

External Quality Assessment of the Internal Audit Activity at

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EXECUTIVE SUMMARY

As requested by the chief audit executive (CAE), the Institute of Internal Auditors, Inc. (IIA) conducted an external quality assessment (QA) of the Office of Internal Audit (OIA) of The Office of Budget and Management (OBM). The principal objectives of the QA were to assess IA activity's conformance to The IIA's *International Standards for the Professional Practice of Internal Auditing (Standards)*, evaluate the IA activity's effectiveness in carrying out its mission (as set forth in its charter and expressed in the expectations of OBM's management), and identify opportunities to enhance its management and work processes, as well as its value to OBM, and the operations of the State agencies they service.

In 2008, Ohio Revised Code Section 126.45 created the Office of Internal Audit within the Office of Budget and Management. The Code also requires OIA to conduct internal audits of certain state agencies according to an annual plan and report audit observations and recommendations to the State Audit Committee. By law, OIA audits all 22 state agencies that are under the Governor's oversight.

OPINION AS TO CONFORMANCE TO THE STANDARDS

It is our overall opinion that the IA activity generally conforms to the *Standards and Definition of Internal Audit*. For a detailed list of conformance to individual *Standards*, please see Attachment A. The QA team did not identify any issues related to conformance with individual *Standards*; however, it has identified opportunities to further enhance IA activity services, details of which are provided in this report.

The IIA *Quality Assessment Manual* suggests a scale of three ratings, "generally conforms," "partially conforms," and "does not conform." "Generally Conforms" is the top rating and means that an internal audit activity has a charter, policies, and processes that are judged to be in conformance with the *Standards* (or as appropriate). "Partially Conforms" means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner. "Does Not Conform" means deficiencies in practice are judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

SCOPE AND METHODOLOGY

As part of the preparation for the QA, the IA activity prepared an advanced document with detailed information and sent out surveys to its staff and a representative sample of OBM and State of Ohio agency executives. Summaries of the survey results (without identifying the individual survey respondents) have been furnished to the IA activity. Prior to commencement of the onsite work by the QA team on November 1, 2012, the team leader conducted a preliminary meeting with the CAE to gather additional background information, select executives for interviews during the onsite field work, and finalize planning and administrative arrangements for the QA. As a part of the review, extensive interviews were held with the State Audit Committee Chairman, OBM and State agency executives (including heads of operating and support divisions), external auditors, and IA activity staff. Also reviewed were the IA

activity's risk assessment and audit planning processes, audit tools and methodologies, engagement and staff management processes, and a representative sample of the IA activity's working papers and reports.

OBSERVATIONS AND POSITIVE ATTRIBUTES

The IA activity environment where the review was performed is well-structured and progressive, where the *Standards* are understood and management is endeavoring to provide useful audit tools and implement appropriate practices. Some successful practices observed were:

- The Audit Committee and senior management of OBM have a high level of respect for and confidence in the CAE
- Agency managers view OIA staff as highly professional and qualified
- Thorough staff training with a high degree of OIA staff professional certifications
- Excellent coordination with external auditors and the State CIO
- Well designed QAIP with effectively used performance metrics
- Participation and leadership in professional organizations

Consequently, comments and recommendations are intended to build on this foundation already in place within OIA.

RECOMMENDATIONS

Recommendations are divided into two groups:

- First are those concerning OBM as a whole and suggest actions by senior management. While these matters are outside the scope of the QA, as set out above, they came to attention of the quality assessment team through the work performed. These observations are included because they are viewed as being important for OBM's consideration, affect the governance, risk and control structure of OBM and may impact the effectiveness and value of OIA.
- Second are those that relate to the OIA's structure, staffing, deployment of resources, and similar matters that should be implemented within OIA, with support from senior management.

Highlights of the more significant recommendations are set forth below, with details in the main body of the report.

PART I – MATTERS FOR CONSIDERATION OF OBM MANAGEMENT

1. **Leverage OIA to further add value to State Operations.** Consider continuation on the development of an Enterprise Risk Management system, as well further advocate OIA's value through communications to State agency executive management. Consider periodically including OIA in appropriate senior level meetings, such as cabinet meetings,

to enhance the IA activity's understanding of key matters and better position IA to add value to the organization. (Successful Practice)

2. **Develop internal control standards, policies and procedures** to provide authoritative and consistent guidance to all levels of management within State agencies. (Successful Practice)

PART II – ISSUES SPECIFIC TO THE OFFICE OF INTERNAL AUDIT

1. **Expand and enhance OIA client relationships** by providing information and education to the State Audit Committee and State agency executive management, and increasing participation in inter-agency work groups, particularly those related to Information Technology (IT). (Practice Advisory 1110-1)
2. **Enhance the OIA audit universe and annual planning process** by adding functional elements to the universe, and expanding the number of agency operating managers involved in annual planning. (Practice Advisory 2010-1)
3. **Enhance the content of the OIA annual plan** by adding a summary schedule which discloses direct audit resources committed to each agency, the amount of resources for overhead items such as training and staff leave, and lump sum estimates of resources provided for services related to categories such as management requests and systems development support. (Practice Advisory 2010-1)
4. **Standardize the distribution of OIA engagement reports** in order to ensure that the proper members of agency management, including the head of the agency, are informed on the results of audit engagements. (Practice Advisory 2440-1)
5. **Implement continuous monitoring activities** to increase audit efficiency and effectiveness, and as a means to provide increased service to agency management. (Successful Practice)

Thank you for the opportunity to be of service to OBM. The QA team will be pleased to respond to further questions concerning this report and to furnish any desired information.



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OBSERVATIONS AND RECOMMENDATIONS

PART I – MATTERS FOR CONSIDERATION OF OBM MANAGEMENT

These observations and recommendations originated principally from the comments received from the management survey, interviews with selected executives, and follow-up of these matters. All are of direct importance to enhancing the effectiveness and added value of the IA activity.

1. Leverage OIA to Further Add Value to State Operations

While the surveys completed and the interviews conducted during the assessment indicate the OIA role within State agencies is accepted as important and necessary and is viewed by management of many agencies as being a function external to their operations. As a result, the communications and interaction between OIA and agency management could be enhanced to leverage OIA's ability to add value to State operations.

Recommendation

Consideration by management of OBM to assist OIA in enhancing its relationship with State agency management by acting as an advocate for OIA in seeking the Governor's assistance in setting a strong tone of support for the OIA. Suggestions to consider:

- *OBM management has an opportunity to significantly strengthen the governance and management of State operations by taking the lead in efforts to develop an Enterprise Risk Management (ERM) system. Consider seeking the assistance of OIA in developing and implementing an ERM system.*
- *Providing the executive leadership of each agency with a copy of the OIA annual report, include a letter advocating the services of OIA, and indicate the Governor's support for OIA as an integral part of the management structure of State operations.*
- *Consider inviting the CAE to attend senior level meetings, including cabinet meetings, as appropriate.*
- *Encouraging State agencies to include OIA in the early discussion phase of new or major redesigned computer systems projects.*

Senior Management Response

OBM management will consider these recommendations and take any actions deemed appropriate if the decision is made to adopt any or all these recommendations.

2. Develop internal control standards, policies and procedures

Interviews with representatives of OBM, the Auditor of State, State agency management, and OIA indicate the State of Ohio has not assigned a single governmental unit with the responsibility as an authoritative source for establishing management, financial, and administrative internal control standards, policies, and procedures for state operations. Given the role OBM plays as a coordinating and controlling function within State government operations, OBM is a logical choice to place responsibility for proper internal controls within the government of the State of Ohio.

Recommendation

Develop and issue comprehensive guidance to State agencies in regard to proper internal control standards, policies, and procedures. The management of OBM could consider using existing Federal and state models already implemented.

Senior Management Response

OBM management will consider this recommendation and take any action deemed appropriate if the decision is made to adopt this recommendation.

PART II – ISSUES SPECIFIC TO THE INTERNAL AUDIT ACTIVITY

1. Expand and enhance OIA Client Relationships

Communication links between OIA and agency management could be enhanced as a basis for increasing the OIA ability to add value to State operations. While advocacy and support from OBM management and the Governor are important elements in this effort, OIA should also continue to take actions to further augment these communication links.

Recommendation

The OIA should continue to nurture and expand its client relationships through marketing and education efforts such as:

- *Providing the State Audit Committee with information and education on the internal auditing profession (sources could include IIA Audit Committee brochures available via the IIA web site and the Tone at the Top newsletter);*
- *Assigning IT Audit Chiefs liaison responsibility to attend Multi Agency CIO (MAC) meetings on an ongoing basis; and*
- *Considering further OIA involvement with the nine interagency CIO groups developing implementation plans for the statewide IT transformation with OIT-DAS.*

Internal Audit Response

The CAE will solicit audit committee input on desired education topics and will provide future training and internal audit resource materials. The CAE has contacted the State CIO to have IT audit chiefs attend future MAC meetings. As statewide IT transformation begins the State CIO agreed to include OIA as a member involved on high level transformation efforts.

2. Enhance the OIA Audit Universe and Annual Planning Process

The OIA, within the OBM, was initiated under legislation of the State of Ohio four years ago. Since that time, the CAE of OIA has taken the appropriate steps to develop an IA activity that is consistent with the requirements of the law, and meets the expectations of the State Audit Committee and OBM management. This assessment of OIA indicates conformance to the requirements for developing an annual plan based on risk. However, as the OIA continues to develop and mature in providing services to State of Ohio agencies, the CAE could consider further development of the identification of the audit universe and the process for developing the annual plan.

Recommendation

Consider taking steps to enhance the annual risk assessment and planning process that reflects the maturity in its development. Two objectives which might be considered are:

- *Expanding the audit universe to include auditable entities that reflect more functionality and program orientation.*
- *Involving a wider group of agency operating managers in assessing risk, and identifying the audit universe.*

Internal Audit Response

To enhance the FY14 OIA audit plan, OIA will begin discussions with agency management to also include those with more functional and program orientation responsibilities.

3. Enhance the Content of the OIA Annual Plan

The CAE has developed an annual plan format which adequately provides the State Audit Committee and OBM management with the information necessary to understand and approve the OIA annual plan and resource budget. However, the CAE could consider taking steps to enhance the information provided to the State Audit Committee and OBM management within the content of the annual plan which is presented for approval.

Recommendation

Consider enhancing the content of the information communicated to the Audit Committee and OBM management in the annual plan as follows:

- *Determine specific time estimates for each planned engagement, and present total hours for all engagements by agency in the summary schedule;*
- *Calculate the total hours estimated for all elements of staff leave and disclose it in the summary schedule;*
- *Calculate all other time required in regard to staff overhead, such as training and staff meetings, and disclose the total estimate for overhead in the summary schedule; and*
- *Estimate gross amounts of time that will be needed for unspecified audit activities such as unplanned management requests for consulting services, investigations, and systems development assistance; present the estimates in the summary schedule separately.*

Internal Audit Response

The CAE will discuss information needs for the annual audit plan with the State Audit Committee and OBM management.

4. Standardize the Distribution of IA Engagement Reports

Under current procedures, the OIA issues audit reports to agency management on a basis determined upon the relationship which has been established with each agency. As a result, consistency of the distribution to management responsible for ensuring appropriate action is taken may be lacking. However, reports are public record and available for review.

Recommendation

Consider implementing procedures to standardize the distribution of all audit reports. The distribution should include the agency head and any other senior management with responsibility for the area reviewed. Also, consider taking steps to include agency heads in the remediation tracking process.

Internal Audit Response

Future audit reports and remediation testing results will be distributed to include the agency directors. Audit procedures and checklists will be modified to help ensure consistency.

5. Consider Implementing Continuous Monitoring Activities

Information Technology exists of an IA activity to utilize in implementation of a program of continuous monitoring. The OIA has the necessary resources to implement such a program, and the nature of State of Ohio operations is an environment which can potentially benefit from a continuous monitoring program. At the present time, the OIA has not established such a program.

Recommendation

Consider utilizing audit software and staff expertise to establish a program for continuous monitoring. This program should provide OIA with the capability of achieving various elements of its annual plan. Also, explore providing this capability to agency clients who may find continuous monitoring compatible with their operations.

Internal Audit Response

OIA has begun to use audit software in limited circumstances for continuous monitoring and will continue to seek opportunities for expanded use at agencies.

OBM

		GC	PC	DNC
OVERALL EVALUATION		X		
ATTRIBUTE STANDARDS		X		
1000	Purpose, Authority, and Responsibility	x		
1010	Recognition of the Definition of Internal Auditing	X		
1100	Independence and Objectivity	x		
1110	Organizational Independence	x		
1111	Direct Interaction with the Board	x		
1120	Individual Objectivity	x		
1130	Impairments to Independence or Objectivity	x		
1200	Proficiency and Due Professional Care	x		
1210	Proficiency	x		
1220	Due Professional care	x		
1230	Continuing Professional Development	x		
1300	Quality Assurance and Improvement Program	x		
1310	Requirements of the Quality Assurance and Improvement Program	x		
1311	Internal Assessments	x		
1312	External Assessments	x		
1320	Reporting on the Quality Assurance and Improvement Program	x		
1321	Use of "Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	x		
1322	Disclosure of Nonconformance	x		
PERFORMANCE STANDARDS		X		
2000	Managing the Internal Audit Activity	x		
2010	Planning	x		
2020	Communication and Approval	x		
2030	Resource Management	x		
2040	Policies and Procedures	x		

2050	Coordination	x		
2060	Reporting to Senior Management and the Board	x		
2070	External Service Provider and Organizational Responsibility for Internal Auditing	x		
2100	Nature of Work	x		
2110	Governance	x		
2120	Risk Management	x		
2130	Control	x		
2200	Engagement Planning	x		
2201	Planning Considerations	x		
2210	Engagement Objectives	x		
2220	Engagement Scope	x		
2230	Engagement Resource Allocation	x		
2240	Engagement Work Program	x		
2300	Performing the Engagement	x		
2310	Identifying Information	x		
2320	Analysis and Evaluation	x		
2330	Documenting Information	x		
2340	Engagement Supervision	x		
2400	Communicating Results	x		
2410	Criteria for Communicating	x		
2420	Quality of Communications	x		
2421	Errors and Omissions	x		
2430	Use of "Conducted in conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	x		
2431	Engagement Disclosure of Nonconformance	x		
2440	Disseminating Results	x		
2450	Overall Opinions	x		
2500	Monitoring Progress	x		
2600	Management's Acceptance of Risks	x		
IIA Code of Ethics		X		

Customer Survey Results

Responses	Excellent (4)	Good (3)	Fair (2)	Poor (1)	N/A
OBM	42.3%	42.4%	8.7%	1.3%	5.3%
IIA History	30.5%	44.2%	15.0%	4.0%	6.3%
Variance	+11.8%	-1.8%	-6.3%	-2.7%	-1.0%

<u>Response Rates:</u>	<u>Number</u>		<u>%</u>
Group 1	20	of 45	45
Group 2	13	of 21	62
Total	33	of 66	50

Staff Survey Results

Responses	Excellent (4)	Good (3)	Fair (2)	Poor (1)	N/A
OBM	38.3%	44.7%	10.1%	1.6%	5.3%
IIA History	30.6%	44.2%	15.9%	4.8%	4.5%
Variance	+7.7%	+0.5%	-5.8%	-3.2%	+0.8%

Response Rates:

	<u>Number</u>	<u>%</u>
Group 1	8 of 8	100
Group 2	15 of 15	100
Total	23 of 23	100