems throughout the agency. Thus, when they also serve as the ICOs, these internal audit directors are responsible for auditing systems that they should have helped establish and monitor on a daily basis. By assigning these multiple, conflicting roles, management impairs the internal audit unit's independence. At 8 of these 12 agencies, although the internal audit directors acted as the ICO, they did not develop or implement the agency's system of internal controls; therefore, these arrangements presented conflicts in appearance, rather than in fact.

Recommendation

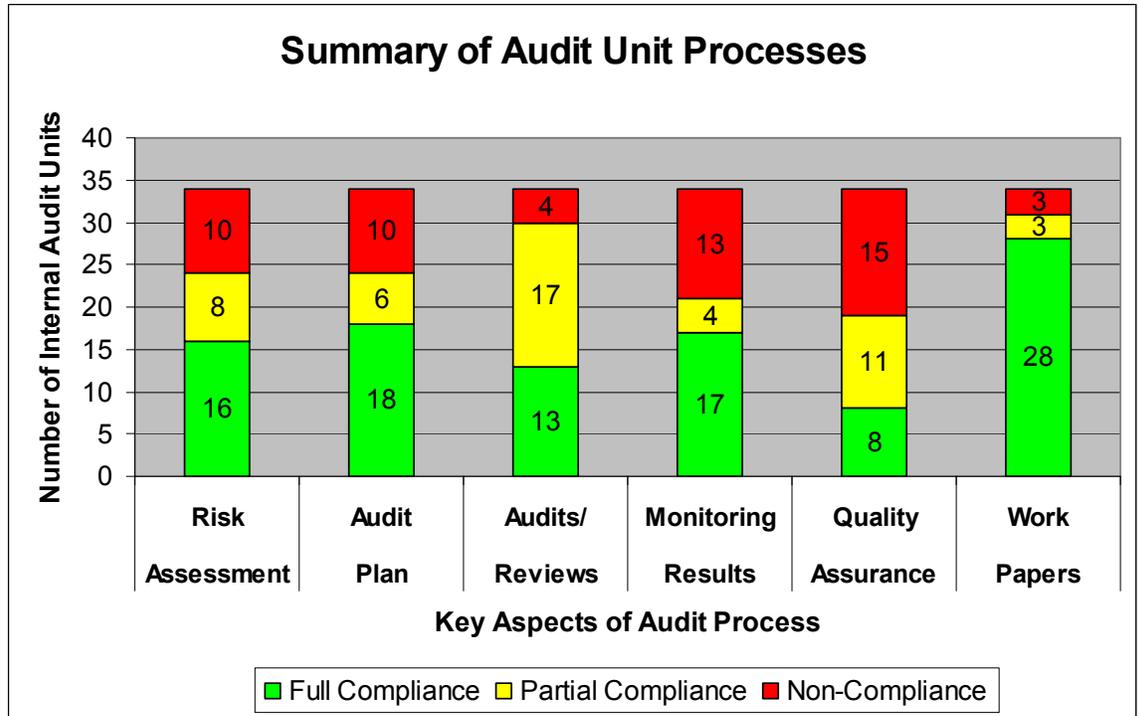
1. Work with the 34 listed agencies to ensure that each one establishes proper internal audit units, as required by the Act and the Standards. These units, at a minimum, must each:
 - have a director with internal auditing education and experience;
 - report directly to the head of the agency or his/her immediate designee;
 - maintain its individual independence by having no other organizational duties that conflict with its internal audit duties;
 - have staff who are qualified; and
 - provide internal audit unit staff with sufficient hours of CPE.

AUDIT PROCESS

The Act requires the listed agencies' internal audit units to review agency operations as a means of ensuring conformance with management policies and the effectiveness of the systems of internal controls, and to conduct these reviews in conformance with the Standards. The Standards, in turn, require internal audit units to:

- perform periodic risk assessments of agency operations;
- develop risk-based periodic audit plans based on these risk assessments;
- perform audits and reviews of those areas identified as the highest risks to the organization;
- establish and maintain systems to monitor the disposition of the audit results communicated to management;
- adopt quality assurance processes to monitor and assess the overall effectiveness of its operations; and
- identify, analyze, evaluate, and record sufficient information to achieve each engagement's objectives.

We found that the internal audit units of just 4 of the 34 listed agencies' (SUNY, DSP, DOT and OPRHP) complied with all six of these requirements. In contrast, we identified 16 agencies whose internal audit units were not in full compliance with at least four of these six requirements. In many of these cases, the units were not performing risk assessments, were not preparing risk-based audit plans, and/or were not conducting sufficient internal audits of agency functions and operations. As a result, these units are not providing the proper oversight of their agencies' internal control frameworks and processes, and the managements of these agencies have no assurance that these systems are operating as intended. The following chart depicts the results of our audit of the 34 listed agencies' internal audit operations.



Risk Assessments

The Standards require the internal audit units to perform organizational risk assessments. We identified ten internal audit units that had not performed any risk assessments and eight units that were only in partial compliance with this standard. Without these organizational risk assessments, the units cannot prepare risk-based audit plans. Thus, these internal audit units cannot ensure that they are performing audits and reviews of the operations that pose the greatest risk to their agencies.

The ten agencies that had not performed risk assessments were DOH, DMNA, DPCA, DCS, DCJS, OMRDD, DHCR, the Department of Economic Development (DED), the Office of Temporary and Disability Assistance (OTDA), and the State Education Department (SED). For example, despite an explicit requirement in its Administrative Policies and Procedures Manual, OTDA's internal audit unit has not performed an independent risk analysis in order to develop its annual audit plans. At SED, audit officials indicated that they had not performed a risk analysis in several years.

The eight agencies that were in partial compliance with this standard were Parole, DEC, the Office of Children and Family Services (OCFS), A and M, DOL, the Office of General Services (OGS), the City University of New York (CUNY), and the Office of Mental Health (OMH). All of these internal audit units, but DOL's, were in partial compliance because they relied on control self-assessments prepared by agency managers as their risk assessments without verifying the information contained in the control self-assessments. Thus, these internal audit units did not have assurance that the managers properly assessed the risks in their operating units. At DOL, the internal audit unit has performed a risk assessment of just one of its many major operations. It has not performed an agency-wide risk assessment.

We identified a best practice used by three smaller agencies to meet this requirement. SIF, DOS, and the Office of Alcoholism and Substance Abuse Services (OASAS) performed detailed testing and analysis of the departmental self-assessments prepared by managers in their agencies. Through this work, these units were able to verify the information contained in the self-assessments and to develop agency-wide risk assessments. As part of this process, they also identified internal control weaknesses and made recommendations to correct these weaknesses. Through this process, these units met the requirements for both agency-wide risk assessments and audits/reviews of their agencies' systems of internal controls.

Audit Plans

The Standards require internal audit units to develop periodic risk-based audit plans to guide their work. We identified ten agencies that have not developed audit plans for their internal audit functions. Of these ten agencies, five (DOH, DMNA, DPCA, DCJS, and DCS) simply had not developed any plans. The internal audit directors at OMRDD, OTDA, and the Department of Public Service (DPS) indicated that they did not develop audit plans because their respective Commissioners directed all of their work. Although DED's internal audit unit had an audit plan, this plan was extremely general in nature and did not identify any actual audit topics or the resources necessary to complete them. SED's Office of Audit Services prepares an audit plan; however, its plan included just 100 days of internal audits out of 3,200 days budgeted for the 2003 calendar year.

We also identified six agencies whose audit plans were either outdated, non-risk based, or did not include internal control issues. For example, WCB's audit plan was not derived from a risk assessment. At OMH, only about 50 percent of the plan was risk-based; the remainder was set aside to handle requests from executive management. The DHCR audit plan included only external audits, not internal audits of the agency's operations. At Parole, the audit plan had not been updated since 2001, while DEC's audit plan did not specify the programs that internal audit was to examine each year. Finally, Banking's internal audit director could not provide us with his audit plan, although he indicated that his risk-based plan was lost when his office was relocated about a year earlier. Without risk-based audit plans, these units have no assurance that they are auditing the areas of highest risk to their respective agencies.

Internal Audits/Reviews

The Act requires internal audit units to evaluate their agencies' internal controls and operations, to identify internal control weaknesses that have not been corrected and to make recommendations to correct these weaknesses. We identified 4 internal audit units that did not perform any audits or reviews of their agencies' systems of internal controls and 17 units that have performed very limited audits, usually just annual Quick Pay audits. Thus, more than half of the listed agencies' internal audit units are not in full compliance with this requirement of the Act.

Four agencies did not undergo internal audits of their operations and systems of internal controls during our audit period. Because DOH and DMNA have no internal audit operations, their systems of internal controls are not audited. DCS had an internal audit unit, but it performed no internal audits and the audit unit at DHCR performed only external audits during our audit period. As a result, the managements of these agencies have little or no assurance that their systems of internal controls are adequate or that these systems are operating as intended.

Seventeen agencies' internal audit units were not in full compliance with this requirement of the Act. For example, four agencies (OMRDD, OCFS, OMH, and SED) did perform some audits during our audit period; however, because these audits were not risk-based, they provided no assurance that the areas

of highest risk were covered. Six agencies' internal audit units (A and M, WCB, Banking, DCJS, DPCA, and DEC) examined only their agencies' Quick Pay processes and one or two other areas during the audit period. Such an inconsistent effort does not provide these agencies with adequate coverage of their entire systems of internal controls.

Monitoring of Results

The Standards state that the chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management. We identified 13 internal audit units that did not have systems for tracking the disposition of the recommendations made in their audit reports. We identified four others whose systems we considered inadequate because unit officials indicated that they tracked the recommendations informally but could not document the status of these recommendations. Thus, these 17 units did not know whether their agencies had actually implemented the improvements the auditors had recommended. As a result, these agencies may not have made necessary improvements, thus placing their assets at a higher risk for waste, fraud, and abuse and their operations and programs at a higher risk for not functioning in an efficient and economical manner.

Quality Assurance

The Standards state that the internal audit units should adopt a process to monitor and assess the overall effectiveness of their operations. Every audit should receive supervisory review and, periodically, an assurance process should occur either through a self-assessment or an assessment performed by a third-party independent from the original audit. We identified 15 agencies that had not received either supervisory or independent review of their audit processes, and 11 units that either were missing one of the two components or did not document the reviews. Of these 26 agencies, 18 had internal audit units staffed by either a director, or a director and one staff member. As a result, many of these units' directors indicated they had no one available to perform the supervisory review and/or the secondary level review of their work. Without these assessments, the units have limited or no assurance that they are performing their audits in accordance with the Standards and/or their own performance measures. As a result, these

units may not be efficiently or effectively providing their managements with independent assurances of the adequacy of their agencies' systems of internal controls. In an effort to meet this requirement, spokespersons for several units indicated that they were seeking to form a group of State agency internal audit units that could work collectively, performing reviews of each other's operations.

The Standards require internal audit units to undergo an external assessment at least every five years by a qualified, independent reviewer or review team from outside the organization. However, agency internal audit units do not need to meet this requirement until 2007; therefore, we did not audit against this standard as part of our review. Nevertheless, we found that two internal audit units, A and M and SUNY, had already undergone external assessments of their operations.

Work Papers

The Standards require internal audit units to collect and document sufficient evidence to support the observations and conclusions they make during an audit. Most of the units we reviewed were in compliance with this standard. However, we identified six units that either had no work papers or whose work papers did not provide sufficient evidence to support the observations and conclusions contained in their audit reports. DOH and DMNA have no internal audit units and, thus, no work papers to support any internal audit activity. In addition, because the DCS internal audit unit performed no audits during our audit period, it had no work papers. Banking, DEC, and OCFS did not fully comply with this standard because they could not produce work papers to support all of their internal audits.

Recommendation

2. Work with the 34 listed agencies to ensure that each one establishes internal audit processes that comply with both the Act and the Standards. At a minimum, each internal audit unit should:
 - perform periodic risk assessments of agency operations;
 - establish audit plans based on the results of these risk assessments;
 - perform comprehensive internal control audits and reviews of its agency's high-risk operations and make recommendations for improvements where necessary;
 - establish systems to monitor the disposition of audit results it communicates to management;
 - perform quality assurance reviews, including supervisory review and independent appraisal of compliance with the Standards;
 - schedule and obtain an independent, external review of its operations by 2007; and
 - document its evidence properly to support the observations and conclusions it makes in its reports.

Appendix A

Listed Agencies and Report Acronyms

| | |
|---|---------|
| Department of Agriculture and Markets | A and M |
| Division of Alcoholic Beverage Control | ABC |
| Department of Civil Service | DCS |
| Department of Motor Vehicles | DMV |
| Department of Health | DOH |
| Division of Probation and Correctional Alternatives | DPCA |
| Department of Economic Development | DED |
| State Insurance Department | SID |
| Office of Alcoholism and Substance Abuse Services | OASAS |
| Department of Public Service | DPS |
| Workers' Compensation Board | WCB |
| State Banking Department | Banking |
| Division of Criminal Justice Services | DCJS |
| Division of Housing and Community Renewal | DHCR |
| Department of Correctional Services | DOCS |
| Office of General Services | OGS |
| Office of Mental Retardation and Developmental Disabilities | OMRDD |
| Office of Parks, Recreation and Historical Preservation | OPRHP |
| Department of State | DOS |
| Department of Labor | DOL |
| Division of the Lottery | Lottery |
| Division of Parole | Parole |
| Office of Temporary and Disability Assistance | OTDA |
| Department of Environmental Conservation | DEC |
| State Insurance Fund | SIF |
| City University of New York | CUNY |
| Department of Taxation and Finance | Tax |
| Department of Transportation | DOT |
| Office of Children and Family Services | OCFS |
| State University of New York | SUNY |
| Office of Mental Health | OMH |
| State Education Department | SED |
| Division of State Police | DSP |
| Division of Military and Naval Affairs | DMNA |

Appendix B

Summary of Results of Audit By Agency

| AGENCY | AUDIT ORGANIZATION | | | | | AUDIT PROCESS | | | | | |
|---------|--------------------|----|----|----|----|---------------|----|----|----|-----|-----|
| | #1 | #2 | #3 | #4 | #5 | #6 | #7 | #8 | #9 | #10 | #11 |
| DMV | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DMNA | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DOH | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DPCA | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| ABC | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| A AND M | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DCS | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DED | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| SID | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| OASAS | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DPS | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| WCB | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| BANKING | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DCJS | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DHCR | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DOCS | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| OGS | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| OMRDD | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| OPRHP | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DOS | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DOL | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| LOTTERY | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| PAROLE | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| OTDA | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DEC | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| SIF | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| CUNY | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| TAX | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DOT | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| OCFS | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| SUNY | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| OMH | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| SED | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| DSP | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |

KEY: Green Dot - Agency in Compliance
 Yellow Dot - Agency in Partial Compliance
 Red Dot - Agency not in Compliance

#1 Director Qualifications #5 Organizational Independence #9 Monitoring Results
 #2 Staff Qualifications #6 Risk Assessments #10 Quality Assurance
 #3 Continuing Education #7 Audit Plans #11 Work Papers
 #4 Individual Independence #8 Audits/Reviews of Internal Controls

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GEORGE E. PATAKI
GOVERNOR

CAROLE E. STONE
DIRECTOR

May 3, 2004

Mr. Frank J. Houston
Audit Director
Office of the State Comptroller
110 State Street
Albany, New York 12236

Dear Mr. Houston:

Thank you for the opportunity to respond to the Office of the State Comptroller (OSC) draft audit report on State Agency Internal Audit Units' Compliance with the Internal Control Act.

In 2003, the Division of the Budget (DOB) completed a survey of agency internal audit units' compliance with the Act and professional standards, and our findings generally corresponded with those included in your draft report. As a result of our survey, and in an effort to improve agency compliance with these internal audit requirements, we began requesting that agencies submit additional information regarding their internal audit units in the annual internal control certifications to DOB. While your report confirms that nearly half of all agencies are substantially in compliance, and most agencies believe they are in full or partial compliance, instances of non-compliance with the Act and professional standards continue.

Based upon our survey, your draft findings and the enclosed agency responses, DOB is moving aggressively to highlight to agency senior management the importance of the internal audit function to their operations and to resolve resource issues where they exist.

As requested, and to be included as an appendix to your final report, enclosed are individual agency responses to each finding identified in the draft report as having partial compliance or non-compliance with the Act and professional standards. Agencies generally agree with most findings included in the draft report and have either already corrected noted deficiencies or have identified measures to bring their internal audit unit into compliance with the Act and the standards. However, in several instances agencies disagree with some of the findings and have provided an explanation for their disagreement.

To illustrate how internal audit compliance has improved since the audit was conducted, some agencies -- notably Children and Family Services, Civil Service, Criminal Justice Services, Economic Development, Education, Environmental Conservation, General Services, Housing and Community Renewal, Mental Retardation, Parole and the State Insurance Fund -- have adopted or are developing measures to clarify internal audit reporting, enhance risk-based audit planning, and strengthen how internal audit units are organized and operate. In addition, Civil Service and Mental Retardation have already appointed qualified internal audit directors, while Criminal Justice Services and State Police are considering similar appointments. Overall, agencies are redeploying resources and adopting new procedures in an effort to augment internal audit's contribution to promoting efficient, effective and accountable agency operations.

As the draft report indicates, two agencies -- the Department of Health and the Division of Military and Naval Affairs -- did not comply with any of the internal audit requirements because they did not have an internal audit unit. The Division is working with these agencies to establish internal audit units that comply with the Act, or to identify alternative actions that will meet the intent of the Act and audit standards, with the goal of ensuring compliance by the end of the current fiscal year. For example, the DOH has already begun the hiring process for an independent Director of Internal Audit and the DMNA is exploring auditing partnerships with other State agencies.

Finally, because of the overlapping responsibilities of our two agencies, this area presents an opportunity to work together. We propose that an Internal Audit Best Practices Group consisting of staff from DOB, OSC and agency internal audit directors be formed to explore and develop cost-effective and practical approaches for internal audit units to meet ongoing organizational and procedural requirements. We suggest that this group explore options to share internal audit resources, expand the host agency concept, provide technical assistance, identify shared training opportunities, and develop a plan for agencies to conduct independent peer reviews between internal audit units. I have asked our Chief Accountant, Ann Foster, to follow-up with appropriate staff at OSC regarding this idea.

We look forward to working with OSC to help bring all agency internal audit units into compliance with the Act and professional standards.

Sincerely,



Carole E. Stone

Enclosure

cc: Agency Heads
Agency DIAs

**State Agency Responses to
Office of the State Comptroller
Draft Audit 2003-S-14**

**“State Agency Internal Audit Units’
Compliance with the Internal Control Act”**

**State Agency Responses to
Office of the State Comptroller
Draft Audit 2003-S-14**

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Department of Agriculture and Markets (A and M)

6 – Risk Assessments

We maintain that our risk assessment process fully complies with section 2010.A1 of the Internal Auditing (IA) Standards. A risk assessment is performed of Department activities and is used in preparing the annual audit plan. As part of the Department's Strategic Planning and Internal Control (IC) Processes, Division Directors meet periodically throughout the year with Executive Management to develop, revise, review and evaluate goals, objectives and performance criteria. In March of each year Division Directors and Deputy Commissioners are required to report and certify to the Commissioner on their IC activities for the past year and identify their planned activities for the upcoming year. Based on the strategic planning and IC reports, the Commissioner, First Deputy Commissioner and Internal Auditor prioritize programs for audit based on available resources. All department high-risk activities are identified in the annual IC Certification and Summary submitted to DOB.

*
Note
1

8 – Audits/Reviews of Internal Controls

The Division of Internal Audit does identify IC weaknesses and make recommendations to correct them. Many IC weaknesses are identified and corrected outside the formal audit process. By building and maintaining a strong working relationship with Department managers, areas of concern are raised on an ad-hoc basis throughout the year. If Divisions are implementing new programs or revising procedures they often ask for guidance on controls. For these reasons we believe we are in full compliance with the Act and Standards. It should also be noted that the Department was limited in its audit activities by OSC's requirement that other audits be conducted for things such as Quick Pay, one for the Department and one for the State Fair/Industrial Exhibit Authority. These audits impact time available for other audits.

*
Note
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Division of Alcoholic Beverage Control (ABC)

1 – Director Qualifications

The audit rates the Director of Internal Audit (DIA) as partially compliant with regard to the DIA's qualifications. This deficiency is based on the DIA's lack of a Bachelor's Degree in Auditing or Accounting. OSC acknowledged the DIA's substantial prior career work experience, however. ABC challenged this rating in the preliminary audit findings meeting with ABC, and continues to contest this rating for the following reasons.

1. OSC could not cite the specific standard or requirement of a Bachelor's degree for this position. An agency review of the International Standards for the Professional Practice of Internal Auditing published by the Institute of Internal Auditors (IIA Standards) makes no mention of degree requirements, and this was pointed out to the auditors. They acknowledged their inability to substantiate this requirement, yet continued to rate ABC's DIA as educationally deficient.
2. The DIA's experience was clearly delineated in the resume he presented, and reflects substantial private sector accounting and IA responsibilities in his expansive banking experience and related competencies.
3. The DIA studied Accounting at the Spencer Business Institute prior to his entry in Military Service.
4. The DIA participated in many auditing and IC courses and workshops, including several sponsored by the State Comptroller's Office.

*
Note
3

2 – Staff Qualifications

OSC rated ABC in partial compliance with maintaining a qualified staff for IA functions. Since the DIA is the sole IA staff member, this criteria is redundant to the first rating. ABC is a small agency (approximately 150) and does not have additional support staff for the IA function.

3 – Continuing Education

OSC rated the ABC as non-compliant by virtue of the DIA's limited participation in new training opportunities during the time period prior to the audit. ABC responded to this rating by citing the DIA's attendance, completion and receipt of Continuing Professional Education (CPE) credits for a variety of training courses. No minimum threshold is cited for continuing professional development course work. Thus, ABC is once again found to be non-compliant with a standard that does not exist. However, in response to this criticism, the DIA has accumulated 10 CPE credits and will continue to maintain ongoing training in accounting and IA programs annually.

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Note
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4 – Individual Independence

In October 2003 the DIA was assigned to report directly to the Chairman. This direct accountability to the agency head ensures the DIA will have individual independence, both in fact and appearance.

5 – Organizational Independence

ABC received a partial compliance rating for the DIA's organizational independence, based on some aspects of his work assignments that could be subject to his own audit responsibilities. ABC continues to maintain a strong system of checks and balances that provides full accounting of all financial transactions. In deference to the statewide freeze on bringing new employees into State employment, ABC anticipates that the Office of General Services (OGS) – our new host agency – will assimilate financial processing tasks once this transition has been fully consummated.

10 – Quality Assurance

OSC rated ABC as non-compliant in quality assurance matters by determining that quality control processes were not fully documented. ABC, then and now, disputes this finding. There is a comprehensive paper trail that directs and assesses IA functions by department, and a notification and review protocol ensures full knowledge of Agency compliance at each level of management. We intend to further document and date reference management review of quality control processes with the addition of a management sign off column on each task assessment report.

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|-----------------------|
| * Note 5 |
|-----------------------|

Office of Alcoholism and Substance Abuse Services (OASAS)

4 – Individual Independence

OASAS acknowledges that the Director of Internal Audit/Internal Control Officer (DIA/ICO) serves a dual role in OASAS. While this is not an ideal arrangement, it is one that OASAS has maintained is necessary given current budget constraints and reductions in the Agency's staffing resources over the last several years.

To guard against the possibility of conflicting roles, the DIA/ICO has clearly separated daily responsibilities to ensure that there is no conflict between internal control and internal audit activities. In those instances where activities as the ICO can potentially become subject to review as the DIA, the DIA recuses himself from that aspect of the IC process to avoid any appearance of a conflict of interest. While the DIA facilitates and provides general guidance to Agency staff on the principles of internal control, he is not directly involved in the design, drafting or installation of policies and procedures. Given the fact that OASAS is a relatively small agency, this approach has assured a reasonable level of compliance with this standard. Until such time that consideration can be given to filling a second position, OASAS will continue with its current arrangement to satisfy the more important need to assure that both functions are being carried out by an appropriately experienced and qualified staff.

10 – Quality Assurance

OASAS acknowledges that due to staffing limitations in its internal audit function, a modified approach must be utilized to ensure that its audits receive periodic quality assurance reviews. Specifically, the standard which calls for a self-assessment or assessment by a third party independent from the original audit cannot be carried out by OASAS' internal audit staff, since a single individual, the DIA/ICO, currently staffs this function.

Accordingly, OASAS will utilize its "external" audit supervisors as independent third parties, on a periodic basis, to assess the work completed by the DIA/ICO. OASAS' external audit supervisors, who are professionally trained in internal controls and audit protocols, are qualified to provide feedback and function independently from the DIA/ICO. Based on discussions with OSC this approach would satisfy this standard.

Banking Department (NYSB)

4 – Individual Independence

Although IIA standards might require separation of these functions, we believe that there are mitigating circumstances at NYSB. At NYSB, each of the divisions/business units is responsible to identify the risks and the appropriate controls associated with those risks within their respective areas. This results in the performance of a control self assessment. Our unit reviews these risks, controls, and weaknesses, and the follow-up of implementation of corrective actions that needs to be taken. Therefore, in our opinion, there is only an appearance of an impairment of independence, not a true impairment.

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Note
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7 – Audit Plans and # 11 – Work Papers

As was indicated in the Draft Report, there was no evidence of either audit plans or work papers. It was explained to OSC that any such documents were lost during an Agency move in December 2002.

8 – Audits/Reviews of Internal Controls

The draft report states that NYSB was one of six agencies that "...examined only their agencies' Quick Pay processes and one or two other areas during the audit period." As mentioned earlier, with a staff of two (the Director of Internal Audit (DIA) and Assistant DIA), reliance has to be placed on monitoring internal controls, and our effort in the annual certification process is in sufficient detail to provide assurance that the internal control environment in NYSB is strong. In addition to the Quick Pay Audit, we also reviewed travel and entertainment activities for NYSB and discussed the results orally with appropriate management.

10 – Quality Assurance

While NYSB agrees that a formal quality assurance process is not in place, it does have an informal process for monitoring controls as established by division heads. NYSB will work to identify internal resources that can be redirected to establish a formal process.

Office of Children and Family Services (OCFS)

2 – Staff Qualifications and # 3 Continuing Education

OSC's report indicates that five of the seven OCFS staff auditors had no internal audit (IA) education or experience. This is not true. The five staff in question work in the Facility Audit Unit (FAU) and conduct compliance, performance and program reviews of the OCFS juvenile residential facilities. They do not perform fiscal reviews. While these staff do not have accounting degrees, they possess the knowledge, skills and other competencies needed to perform their individual responsibilities. All five staff gained extensive experience working in OCFS residential facilities. In addition, these staff are assigned to an experienced auditor for all assignments and follow audit programs and audit manuals prepared by audit managers.

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Note
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All FAU staff have taken training to enhance their competencies. Training records for the five staff referenced in the audit report and provided to OSC reveal that from January 1998 to August 2003, 154 total hours of training were received in audit related training, 61 hours in effective work groups or team building, 53 hours in programs specific to OCFS residential facilities and 173.5 hours in leadership and supervision. At the time of the audit, three of the five auditors worked in the FAU for only 21 months.

4 – Individual Independence and # 5 – Organizational Independence

The Director of Internal Audit (DIA) was assigned to the Deputy Commissioner for Administration as a transitional organizational measure. This reporting structure will be revisited. In addition, the Internal Control Officer (ICO) reports to the DIA. The ICO will report any issues pertaining to the assessment of internal controls over the Internal Audit Unit to the Executive Deputy. In addition, the OCFS and the Office of Temporary and Disability Assistance are exploring the possibility of working cooperatively to perform a mutual peer review over the IA process.

6 – Risk Assessments and # 8 – Audits/Reviews of Internal Controls

OCFS considers a variety of factors in the development of its risk assessment and does use the assessment to develop its audit plan. Factors such as funding level, staff deployment and experience, safety and health factors, complexity of the program, and prior audit findings are all considered. In addition, follow up on the Facility Self-Assessments is part of a facility audit program.

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Note
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11 – Work Papers

A full set of work papers could not be provided for one of the audits in the OSC sample. These work papers were destroyed after the follow up review was completed and there were no issues that needed further clarification or resolution. The record retention policy for audit work papers has been revised to require that all work papers be maintained for an appropriate period of time.

City University of New York (CUNY)

3 – Continuing Education

CUNY agrees with the finding; however, due to fiscal limitations, sufficient funding has not been available to fully support continuing professional education (CPE). CUNY has no formal in-house training programs geared to auditors. However, some audit staff have recently been allowed on a limited basis to attend training sessions offered by the New York City Department of Citywide Administrative Services. To provide additional training opportunities at a nominal cost, we suggest OSC consider sponsoring or coordinating with other State training programs a series of training sessions conducted in the New York City area for all internal auditors working for State agencies located in the City. CUNY audit staff would welcome this additional CPE training opportunity.

#4 – Individual Independence

CUNY strongly disagrees with this finding, and have found that the ties to the Internal Audit Office have only served to enhance the importance placed on the University-wide internal control (IC) program. Moreover, CUNY believes that individual independence is maintained between both functions.

The IC program complements the efforts of the Internal Audit Office, as well as the annual audit conducted by an independent certified public accounting (CPA) firm regarding CUNY's accounting policies, operations and internal controls as they relate to Generally Accepted Accounting Principles (GAAP).

While the Internal Audit Office has oversight responsibilities for the IC program, the way in which IA and IC functions accomplish their objectives remains distinct. The IC program provides the impetus and direction that enables campus-based department managers to perform yearly self-evaluations of their IC systems. These evaluation reports, covering all major operations at each college, have become a useful management tool for department heads to evaluate and assess their respective operations and control procedures. The information included on these reports (including status of any planned improvements or corrective actions) is stored and tracked on a computerized database system and used to identify potential audit areas and keep abreast of any significant operational changes. The IC program was essentially designed as a way to assist managers in the running of their operations at the department level.

In contrast, the Internal Audit Office was established to address, from a CUNY perspective: 1) areas of risk exposure, determined through an assessment of various factors such as level of vulnerability in terms of errors, irregularities or other mishaps; 2) areas where non-compliance puts CUNY financially at risk; and, 3) newly enacted legislation or changes in existing regulations that impact current operating procedures. This assessment or analysis is an ongoing activity that reflects the cumulative body of evidence available from a number of resources including audit reports, annual IC review

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Note
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reports, investigations, CUNY management concerns and attendance at various University-wide council meetings.

Far from being a potentially compromising situation, the relationship between the IA and IC functions is both mutually beneficial and at the same time, exclusive in terms of audit responsibilities. The IC program, particularly the annual review reports, serves as one of several important resources of information used to identify areas of risk exposure confronting CUNY and the individual colleges.

6 – Risk Assessment

The Internal Audit Office considers its approach to planning audit activities a form of risk-based assessment which should translate into full compliance. CUNY's IA activities are developed based upon analysis of IC and audit information to identify areas deemed to be major risks. The planning of audit activities involves an analysis of operations/processes in terms of relative risk, specifically its vulnerability to fraud, abuse, mismanagement, IC and accounting standards. This analysis or assessment is an ongoing function that reflects the cumulative body of evidence available from the following:

- Findings and recommendations contained in audit reports issued by both the CUNY's IA Office and external audit groups;
- The annual IC review reports submitted by the colleges;
- Attendance at various University-wide council meetings (including Administrative, Business Managers, Registrars and Financial Aid);
- Discussions with Central Office and college officials regarding their respective areas of concern; and,
- Investigations undertaken to resolve allegations or known irregularities.

As this information is collected and analyzed, additional consideration is given to those activities where one or more of the following conditions exist:

- Recurring management, operational, and oversight deficiencies identified in audits and follow-up reviews;
- Severity of potential loss (including assessment of liability coverage for specific institutional exposure);
- Newly enacted legislation or changes in existing regulations that will likely impact current operating procedures;

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- Areas that could result in negative and highly publicized attention by the media; and,
- Functions or activities deemed inherently vulnerable to errors, irregularities or other mishaps.

In summary, this approach is all encompassing and provides a systematic basis to identify specific operations and processes that merit special priority for audit.

8 – Internal Audits/Reviews of Internal Controls

The Internal Audit Office disagrees with this finding and believes that CUNY's control network, comprised of the IA function and the program of IC reviews provide a proactive, systematic approach for determining asset vulnerability and identifying IC weaknesses. These two operations share common objectives which are to ensure: (1) operational efficiency, economy and effectiveness, (2) adherence to laws, regulations, and policies, (3) safeguarding of assets and resources, and (4) accurate and reliable data for reporting purposes.

The Internal Audit Office assists CUNY management in the effective discharge of their responsibilities, by furnishing them with objective analyses, recommendations, appraisals and pertinent comments concerning weaknesses in the general control environment and operating procedures. The Internal Audit Office conducts audits of CUNY operations to determine asset vulnerability and risk exposure to potential loss from fraud, theft, abuse and accidents.

Another major component of CUNY's system of IC and accountability is the University-wide program of IC review. The program is involved directly with implementing and maintaining systems of IC throughout CUNY. The program includes self-evaluation of IC systems performed by campus-based department managers. The program complements the efforts of the Internal Audit Office, which serves as an independent appraisal function and conducts audits, including evaluating the adequacy and effectiveness of these IC systems.

The program of IC review, primarily through the annual review report process, is intended to provide department managers with a mechanism to evaluate and assess their respective operations and control procedures. The program is essentially designed as a way to assist managers in the running of their operations at the departmental level and, in the process, to strengthen already existing safeguards. The program includes communicating to managers and staff the University's general policies and standards for the purpose of informing them of their responsibilities and rights and to ensure that CUNY's objectives are met.

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#10 – Quality Assurance

The Internal Audit Office disagrees with this finding and considers the audit function partially compliant with this standard regarding quality control. The Internal Audit Office maintains an audit manual that contains procedures and provides guidelines for developing audit programs, preparing work papers, writing reports, and other job-related matters. In fact, one chapter of the manual is devoted exclusively to audit work papers and provides detailed information on preparation, content and arrangement of work papers. A copy of this manual was provided to OSC in August 2003.

During orientation, new audit staff are provided with a copy of this manual to ensure consistency in audit coverage. The audit staff is evaluated on their work paper technique as part of our quality control process.

On the issue of independent third party review, the Internal Audit Office has never undergone a peer review. CUNY welcomes any assistance or suggestions from OSC for complying with the external review requirement.

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Department of Civil Service (DCS)

1 – Director Qualifications

In August 2003, DCS appointed a new Director of Internal Audit (DIA), a Certified Public Accountant (CPA) with extensive education and internal audit (IA) experience.

2 – Staff Qualifications

In addition to the new DIA, DCS also hired an Internal Control Officer (ICO) that works in conjunction with an Internal Control (IC) Steering Committee.

3 – Continuing Education

The new DIA receives annual Continuing Professional Education (CPE). Since becoming a CPA in 1993, the DIA has been a member of the American Institute of Certified Public Accountants and the New York State Society of CPAs. These organizations require 40 hours of CPE annually and the DIA has fulfilled this requirement. In the past year the DIA has taken several courses or seminars that relate directly to IA.

4 – Individual Independence

The new DIA does not have other organizational responsibilities that might create the potential for conflicts of interest. DCS designated a new ICO, who is separate from the IA Unit. The ICO reports to the head of the agency to implement and review the IC responsibilities established. The ICO works with appropriate personnel within the DCS to coordinate the IC activities of the agency, and to assure that DCS' IC program meets the requirements.

Although the ICO evaluates the adequacy of the IC reviews performed by DCS staff, the DIA is responsible for identifying IC weaknesses that have not been corrected and make accommodations to correct the areas in most need for review or testing. Also, the Information Security Officer is now separated from the IA function, further enhancing the independence of the unit.

6 – Risk Assessments

For the past six months, the DIA has met with division leaders in areas within DCS to become familiar with the major functions of the units as well as understand the controls in place. The DIA is in the process of working with the ICO to map controls in key areas in DCS to determine the likelihood, significance and cause of an unfavorable event occurring. When this exercise is completed, a grid will be developed that will clearly present the high, medium and low risks to DCS and will provide the basis for an effective audit plan.

7 – Audit Plan

While the risk assessment process is ongoing, the Internal Audit Unit has been involved with examining high-risk areas such as our testing process, including the protection of our test question database. Also, through the use of auditing software, the unit has reviewed possible duplicate payments as well as reviewing whether payments have been made fraudulently to individuals within the Department. The Internal Audit Unit is also reviewing how the Information Technology Department supervises its contractors. This includes the review of time supervision over contractors as well as organization and time allocation for proposed projects.

8 – Audits/ Reviews of Internal Controls

Currently, three internal audits of high-risk areas are being performed. In each area, internal controls have been documented and recommendations developed. Final recommendations will be presented upon completion of the audit.

9 – Monitoring Results

DCS policy requires that audit reports include a response from program managers indicating if they agree with the recommendations and when implementation is expected. IA staff will follow-up to ensure completion of expected actions.

10 – Quality Assurance

A quality control process has been developed which provides for periodic review by agency executives and a self-assessment by responsible parties to each audit.

11 – Work Papers

Work papers are now being developed for all audits.

Department of Correctional Services (DOCS)

1 – Director Qualifications

OSC stated that the Director of Internal Controls functions as the Director of Internal Audit (DIA). They indicate that the DIA should have an education background involving accounting and auditing.

DOCS disagrees with this recommendation. DOCS does not have the position of DIA. DOCS took steps to implement the Internal Control Act from its inception back in 1987. DOCS feels that using the American Correctional Association accreditation process as the centerpiece for internal control (IC) best meets DOCS' needs. An accounting degree was not considered essential for DOCS' implementation of the Act. It is still not considered such to accomplish the DOCS' mission. The fact that DOCS was found by OSC's audit to be significantly in compliance with the Act supports this.

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Although the Director of Internal Controls does not have a degree in accounting, he has a Master's Degree in Criminal Justice, more than five years experience as a Deputy Superintendent for Administration in maximum, medium and minimum security facilities, ten years experience as a Correctional Services Internal Auditor III, and seven years experience as Assistant Inspector General for DOCS. It is felt that this combination of education and experience best meets the Internal Control needs of the Department.

5 – Organizational Independence

OSC indicates that the DIA should report directly to the Commissioner.

DOCS disagrees with this recommendation. As previously stated, DOCS does not have a DIA. The Director of Internal Controls reports to the Assistant Commissioner for Compliance and Review. The Assistant Commissioner for Compliance and Review reports to each Deputy Commissioner on matters that are within their purview. When necessary, the Assistant Commissioner for Compliance and Review can report directly to the Commissioner. This chain of command better serves DOCS' mission.

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10 – Quality Assurance

OSC found a weakness in DOCS' quality control process for audits because supervisory review of audit working papers was not documented. DOCS agrees with this recommendation. Supervisory review of audit working papers is now documented.

Division of Criminal Justice Services (DCJS)

1 – Director Qualifications

The Director of Internal Audit (DIA) is expected to retire by summer 2004. DCJS will review the pertinent section of the Act, citing required qualifications for DIA's, prior to selecting a replacement.

3 – Continuing Education

Two staff in the Internal Audit Unit (IAU) did not have the required amount of training, the director and the principal accountant. The decision was made to devote the limited resources available for training to those audit staff in the IAU who actually perform the most audit duties. In the future, all auditing staff in the unit will be required to obtain the necessary training.

6 – Risk Assessments

The agency disagrees. Although DCJS concedes that the IAU has not prepared a formal organizational risk assessment for the last several years, it is inaccurate to conclude that DCJS does not consider risk in audit planning. Risks identified by senior management and risks known by audit staff have been considered in utilizing the limited resources and staff available for audit duties. Such audit duties have been assigned where deemed to be most beneficial to protect DCJS' (and the state and federal governments') interests.

In the future, the IAU will periodically prepare a formal risk assessment of DCJS, and will document senior management input – identified as 'a best practice' in OSC's report.

7 – Audit Plans

DCJS has concentrated its audit resources on the grantee side of its functions, given the many millions of dollars, both State and Federal, with which it funds hundreds of projects managed by not-for-profits and local jurisdictions. It also performs hundreds of audits (495 during the period audited by OSC) of criminal history record access by criminal justice agencies throughout the State. In OSC's perspective, these are not considered 'internal audits'. DCJS, however, sees them as the two highest-risk areas in the agency, and have developed audit plans covering these activities.

DCJS agrees that additional audits of internal functions is a worthy goal. During the audit period, the Division of Probation and Correctional Alternatives Quick Pay process was audited once, the DCJS Quick Pay process was audited twice, and the DCJS travel voucher process was audited once, but there are certainly other areas of the agency in which risk exists. DCJS will therefore request the establishment of additional audit positions to allow reasonable review of these areas. With current staffing levels in the unit, requirements accompanying federal funding, and the importance of ensuring the

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security of the state's criminal history database, it is not possible to increase the number of audits now being conducted.

8 – Audits/Reviews of Internal Controls

An assessment of internal controls was performed as part of the Quick Pay audits and will continue to be part of any audit of agency functions. If DCJS is able to increase staffing levels in the IAU, they will be able to review internal controls throughout the agency.

9 – Monitoring Results

All audits of internal functions contain a review of internal controls. As in the Quick Pay audits cited by OSC, subsequent audits of the same or similar function provide a follow-up in noted areas to ascertain whether recommendations have been implemented. The audit of the travel voucher process (also cited by OSC) was completed in July 2003; and a follow-up review is planned for July 2004. In all audits performed by DCJS, there has been (and will continue to be) follow-up review for any significant findings and recommendations.

#10 – Quality Assurance

To be compliant with the professional standards, the agency will continue to document its review of work papers. In addition, the agency will consider the option of utilizing a third-party to conduct the audit process as allowable under professional standards.

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Department of Economic Development (DED)

4 – Individual Independence

DED does not have audit staff beyond the Director of Internal Audit (DIA). Upper management is in process of redeploying additional audit staff.

6 – Risk Assessments

DED was in compliance for 2001-2002 but our Internal Control Officer (ICO) retired and members of the IA Committee moved into other assignments. DED plans to name an ICO and renew its IC Committee in 2004. Upper management is working on assigning the proper personnel to these assignments. Once established, proper oversight requirements will be in place.

7 – Audit Plan

When OSC reviewed DED, a draft audit plan was in place awaiting upper management approval. A more detailed plan is being developed.

8 – Monitoring Results

Currently, the DIA reviews and communicates the findings and makes recommendations. In moving forward, with the assistance from staff within the Fiscal Unit, monitoring and tracking will become a continued function.

#10 – Quality Assurance

DED is redeploying staff for assistance in this area. The Fiscal Unit has been identified as having the necessary functions and qualifications to perform such tasks.

State Education Department (SED)

5 – Organizational Independence

SED disagrees with OSC's determination that the agency is not in compliance with this requirement. The Office of Audit Services (OAS) reports to the Associate Commissioner for Planning and Policy Development who reports directly to both the Commissioner and the Chief Operating Officer (COO). In addition, the Regents Subcommittee on Audits reviews all of the work of OAS, including the Tactical Audit Plan and all reports issued. This reporting relationship results in OAS being free from interference in determining the scope of internal auditing, performing work, and communicating results. SED's administrative offices are currently undergoing reorganization and in the near future OAS will report directly to the COO.

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6 – Risk Assessments

SED agrees with OSC's determination that the agency is not in compliance with this requirement insofar as it has not conducted annual risk assessments. However, OAS has conducted risk assessments in the past and will continue to do so. In addition, OAS will utilize the results of the operational risk assessment and other internal control (IC) activities coordinated by SED's Internal Control Officer (ICO). SED strongly disagrees with the comment in the report that SED officials "considered the [risk assessment] process a waste of time and resources." In fact, in the response to the preliminary audit findings, SED officials stated, "We have performed risk assessment in the past and recognize the importance."

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7 – Audit Plans

SED disagrees with OSC's determination that the agency is not in compliance with this requirement. OAS has a two-year Tactical Audit Plan that is prepared taking into account the Board of Regents Strategic Plan, risk assessment, and input from senior managers (including the Commissioner) and the Regents Subcommittee on Audits. Furthermore, the report is factually incorrect in stating SED has not even used the 100 hours it had budgeted for internal audits for the 2003 calendar year. SED budgeted 100 days (not hours) for IC reviews for the year ended June 30, 2003 and used almost that number of days for internal audit (IA) activities during the same period.

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8 – Audits/Reviews of Internal Controls

SED disagrees with OSC's determination that the agency is in partial compliance with this requirement. OAS evaluates SED's internal controls and operations, identifies IC weaknesses that have not been corrected, and makes recommendations to correct these weaknesses. OAS relies on a variety of methods to evaluate the adequacy of SED's ICs. These include results of internal audits, audits of Department operations by OSC and CPA firms, the annual IC certification process, and external audits of entities regulated by SED. This information is evaluated to determine the adequacy of controls

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and the need for corrective action. When necessary, OAS will make recommendations to correct weaknesses and has done so.

9 – Monitoring Results

SED agrees with OSC's determination that SED is not in compliance with this requirement. A procedure was implemented to follow up on the recommendations made in IA reports.

10 – Quality Assurance

SED agrees with OSC's determination that the agency is in partial compliance with this requirement. OAS has a procedure requiring a supervisory review and an independent review. Currently, both the supervisory and independent reviews are being completed.

Department of Environmental Conservation (DEC)

1 – Director Qualifications

DEC disagrees with this finding. DEC’s Director of Internal Audit (DIA) could provide documentation that he had taken audit-related courses, and offered same. During the course of the audit, however, OSC’s auditors explained that they were taking the position that the education requirement can only be met by way of a Bachelor’s degree in accounting or auditing, or some evidence of audit-related courses having been taken while in college. The DIA offered evidence of audit-related courses taken more recently than the audit-related courses that he had taken in college over thirty years ago.

More importantly, neither the Internal Control Act nor the Institute of Internal Auditors’ (IIA) standards require a DIA to possess a Bachelor’s degree in accounting or auditing, or to have taken any audit-related courses while in college. The Act states that DIAs shall be appointed “based on appropriate internal auditing credentials of the proposed appointee, consistent with generally accepted standards for internal auditing, including internal auditing education and experience.”

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The “internal auditing education” referred to in the Act is described in the IIA Standards and does not require DIAs (or any internal audit (IA) staff) possess a specific college degree in a specific field or fields, or that they take any audit-related courses while in college. What the Standards do require (Section 1210 - Proficiency) is that auditors “possess the knowledge, skills, and other competencies needed to perform their individual responsibilities.” The IIA Standards recognize that these proficiencies, knowledge, skills, and other competencies can be acquired through a variety of professional education venues, formal academic degrees, and career work experience. The Standards only specific requirement regarding education is that internal auditors “should enhance their knowledge, skills, and other competencies through continuing professional development (Section 1230).” The audit report addresses such continuing professional development in another section of the report and finds that DEC’s DIA (and DEC’s IA staff) meet this requirement.

4 – Individual Independence

DEC does not necessarily disagree with this finding, but does disagree with the resulting recommendation. Neither the Act nor the Standards prohibit the DIA from serving as the Internal Control Officer (ICO), even where such service poses an actual conflict rather than one of appearance only. Further, even where the DIA has been assigned “other organizational duties,” there is nothing in the Act or the Standards that prohibits this. Indeed, the Standards provide for such situations. Section 1100 of the Standards, entitled Independence and Objectivity, contains sub-section 1130 - Impairments to Independence or Objectivity, which states: “If independence or objectivity is impaired in fact or appearance, the details of the impairment should be disclosed to appropriate parties.”

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Where such impairments exist, DEC has disclosed all details of the impairment to appropriate parties so as to comply with the Act and the Standards. For example, during the course of this audit, DEC provided the auditors with copies of its risk assessment and disclosure regarding its DIA serving as the ICO.

OSC itself has recognized that such "impairments" are allowed. For example, the audit report points out that the DIAs at twelve agencies (including DEC) serve as their agency's ICO. The ICO's of the various state agencies belong to the New York State Internal Control Officers Association, an organization established specifically for the State's ICO's. Representatives from DOB and OSC regularly attend this association's meetings and discuss issues of common interest. At several of these meetings, the issue of the DIA serving as ICO has been discussed. When asked, OSC officials have advised this group that there is not necessarily anything wrong with the DIA serving as the ICO, as long as the agency examines and assesses the risks involved. This is exactly what DEC has done.

6 – Risk Assessments

DEC agrees with this finding. DEC's IA Unit (IAU) is in the process of implementing a project to test and verify the information provided in DEC's control self-assessments and to establish a more formal risk assessment process.

7 – Audit Plans

DEC disagrees with this finding. Neither the Act nor the Standards require the annual audit plan to contain the level of specificity here referenced by the auditors. On the contrary, the IIA has recognized that audit plans need to remain flexible so as to accommodate quickly changing conditions.

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8 – Audits/Reviews of Internal Controls

DEC disagrees with this finding and the recommendation. The three audits referred to in the audit report are the three assurance engagements conducted by the internal audit unit during the audit period. This does not include the number of consulting engagements completed during the same period. The Act does require that IA units identify internal control weaknesses and make recommendations to correct such weaknesses. However, the Act does not require that such identifications and recommendations result from assurance engagements alone. Thus the finding does not reflect the true extent of the IAU's identification of control weaknesses and recommendations to correct same. In addition, one of the three assurance agreements here cited, along with the major consulting engagement conducted during this period, were the very same "comprehensive internal control audits and reviews of (the) agency's high-risk operations" referenced in the recommendation. Nevertheless, DEC's IAU will be examining ways in which it can expand the number of assurance engagements performed.

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9 – Monitoring Results

DEC agrees with this finding. DEC's IAU will work toward better documentation of its efforts in this area and the formalization of its follow-up procedures

10 – Quality Assurance

DEC agrees with this finding. DEC's IAU is in the process of establishing standard procedures for documenting supervisory review. The IAU is also in preliminary discussions to arrange for independent appraisals.

11 – Work Papers

DEC agrees with this finding. DEC's IAU is in the process of establishing standard procedures for the proper documentation of its evidence.

Office of General Services (OGS)

5 – Organizational Independence

The OGS Director of Internal Audit (DIA) previously had dual reporting lines, reporting to and providing audit reports to an audit committee (chaired by the First Deputy Commissioner) that provided operational direction and also reporting to the Director of Administration, who served in a supervisory capacity. This was found to be an organizational impairment, which has been addressed by having the DIA report directly to the First Deputy Commissioner.

6 – Risk Assessment

OGS believes that the process it uses for risk assessment provides a thorough self analysis and assessment process that includes reviews of program functions (in excess of 400) using a standard assessment tool, review of those results in prioritization of the work of the Internal Audit Unit (IAU), and additional input from managers and executives. We believe this process satisfies the risk assessment requirements of Institute of Internal Auditors (IIA) Standards. There are many methods of assessing risks; because our process does not fit OSC's narrow model does not negate the validity of our approach. We believe that our process provides the best coverage of our agency consistent with the dedication of resources to actually perform audits based on the results of the assessment.

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8 – Audits/Reviews of Internal Controls

OSC found that OGS did not audit, on a comprehensive basis, OGS's internal control (IC) system as required by the Act. We audit ICs as part of each audit. However, the audit found that we do not do enough audits to offer assurance that OGS' ICs across the entire agency are functioning as desired. OGS IAU uses finite resources based on its understanding of the risks facing the agency as prioritized by the audit committee. With this approach we "identify internal control weaknesses that have not been corrected and make recommendations to correct these weaknesses" and thus are in compliance with Executive Law Article 45 Section 952.

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9 – Monitoring Results

OGS started its IAU in 1997. Due to the number of audits and reviews that had been identified, the finite resources available, and the new projects that have to be incorporated into the audit plan as they are identified, OGS chose not to view follow up audits or monitoring the resolution of audit findings as a priority among planned activities. It was felt that audit resources were better used developing findings in areas that had not yet been audited. Subsequent to OSC's audit we have added follow up audits to our audit plan and will now track the status of audit recommendations.

10 – Quality Assurance

IIA Standards require internal and external assessments of the performance of the internal audit activity in complying with the Standards. The DIA reviews each audit report and the associated work papers and audits performed by the DIA are reviewed by one of the other internal auditors. To meet standards we will need to perform periodic self-assessments of our operations.

To satisfy the external assessment requirement, OGS' DIA is working with a committee formed by the New York State Internal Control Association that is investigating ways that agencies can lend auditors to perform external assessments of other agencies and have other auditors perform such assessment of their agency.

Department of Health (DOH)

Subsequent to the passage of the Internal Control Act, DOH established an internal audit (IA) function headed by a Deputy Commissioner and two IA positions. The organizational plan envisioned supplementing this core staff with program and fiscal audit staff on a project-by-project basis to comprise teams capable of conducting internal audits of the agency programs. Over a period of time, as additional programs were assigned statutorily to DOH, this organizational structure fell into disuse as staff were reassigned to programmatic duties.

To comply with the requirements of the Act, DOH is reconstituting an IA unit which will be headed by an independent Director of Internal Audit (DIA) directly reporting to the Executive Deputy Commissioner. The IA program will be governed by an IA committee comprised of executives from the Department's major organizational divisions which will review and approve an annual audit plan. The DIA position is currently undergoing classification at the Department of Civil Service. When established and filled, the position will be responsible for assembling a qualified staff and developing and implementing an internal audit plan in accordance with generally accepted principles as described in OSC's report.

Although DOH does not currently have a formal IA unit in place, many other monitoring, audit and review activities are undertaken to safeguard DOH's assets and ensure that compliance with internal control policies and procedures is attained and corrective action initiated when warranted. These safeguards include:

- DOH is continuously audited by external audit agencies. At any point in time, on an annual basis, there are between 20 and 25 audits of DOH programs in progress by the Office of the State Comptroller (OSC). Since 1994, OSC has conducted more than 130 audits of Department programs, more than any other State agency. In addition, the federal Centers for Medicare and Medicaid Services (CMS) Audit Agency as well as the Department of Health and Human Services' Office of the Inspector General conduct approximately 10 audits annually. Further, auditors from OSC are permanently on-site conducting prepayment reviews of the Medicaid program's weekly disbursements. CMS also maintains an on-site staff of five auditors to review Medicaid funding requests and claims submitted by DOH to CMS. The Department also undergoes an annual financial management review by the U.S. Department of Agriculture (USDA) that includes a comprehensive analysis of both the WIC and CACFP programs as well as periodic audits by USDA. These audits are in addition to the annual Single Audit of major federal financial programs and the annual general financial statement audit.
- Moreover, DOH undertakes a major effort with its own staff auditors, as well as contract resources, to ensure program and fiscal integrity over payments made to recipients (individual and institutional) of government

funds. A significant audit staff (organizationally a division) is devoted exclusively to the Medicaid program while a separate audit staff focuses on contract and program audits of other programs. Medicaid audits ensure the integrity of the Medicaid program and control fraud, waste and abuse through a myriad of activities including prepayment reviews and edits, targeted and routine post payment audits, investigations, undercover activities and recoveries from third-party vendors. Non-Medicaid audits are contract specific audits of certain DOH programs. If issues of concern are identified with a DOH contractor, an audit will be undertaken of all DOH funded programs at that agency. Audit staff are also deployed when significant financial issues are identified during program reviews and undertake fiscal audits to the extent necessary to evaluate issues raised, including referral to enforcement agencies as appropriate.

- To further safeguard the assets reflected in DOH's extensive grants-in-aid programs to local governments and not-for-profit agencies, the Department conducts an extensive audit clearinghouse function which reviews contractually required independent audit reports from agencies which receive in excess of \$300,000 per year. This helps to ensure that public funds are spent in accordance with DOH's programmatic and fiscal requirements. A compliance procedure is in effect which implements progressively punitive steps (up to and including contract termination, and prohibiting future contracts with DOH) for contractors that choose not to comply with the requirements of this policy.
- Finally, DOH maintains a formal process for internal control (IC) standards development and reporting as reflected in the Administrative Policy and Procedures Manual. All DOH programs at the bureau level and higher are required to complete a comprehensive annual IC questionnaire that addresses administrative and accountability functions and develop and implement corrective action plans to eliminate any identified weaknesses in their procedures. This provides continuous review and assurance that these issues, once identified, are addressed.

In conclusion, when fully approved and staffed, the Internal Audit Unit will complement the DOH's other extensive prepayment and post-payment audit and IC initiatives to safeguard Department assets.

Division of Housing and Community Renewal (DHCR)

6 – Risk Assessments

DHCR is in agreement that the agency did not perform a risk assessment as required by the Standards, as a result of the unit director leaving the agency. However, since the completion of the audit, DCHR has adopted "The Four Step Process for Internal Control" and is currently completing its annual risk assessment. All unit managers have submitted their assessments to the new Director of Internal Audit (DIA), who is analyzing the results and developing a schedule of internal control (IC) reviews with the appropriate units.

7 – Audit Plans

DHCR agrees that the agency's audit plan included only external audits (CAFR audits), and not internal audits of the agency's operations. The Internal Audit Unit (IAU) is developing this year's audit plan based on the results obtained from performing the annual risk assessment. This plan, once approved by the DHCR Commissioner will assure that the agency's IAU is auditing areas of highest risk.

8 – Audits/Reviews of Internal Control

DHCR agrees that the IAU did not adequately evaluate the DHCR's IC and operations to identify IC weaknesses during the audit period reviewed. This issue is being addressed as the agency implements its process for reviewing ICs. The IAU plans to document and evaluate the internal controls within each organizational unit, identify any weaknesses and make the necessary recommendations to correct those weaknesses.

9 – Monitoring

During the audit period covered, DHCR agrees that the agency had not maintained a system to monitor whether the organizational units had actually implemented any recommended improvements. Once again, the IAU is developing the audit plan and will establish ongoing monitoring controls, and document the status of the recommendations made by the IAU.

10 – Quality Assurance

DHCR concurs with the finding that the agency had not received supervisory or independent reviews of the audit process, due to the fact that the agency had no qualified resources available to perform the secondary level review of the audit work. The IAU plans to establish a process of self-assessment to address this issue, however since this finding was the area of highest non-compliance among the 34 agencies we are looking for some additional guidance/recommendations from DOB/OSC to assure we are performing our audits in accordance with the Standards.

State Insurance Department (SID)

10 – Quality Assurance

SID takes exception to the overall conclusion that its Internal Audit Unit (IAU) does not follow the Quality Control Standards set forth by the Institute of Internal Auditors (IIA) and contends that this standard is partially satisfied.

OSC defines Quality Assurance (QA) on page three of the draft report:

“The internal audit unit should adopt a process to monitor and assess the overall effectiveness of the Unit’s operations. Every audit should receive a supervisory review and, periodically, an assurance process should occur either through a self-assessment or an assessment performed by a third party independent from the original audit”

The IIA Standards concerning QA, covered by the above statement are:

1310 Quality Program Assessments; 1311 Internal Assessments; 1312 External Assessments, noted within the Practice Advisory 1311 – 1: Internal Assessments, is engagement supervision described in Practice Advisory 2340 – 1 (“2340”).

Contrary to OSC’s conclusion, SID’s IAU is a one person unit reporting directly to the Superintendent of Insurance or First Deputy, who receives all audit reports and performs the annual performance evaluation. Often it is the Superintendent that requests certain audits be conducted, which is part of the basis for the audit planning process that is mainly guided by risk assessment. Therefore, the Director of Internal Audit’s (DIA) overall actions are supervised.

The Practice Advisory 2340 – 1 (cited in 1311 – 1), establishes that the chief audit executive “...is responsible for assuring that appropriate engagement supervision is provided.” As a sole practitioner within SID, the DIA both supervises and performs each audit and all other audit activities. There obviously is no segregation of duties from a practical standpoint since the DIA is the only person in the IAU. The requirements of 2340 are silent on this. It must be emphasized that the DIA does, however, report to the Superintendent who, in turn, evaluates the overall performance of all auditing activities.

Supervision as noted in 2340 includes ensuring proper knowledge and skills, appropriate instruction, working with an approved program, work papers support conclusions, proper communications and meeting objectives. Evidence of supervision must also be retained. As a sole practitioner, all of these items are met. This advisory also states that the chief audit executive is responsible for all 2340 objectives and requirements. Furthermore, during closing conferences, supporting documentation is always provided to the satisfaction of the auditee who may not agree with IAU’s conclusions (this situation is important when there are negative findings, and the accuracy of those conclusions have not been challenged). This advisory also states that the chief audit executive is responsible for all significant professional judgments.

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Thus, the chief audit executive makes all professional decisions and documents them when necessary.

SID's IAU also has created a charter (signed by the Superintendent) and overall internal planning standards, which are adhered to in all IA practices.

One of the measurements of the performance of an audit unit is customer satisfaction. SID's DIA is often asked for input and opinions on a variety of control issues as well as requested to formally review and/or audit a number of functions. Therefore, the DIA's activities are not only supervised, but often requested due to her credibility and the expertise she can share with other staff members of SID.

The only item not present in the current quality control structure is an external review/verification of the IAU's adherence to proper procedures and other IIA standards. The process of formal self-assessment and verification of these assessments by an external qualified party is being explored with other state auditors.

State Insurance Fund (SIF)

5 – Organizational Independence

As correctly stated, the Act requires that the Director of Internal Audit (DIA) report to the head of the agency. During the audit period the former acting DIA did not report to the head of the agency and therefore this is a valid finding. Since this is a compliance issue and we agree that we were not in compliance, the remainder of the discussion in this finding has no value to SIF, particularly since SIF recognized that this had to change and in fact has been changed. For consistency purposes, if OSC is going to bring up the appointment of the new DIA, disclosure of the new reporting relationship would be appropriate.

8 – Audits/Reviews of Internal Controls

While SIF agrees that the total audit coverage was less than we would have liked and accept that we are only in partial compliance with the Act, SIF does not agree that the internal audit (IA) function is responsible to “ensure that the SIF’s entire internal control system is operating as intended.” As OSC states in the background section, “B-350 and the Act both assign the IA unit the responsibility for evaluating the agency’s internal controls and operations, identifying control weaknesses that have not been corrected, and making recommendations to correct those weaknesses.” SIF’s partial compliance should relate to this responsibility as defined in the background section. SIF will increase audit coverage.

9 – Monitoring Results

SIF agrees that there was no system in place to monitor implementation of recommendations. However, SIF does not agree that this was the result of untimely response by management to the initial audits. There is no timeliness issue on response from management and we take particular exception to this sentence in the finding. SIF has implemented a system for monitoring implementation of recommendations which includes follow-up audits completed six months after the initial audit.

10 – Quality Assurance

SIF agrees with this finding. A process to monitor and assess the IA Unit’s overall effectiveness has been developed.

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| * Note 21 |
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Department of Labor (DOL)

6 – Risk Assessment

The Internal Audit Unit (IAU) has begun an updated Department-wide risk assessment, which is anticipated to be completed later this year.

8 – Audits/Reviews of Internal Controls

The audit report states that audits have been completed and recommendations have been made, but the OSC conclusion of partial compliance was based on information solely related to our audits/reviews of the Unemployment Insurance Program and thus failed to take into account the activities performed by the IAU regarding other programs. The IAU has also performed a variety of other audits to address either high-risk activities or audit requests from program management. These include a Department-wide review of procedures for handling cash receipts, audits of operations in Administrative Finance, Human Resources Management, Safety and Health, and Information Technology programs, and monitoring DOL's multi-million dollar emergency program to assist individuals recovering from the World Trade Center Disaster. Taking all of this activity into account, we believe that audit coverage is more extensive than indicated by the report.

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| * Note 22 |
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Division of the Lottery (Lottery)

5 – Organizational Independence

OSC correctly pointed out that the Lottery's Director of Internal Audit (DIA) reports to the Administrative Officer who is on the same reporting level as the Director of Sales and Marketing and the Director of Operations. We understand and appreciate OSC's concerns about the DIA's organizational independence. However, the Lottery is a relatively small agency and like most small organizations our size poses a challenge to our organizational structure. The Administrative Officer was hand picked to supervise the Internal Audit Unit (IAU) by the former Lottery Director because of his experienced financial background and understanding of the role that internal audit plays in an organization.

In light of the audit findings the Lottery will implement the following controls to compensate for the independence concerns disclosed by the auditors.

- The DIA will submit draft risk assessment and audit plan to both the Lottery Director and the Administrative Officer concurrently for review and approval.
- The DIA will provide quarterly reports to the Lottery Director showing progress against the audit plan.
- The Lottery Director, the DIA and the Administrative Officer will meet regularly to discuss relevant issues.
- The practice of sending all audit reports to the Lottery Director will continue.

We believe that the Lottery Director's involvement in each of these areas will help to ensure that the IAU continues to provide coverage to all areas of the organization. As the number of employees retiring increases, the Lottery has to adapt its organization to continue in the best way possible. The Lottery will consider the IAU's placement in the organization and the OSC auditors concerns with any future changes to the organization. However at this time the Lottery is not prepared to commit to making the recommended change.

9 – Monitoring Results

The Lottery's IAU will establish and maintain a system to formally follow-up on all audit recommendations as applicable.

Office of Mental Health (OMH)

4 – Individual Independence

As OSC stated in its report, “(a)t 8 of these 12 agencies, although the internal audit (IA) directors acted as the Internal Control Officer (ICO), they did not develop or implement the agency’s system of internal controls; therefore, these arrangements presented conflicts in appearance, rather than fact.” OMH agrees with this OSC statement; that the conflict is only in appearance and not fact. OMH’s Audit Unit is responsible for internal audits, and for ensuring OMH compliance with the Internal Control Act, but is not responsible for establishing IC systems within the agency; therefore, the Audit Unit maintains its independence. OMH plans to continue to designate the Audit Unit supervisor as OMH’s ICO.

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Note
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6 – Risk Assessments

OMH has and will continue to utilize self-assessments prepared by operating units as a means to accomplish organizational risk assessments. We have found such efforts, as well as risk assessments by the Audit Unit, along with recommendations from Executive Management, to be useful in identifying high-risk areas for audit. Moreover, OMH recently updated and issued a Self-Assessment Questionnaire for facility business office operations, which all psychiatric centers will be required to complete during the 2004-05 fiscal year to maintain compliance with the Internal Control Act. The questionnaire covers important fiscal control aspects of facility functions including: cash; patient accounts; payroll; inventory; and purchasing (including travel and procurement credit cards).

7 – Audit Plans

OMH is in general agreement with OSC’s statement in the draft report, “(a)t OMH, only about 50 percent of the plan was risk-based; the remainder was set aside to handle requests from the Commissioner’s Office.” However, the term “Commissioner’s Office” should be changed by OSC to “Executive Management.” It should be noted that OMH had also developed an annual audit plan for its audits of facility Quick Pay purchasing procedures which was provided to OSC during the audit. OMH believes that an audit plan for all internal audits is not feasible since many internal audits are undertaken at the request of facility management or OMH Executive Management. Since these requests are evaluated using a risk-based approach, OMH believes that its current practice addresses the priorities of the internal audit unit, consistent with organizational goals and objectives.

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Note
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8 – Audits/Reviews of Internal Controls

OMH does not agree with some of OSC’s statements in this area. For example, OSC indicated “four agencies (including OMH) did perform some audits during our audit

period; however, because these audits were not risk based, they provided no assurance that the areas of highest risk were covered.”

OMH internal audits are performed pursuant to a risk-based Quick Pay audit plan, risk assessments, and requests from facility and Central Office Executive Management. Such requests are based on a determination by management that there is a high risk associated with the area recommended for audit. Other internal audits are based on risk assessments made by the OMH Audit Unit. For example, the Audit Unit recently completed a review of travel credit cards and have begun an audit of procurement cards. The audits were selected due to the materiality of amounts spent, and because of abuses identified by the U.S. General Accounting Office (GAO) during their audits of credit cards used by Federal government agencies. The audit of travel credit cards showed that OMH is in compliance with applicable guidelines, and has none of the serious issues which were identified at the Federal agencies.

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Note
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9 – Monitoring Results

OMH performs both formal on-site reviews, and informal telephone follow-up reviews on areas of concern identified during internal audits, as appropriate. Such reviews are undertaken based on the adequacy of the written plan of corrective action, which is required from the responsible OMH manager, as well as an assessment and determination of the level of risk by the Audit Unit, thereby utilizing existing resources in the most efficient manner. Moreover, OMH closely reviews all OSC final audit reports and identifies potential areas of risk. OMH then follows up on those areas, often by telephone and occasionally through on-site reviews, to ensure that appropriate corrective action has been taken.

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Office of Mental Retardation and Developmental Disabilities (OMRDD)

1 – Director's Qualifications and #3 – Continuing Education

OMRDD is now in full compliance. The Director of Internal Audit (DIA) has been assigned to an individual that has the requisite continuing professional education to maintain a Certified Internal Auditor (CIA) certificate. OMRDD is committed to providing its internal auditors with the continuing professional education needed to enhance their knowledge skills and competencies.

5 – Organizational Independence

OMRDD is working towards full compliance. The DIA receives direction from the Commissioner and the Executive Deputy Commissioner on an ongoing basis.

6 – Risk Assessments

OMRDD is now in full compliance. Since the completion of the audit, OMRDD has completed its first annual risk assessment. The Internal Control Officer's input is included as part of that model after self-assessments have been reviewed for quality.

7 – Audit Plans

OMRDD is now in full compliance. OMRDD takes exception to OSC's statement on page 14 regarding the need for an audit plan. While OMRDD did not have an audit plan when OSC was on site, OMRDD never took the position that audit plans were not needed, as stated by OSC. OMRDD's annual audit plan now includes a risk component. Scheduling of these audits, however, is subject to executive priorities.

8 – Audits/Reviews of Internal Controls

We believe OMRDD has always been in compliance. The Internal Audit Unit evaluates internal controls and issues appropriate recommendations as required by Executive Law Article 45, Section 952.

10 – Monitoring Results

OMRDD is working towards full compliance. The review of audit reports by OMRDD managers is an integral part of monitoring the overall effectiveness of internal audit operations. We will also ensure supervisory review and signoff of work products as a part of all future audits. OMRDD will work with interested parties (i.e. DOB, the New York State Internal Control Association or local chapter of the Institute of Internal Auditors) to develop/employ a peer review process prior to the 1/1/07 target date as described in the Standards.

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| * Note 26 |
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Division of Military and Naval Affairs (DMNA)

The agency has reviewed the findings, but is of the general opinion that DMNA's State audit requirements are minimal, due to the fact that the vast majority of agency operations are either completely federally funded, or are Federal-State cost-shared programs which are already routinely audited by the federal government.

To address the perceived shortcomings in the agency's internal audit capabilities, DMNA will first maximize its use of available Federal internal audit capabilities. Having already determined that it is not cost effective for a small agency such as DMNA to support an audit function in-house, the agency will address the remaining audit needs by exploring auditing partnerships with other State agencies.

Department of Motor Vehicles (DMV)

3 – Continuing Education

DMV agrees with this finding and has actively encouraged (and financially supported) continuing education for auditors. However, the State's recent financial situation has made this increasingly difficult. DMV has also experienced difficulty finding relevant training opportunities for auditors outside of Albany (we have staff based in Long Island and western New York).

DMV has been able to take advantage of low cost training offered by the local professional organizations in the Albany area (Association of Government Accountants (AGA), Institute of Internal Auditors, and Information Security and Control Association (ISACA)). DMV has also been able to use some offerings by the Governor's Office of Employee Relations (GOER) and Office for Technology (OFT). However, the GOER and OFT offerings are not audit-specific, and are frequently repeated. Providing audit-specific training opportunities to auditors based outside Albany should be a priority.

4 – Individual Independence

DMV disagrees with the independence issues cited in this finding. DMV does not feel that having the Director of Internal Audit (DIA) also serve as the agency Internal Control Officer (ICO) poses a conflict, whether actual or in appearance. DMV's DIA has served as the ICO since approximately 1996.

According to Article 45 of the Executive Law, "The *head of each state agency*" is responsible for establishing IC guidelines and a system of IC. Further, the agency head is to "designate an ICO, who shall report to the head of the agency, to implement and review the internal control (IC) *responsibilities...*". The law does not say that the ICO is responsible for establishing IC.

Budget Bulletin B-350 states that ICO "works with appropriate personnel within the agency or authority to coordinate the IC activities of the agency or authority, and to assure that the agency or authority's IC program meets the responsibilities established by this Bulletin. Although the ICO evaluates the adequacy of the IC reviews performed by agency or authority staff, *program and line managers are responsible for conducting reviews to assure adherence to controls, and analyzing and improving control systems.*"

Based on our reading of the Executive Law and Budget Bulletin B-350, we see no conflict with the DIA also being the ICO; in fact, we find these to be complementary functions. Neither document states that the ICO *establishes* internal controls, so there would be no conflict with IA duties. Furthermore, the certification on the adequacy of the internal control filed annually is certified to by the Commissioner of Motor Vehicles (as required by Budget Bulletin B-350).

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9 – Monitoring Results

DMV agrees with this finding. In the past, DMV had a process where mid/high level managers followed up on audit recommendations for areas within their organization. Due to staffing changes and reorganizations, this process lapsed. DMV is in the process of developing a new procedure to follow up on audit recommendations and plans to have the process in place by June 2004.

10 – Quality Assurance

DMV agrees with the recommendation concerning external assessments. To date, DMV have not made any arrangements for an external quality assurance assessment (peer review).

DMV has an internal review process for all audits. DMV made some minor adjustments after the OSC audit fieldwork was completed, and was found to be in compliance in this area.

DMV would recommend that the Division of the Budget facilitate some type of interagency process to do this. It would seem to be more efficient and cost effective to have multiple agencies participate in this than to contract out for it. OSC has such an arrangement with State Auditor agencies in other states. DMV has participated in peer reviews of a specific operation common to all state DMVs. The primary commitment is staff time.

Division of Parole (Parole)

1 – Director Qualifications

Parole's Director of Administration, who reports to the Executive Director, currently supervises the Internal Audit Unit (IAU). The Director of Administration's qualifications include a Bachelor's Degree in Business Administration and three years experience as a Senior Business Management Assistant, in which his main responsibilities included auditing correctional facilities reconstruction projects. He has also served six years as a Budget Analyst and 21 years as Director of Finance.

Parole is currently reviewing the reporting structure of the IAU to ensure full compliance with the Internal Control Act.

3 – Continuing Education

The Division concurs with this recommendation. As you are aware, the sole staff person was unable to obtain the required continuing professional education (CPE) during the 2002-2003 fiscal year mainly because he was on Military Leave from January through September 2002. Prior to this period, the Internal Audit Unit (IAU) was in compliance with the CPE requirements. During the current fiscal year, the IAU is again in compliance. The Division acknowledges and supports the CPE requirements and encourages audit staff to explore all options to obtain the required CPE.

4 – Individual Independence

The Division concurs with this recommendation. As an interim step, the IAU has been placed under the administrative oversight of the Director of Administration who reports directly to the Executive Director. In addition, Parole is in the process of reviewing required restructuring to ensure compliance with the above independence requirements.

6 – Risk Assessments

Unit managers continue to perform annual control self-assessments to identify areas of high risk. The IAU coordinated the development of Parole's internal control program including assisting Division Managers with self-assessments. Parole is interested in reviewing the "best practice" testing and analysis of departmental self-assessments identified by OSC in the draft audit report.

7 – Audit Plans

The IAU prepares its audit plan based on the direction of the Executive Director. The risk assessments were used by the Executive Director in deciding which high-risk areas are to be audited.

8 – Audits/Reviews of Internal Controls

Parole has always considered internal control (IC) audits and reviews of its high-risk areas a priority. During the audit period, the limited staff available in the IAU impacted the quantity of IC audits and reviews that were conducted. During this period, the IAU has been providing consultant type services to the Quality Control Unit and Division Administration as well as liaison activities with external auditors.

9 – Monitoring Results

The IAU formally follows up on audits as a matter of policy. Given the limited staff resources, the IAU has conducted limited follow-ups. The IAU routinely interacts with Division Managers responsible for areas that had been audited and is kept aware of the implementation of any audit recommendations.

10 – Quality Assurance

As a matter of policy, the IAU has conducted quality assurance reviews. The limited staff available to the IAU has impacted its ability to perform quality assurance reviews. In addition, Parole is reviewing options to obtain an independent appraisal of its compliance with Institute of Internal Audit Standards.

Division of Probation and Correctional Alternatives (DPCA)

It is not accurate to reach the conclusion that OSC does in the following excerpt: "DPCA has no Internal Audit Unit (IAU). To compensate, the IAU of the Division of Criminal Justice Services (DCJS) provides internal audit (IA) services to DPCA. However, during our 26-month audit period, this unit performed only one IA for DPCA – an examination of the DPCA Quick Pay process. This audit alone does not provide DPCA with enough feedback on the adequacy of its internal control (IC) systems and does not indicate whether the systems are working as intended."

In addition to the audit of DPCA Quick Pay, the DCJS IA Unit (IAU) has performed formal audits of ten grants administered by DPCA. Five of these grants were awarded to local probation departments, and the five others were awarded to a not-for-profit corporation. Reported findings resulting from these audits certainly provided significant feedback to DPCA on its IC over grant administration, considered by experienced staff at the agency to be one of its highest risk activities.

Since DCJS provides the IA function for DPCA, the DPCA responses to the findings contained in this report are the responses of DCJS. This is especially apt given that the Budget Policy and Reporting Manual Item B-350, dated October 21, 2003, does not include DPCA on the schedule of State agencies required to establish and maintain the internal audit function.

Department of Public Service (DPS)

4 – Individual Independence

OSC found the Internal Audit Section (IAS) to be in full compliance with the standard requiring evaluations of internal controls and operations and identification of weaknesses and recommendations to address weaknesses. That OSC found IAS to be an integral and valuable asset in the Department is the most important issue in our judgment. While the Department understands and appreciates the standard requiring an impartial and unbiased attitude, small audit shops need to strike a balance between effectiveness and independence. We feel that balance is achieved in the Department while recognizing that it sometimes requires IAS to have a more "hands on" approach than the standards suggest. At the same time, decisions to implement recommendations or make process changes which tighten controls ultimately lie with either the effected program groups, the internal Control Officer, or with Executive Management, not IAS.

5 – Organizational Independence

While the DIA does report on a daily basis to the Director of Administration, the IAS also receives assignments directly from Executive Management. For the past two years, the work as Internal Security Coordinator has been under the direction of the Chairman and Executive Deputy. This has been a significant commitment of IAS' resources during the audit period. In addition, the DIA and the Director of Administration keep our Executive Office informed and involved in all key action items – including internal controls, computer security, and issues involving employee wrongdoing.

7 – Audit Plans

OSC correctly notes that the work of the IAS has been directed by need and emerging issues, and not a formal risk plan. The Department agrees that there should be more formal audit planning and will begin this process next year, augmented by the recent agency-wide risk assessment. The Department notes, however, that the work performed by IAS has clearly addressed high-risk areas in the Department, namely, internal and computer security.

9 – Monitoring Results

As OSC notes, the IAS does follow up on recommendations made by internal and outside audit entities. The Department will implement a formalized tracking system.

10 – Quality Assurance

OSC correctly notes that IAS does not have a quality assurance process. The Department would welcome the opportunity to share best practices among other small IA shops, perhaps in conjunction with the Institute of Internal Auditors – Albany Chapter or the New York State Internal Control Association (NYSICA). In fact, there have been some preliminary informal discussions centered on peer reviews, both for internal audit and internal control programs.

Department of State (DOS)

10 – Quality Assurance

Although it is true the Internal Audit Unit (IAU) is a one-person operation, it does not automatically follow that IAU is not in compliance with this standard. In fact, it is our contention that IAU is, in fact, in compliance with all standards. Because the Director of Internal Audit has no staff, there may not be a clear, definitive segregation of his duties. However, he has the requisite skills and experience to perform oversight of his work. Furthermore, he performs ongoing reviews of his work by meeting many or all of the engagement supervision practices prescribed in both Institute of Internal Auditors' Practice Advisory 2340-1, "Engagement Supervision" and IIA's practice Advisory 1311-1, "Internal Assessments." In addition, his work is supervised by the First Deputy Secretary of State. These activities, when considered in the aggregate, are in keeping with Standard 1300.

OSC's fieldwork did not establish sufficient, competent evidence to support a finding that DOS' IAU is not in compliance with the quality assurance standard. Therefore, they should revise the report, as well as the table at the end of the report, to reflect that DOS internal audit is in compliance with all 11 attributes.

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| * Note 20 |
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Division of State Police (DSP)

1 – Director Qualifications and # 4 – Individual Independence

DSP agrees that it does not have an Director of Internal Audit (DIA) as contemplated by the Act. The internal audit function in DSP is a part of the Internal Affairs Bureau (IAB), which reports to the Deputy Superintendent-Internal Affairs who reports directly to the Superintendent.

DSP is examining the possibility of adding a civilian Director of Internal Audit, reporting directly to the Deputy Superintendent-Internal Affairs, to develop audit plans and surveys and work with inspection teams to conduct financial and programmatic audits of the Division's programs. Given the nature of activities being audited, it has been our opinion that this model will work best in DSP.

DSP believes that given the nature of our organization, a civilian DIA reporting directly to the Deputy Superintendent-Internal Affairs is the model that would meet the spirit of the Act and would work best for this organization. Any civilian DIA hired will possess the appropriate education and training to meet established professional standards for the position.

3 – Continuing Education

DSP agrees that no formal training has been provided to each "auditor", but disagrees that it is necessary given the skill sets possessed by members of the IAB unit. Although not formally trained as auditors and not receiving formal continuing professional education as auditors or accountants, the personnel assigned to the IAB are among the most highly trained investigators in the world. These investigatory skills are easily transferable to those skills necessary to conduct internal audits of the programs of the agency.

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Department of Taxation and Finance (Tax)

4 – Individual Independence

As was reported in the preliminary findings given to Tax, the Director of Internal Audit (DIA) did not actively aid in the development of the Tax's current IC systems. Therefore, the preliminary states the DIA's individual independence is impaired in appearance. We question the reason for our partial compliance rating. The appearance of an impairment to independence does not equate to partial compliance.

10 – Quality Assurance

The preliminary findings given to Tax indicated supervisory review was properly performed but stated periodic self-assessments were not done. Tax disagrees with OSC's contention that it does not have periodic self-assessments. Compliance with standards is monitored through the internal control program. Since non-compliance with Institute of Internal Auditors (IIA) Standards is an identified risk, we periodically test the controls for compliance with IIA Standards. We believe this periodic testing qualifies as a periodic self-assessment.

It should also be noted that supervisory review of our audit work is made at multiple levels. Our supervisory staff include Certified Public Accountants, Certified Internal Auditors, and Certified Government Financial Managers. Their review of Tax's audit work provides adequate assurance that the audit work meets IIA Standards. This is evidenced by the lack of any findings of non-compliance in the performance of our audits.

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| * Note 28 |
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Office of Temporary and Disability Assistance (OTDA)

6 – Risk Assessments

The Office of Internal Audit has been reviewing the entire OTDA internal controls (IC) self-assessment process, including assessments performed by individual units, which will include testing of selected internal controls. Upon completion of the review process, we will use the outcomes that indicate the highest areas of risk to prepare the audit plan as required.

7 – Audit Plans

As stated in the response to questions six and eight OTDA will use the outcomes of the risk assessment to prepare an audit plan as required.

8 – Audits/Reviews of Internal Controls

In conjunction with the review and evaluation of the IC self-assessments, we are in the process of developing a methodology to ensure that action is taken on identified internal control weaknesses.

10 – Quality Assurance

The OTDA Commissioner is committed to ensuring compliance with professional standards. To that end, OTDA and the Office of Children and Family Services Commissioner's offices are continuing to discuss and coordinate plans to review each other's internal audit units.

Workers' Compensation Board (WCB)

3 – Continuing Education

A new Director of Internal Audit (DIA) was hired. The DIA received 16 continuing professional education (CPE) training hours in 2000, 8 in 2001, and 39 in 2002. Both the DIA and Principal Internal Auditor were approved for 12 CPE's for 2003. The DIA will complete an additional 8 CPE's of self-study.

7 – Audit Plans

At the time of the audit, WCB had an audit plan, but most high risk areas were not included in the plan. WCB will address these areas in the 2004 Audit Plan.

8 – Audits/Reviews of Internal Controls

WCB will address these in the 2004 Audit Plan.

State Comptroller's Notes

1. The Standards require internal audit units to perform annual risk assessments of their agencies' operations. Officials at A and M, CUNY, OCFS and OGS stated in their responses to our draft audit report that they perform risk assessments or base their audits on known risks. In each case, the risk assessments cited are control self-assessments performed by unit managers. The unit managers may or may not have properly assessed the risks for their operations. However, these agencies' internal audit units do not verify the validity of these self-assessments.
2. The Act requires the internal audit function to evaluate an agency's internal controls and operations, to identify internal control weaknesses that have not been corrected and to make recommendations to correct these weaknesses. A and M officials stated that their Division of Internal Audit identifies weaknesses and makes recommendations to correct them. They further stated that many of these weaknesses are identified and corrected outside the formal audit process. The Division of Internal Audit completes audits of the State Fair and the Quick Pay process each year. However, this leaves many of A and M's operations without formal audit coverage and does not provide a comprehensive review of the entire system of internal controls.
3. The Act requires agencies to hire an internal audit director who has both auditing experience and education. Auditing education is a regular component of most business degree programs at the bachelor's and master's degree levels. Therefore, we looked for evidence of either a business degree or other formal coursework in auditing prior to each director's employment. At ABC, the internal audit director has extensive auditing experience. However, he provided us with no evidence of formal auditing or business education.
4. The Standards state that internal auditors should enhance their knowledge, skills and other competencies through continuing professional development. At ABC, the internal audit director is the sole member of the unit. He received no continuing professional education in 2002 or 2003, and only 9.5 hours in 2001. This does not comply with the requirements of the Standard.
5. The Standards require internal audit units to undertake a process to monitor and assess the overall effectiveness of the unit. This process should include both supervisory review of individual audits and periodic assessments performed by independent third parties. ABC has no formal, documented review process for each audit and no periodic assessment performed by a third party independent of the original audit.
6. The Standards state that internal auditors should have an impartial, unbiased attitude and avoid conflicts of interest. By definition in the Act, the Internal Control Officer (ICO) is charged with implementing and reviewing the agency's internal control responsibilities. The internal audit unit is responsible for evaluating the agency's internal controls. Thus, when the same person is both ICO and internal audit director, an inherent conflict of

interest arises, as the internal audit director must evaluate internal controls he/she helped to implement. The Standards do not differentiate between impairments in fact and impairments in appearance.

7. We have changed the report to reflect the information provided to us by OCFS officials regarding their staff qualifications.
8. The Act requires the internal audit function to evaluate an agency's internal controls and operations, to identify internal control weaknesses that have not been corrected and to make recommendations to correct these weaknesses. Except on a very limited basis, such as Quick Pay audits, CUNY's internal audit function does not provide an independent appraisal of the system of internal controls. Unverified self-assessments performed at the operational levels are not a substitute for this internal audit activity.
9. The Standards require internal audit units to undertake a process to monitor and assess the overall effectiveness of the unit. This process should include both supervisory review of individual audits and periodic assessments performed by independent third parties. Although CUNY officials disagree with our finding, their response provides no evidence that audit work undergoes either supervisory review or a periodic assessment by a third party independent of the original audit.
10. The Act requires agencies to hire an internal audit director who has both auditing experience and education. Auditing education is a regular component of most business degree programs at the bachelor's and master's degree levels. Therefore, we looked for evidence of either a business degree or other formal coursework in auditing prior to each director's employment. DOCS officials believe that the person who serves as the internal audit director has the necessary education and experience to perform the task they have assigned, overseeing the accreditation process for their prisons. However, since the director does not have formal auditing education, DOCS is only in partial compliance with this requirement of the Act.
11. The Act requires that the internal audit director report directly to the head of the agency. Both DOCS and SED acknowledge that their directors report to lower level officials.
12. The Standards require internal audit units to perform annual risk assessments of their agencies' operations. Officials at DCJS and SED agreed that they had not performed risk assessments, but disagreed that they do not consider risks in developing their audit plans. However, they provided no evidence that their audit plans were based on risk.
13. The Standards state that the internal audit unit should establish and maintain a system to monitor the disposition of the audit results communicated to management. DCJS officials stated that they follow up on audit recommendations when they perform the next audit in an area, but that they have no formal monitoring process for determining the implementation of audit recommendations. Because none of the audits completed during our audit scope period had been repeated, DCJS had not yet followed up to determine whether management had implemented the recommendations.

14. The Standards require the internal audit director to develop risk-based audit plans to determine their units' priorities, consistent with their organizational goals. SED officials stated that they prepare a two-year tactical audit plan. However, the tactical audit plan included only about 100 days of internal audit activities out of 3,200 days planned. This is not a sufficient level of activity to properly assess the organization's system of internal controls.
15. The Act requires the internal audit function to evaluate an agency's internal controls and operations, to identify internal control weaknesses that have not been corrected and to make recommendations to correct these weaknesses. SED's internal audit unit devoted little effort to evaluating the agency's internal controls. SED had no internal audits completed during the last year of our audit period, and the internal audit unit issued one memo concerning weaknesses uncovered by an external audit.
16. The Act requires agencies to hire an internal audit director who has both auditing experience and education. Auditing education is a regular component of most business degree programs at the bachelor's and master's degree levels. Therefore, we looked for evidence of either a business degree or other formal coursework in auditing prior to each director's employment. The internal audit director of DEC did not provide us with evidence of formal auditing education that had occurred prior to his employment.
17. The Standards require the internal audit director to develop risk-based audit plans to determine their units' priorities, consistent with their organizational goals. The DEC audit plan was a short list of potential audit topics with no other information or link to either a risk assessment or organization goals. We do not believe this satisfies the Standards' requirement for risk-based audit plans.
18. The Act requires the internal audit function to evaluate an agency's internal controls and operations, to identify internal control weaknesses that have not been corrected and to make recommendations to correct these weaknesses. During our audit scope period, DEC's internal audit unit completed two Quick Pay audits and one program audit. Although each audit addressed internal controls related to the specific operational areas under review, this level of activity is not sufficient to evaluate the overall adequacy of DEC's internal controls.
19. The Act requires the internal audit function to evaluate an agency's internal controls and operations, to identify internal control weaknesses that have not been corrected and to make recommendations to correct these weaknesses. During our audit period, OGS' internal audit unit completed six limited-scope audits. Although these audits addressed the internal controls specific to the operations audited, they did not constitute an assessment of agency-wide internal controls.
20. The Standards require internal audit units to undertake a process to monitor and assess the overall effectiveness of the unit. This process should include both supervisory review of individual audits and periodic assessments performed by independent third parties. At

SID and DOS, the internal audit directors provided no evidence that their audit work was reviewed by any person in their respective organizations other than themselves.

21. The item cited in the SIF response was not included in either the draft audit report or this final audit report.
22. The Act requires the internal audit function to evaluate an agency's internal controls and operations, to identify internal control weaknesses that have not been corrected and to make recommendations to correct these weaknesses. DOL's internal audit unit completed 4 audits in 2001, 2 audits in 2002, and none since 2002. Officials indicated that most of their resources were used to conduct the emergency aid program for individuals recovering from the World Trade Center disaster. The other audits cited in the agency's response all occurred prior to our audit scope period.
23. The Standards require the internal audit director to develop risk-based audit plans to determine their units' priorities, consistent with their organizational goals. OMH officials agree that only 50 percent of their audit plan is risk-based and state that the remainder is developed based on risks identified by executive and facility management. We were not presented evidence that this risk assessment process is occurring.
24. The Act requires the internal audit function to evaluate an agency's internal controls and operations, to identify internal control weaknesses that have not been corrected and to make recommendations to correct these weaknesses. OMH's audits were not selected based on risk assessments. Instead, they were initiated by requests from management. Thus, OMH has no assurance that the areas of highest risk were audited.
25. The Standards state that the internal audit unit should establish and maintain a system to monitor the disposition of the audit results communicated to management. Although it performed follow-ups of certain internal and external audits, OMH does not have a formal system to track the results of its internal audits. Instead, it only performs follow-ups when audit management determines the findings are serious and warrant further review. Therefore, officials could not provide documentation on the outcome of audit recommendations.
26. The Act requires the internal audit function to evaluate an agency's internal controls and operations, to identify internal control weaknesses that have not been corrected and to make recommendations to correct these weaknesses. OMRDD completed six audits during our audit period. Because it does not select audits through a risk assessment process, OMRDD has no assurance that these audits addressed the areas of highest risk.
27. The Standards state that internal auditors should enhance their knowledge, skills and other competencies through continuing professional development. State Police officials agree that the staff has not received continuing professional education. However, staff has received extensive training as investigators and they believe this is transferable. Because this was not audit-related education, it does not meet the requirements of the Standard.

28. The Standards require internal audit units to undertake a process to monitor and assess the overall effectiveness of the unit. This process should include both supervisory review of individual audits and periodic assessments performed by independent third parties. Tax provided us with a copy of the most recent internal control self-assessment for the internal audit unit. However, this assessment did not address the unit's compliance with the Standards.