REPORT OF THE
SECRETARY OF FINANCE

# Special Report
# On The Duties And
# Responsibilities Of The
# Department Of The
# State Internal Auditor

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

# HOUSE DOCUMENT NO. 29

COMMONWEALTH OF VIRGINIA
RICHMOND
1990

Special Report
on the Duties and Responsibilities
of the Department of the
State Internal Auditor

Prepared by the
Secretary of Finance

November 21, 1989

# COMMONWEALTH of VIRGINIA

*Office of the Governor*

*Richmond 23219*

Stuart W. Connock
Secretary of Finance

November 21, 1989

TO:      The Honorable Gerald L. Baliles
         Governor of the Commonwealth of Virginia

              and

         The General Assembly of Virginia


    I am pleased to transmit to you this report relative to my review of the duties and responsibilities of the Department of the State Internal Auditor. This report has been prepared in accordance with the provisions of Code §2.1-234.34.


        Respectfully submitted,

        Stuart W. Connock

# EXECUTIVE SUMMARY

# EXECUTIVE SUMMARY

The Department of the State Internal Auditor (DSIA) was created by statute on July 1, 1985.  Prior to July 1, 1985, the function existed as a separate program within the Department of Accounts. The program was established because there were significant shortcomings reported in the State's overall internal auditing program.  Two previous studies of the program were conducted by the Department of Management Analysis and Systems Development in 1979 and the Department of Information Technology in 1985.

The statutory mandate to DSIA was ". . . to provide for the development and maintenance of internal audit programs in state agencies in order to ensure that the Commonwealth's assets are subject to appropriate internal management controls."  In connection with its overall mission, certain duties were delineated through the Code.  These duties were:

"1.  To establish state policies, standards, and procedures which will ensure an effective internal audit program in all state agencies;

2.  To provide technical information to state agencies concerning trends and new techniques in internal auditing;

3.  To develop evaluative tools and other modern methods to assist agency internal auditors in performing audits;

4.  To assist state agencies in developing and implement-ing automated data processing internal audit programs in the Commonwealth;

5.  To provide general technical and audit assistance to agency internal auditors and to the Auditor of Public Accounts and the Governor on request;

6.  To assist agency heads and collegial bodies in establishing and operating internal audit organizations;

7.  To assist in the professional development of agency internal auditors by developing and conducting training programs;

8.  To examine the adequacy of agency internal audit programs through periodic assessments of such programs and provide Governor's Secretaries and agency heads with the results of such assessments;

9. To develop, in conjunction with the State Comptroller, the Auditor of Public Accounts, the Joint Legislative Audit and Review Commission, and other appropriate state officials, a plan for accommodating the internal audit needs of agencies that do not require full-time internal auditors; and

10. To prepare a biennial report for the Governor, Governor's Secretaries, Auditor of Public Accounts, and appropriate agency heads on the status of agency internal audit programs generally, and on agency adherence to other legislative requirements on internal auditing."

In addition to describing the Department's specific duties, the Code also required that the Secretary of Finance review the DSIA functions ". . . to determine if the duties of the Department should be restructured or eliminated." While the review was initially established to occur five years from the effective date of the statute or in the summer of 1990, because the Department prepares biennial reports to the Governor relative to the status of the State's internal auditing program, it was deemed more appropriate and efficient to conform the date of the accompanying report with the second biennial report to the Governor.

The accompanying report has been formatted to analyze and evaluate each of the ten specific duties highlighted above by applying the following criteria and questions:

Need--Why was the duty initially established?

Accomplishment--What has DSIA done to fulfill the duty?

Relevancy--Is this duty still relevant? Why?

The results of the current review indicate that all of the existing duties of DSIA remain relevant and appropriate. In addition, the results reflect the excellent professional leadership and direction DSIA has provided to the State's administrators, national and local auditing organizations and State agency internal auditors. The results also show that Virginia's internal auditing program is nationally recognized as one of six states which have adopted the Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing.

Based on this review and the State Internal Auditor's June 30, 1989 Biennial Report to the Governor of Virginia, it became apparent that additional requirements were needed to strengthen

accountability and overall effectiveness of the State's internal auditing program. The following additional require- ments are therefore recommended:

- That the Governor, the State Comptroller and the Director of the Department of Planning and Budget receive copies of DSIA's external review reports in addition to State agency heads and Cabinet Secretaries who already receive the reports. Code Section 2.1-234.32.8 must be amended to implement this recommendation.

- That this expanded reporting structure require DSIA to develop a process to report periodically to the Governor unresolved weaknesses in agency internal auditing programs. Through such a process, the Governor will have the opportunity to address significant agency internal auditing issues in a timely and decisive manner.

The two expanded responsibilities of DSIA will promote opportunities for increased accountability of agency internal auditing programs at a time when effective management controls of complex technological systems and procedures will be necessary to meet the challenges of the 1990's and on into the 21st Century.

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# INTRODUCTION AND PURPOSE

The intent of this report is to review the duties of the Department of the State Internal Auditor (DSIA) as enacted in Code Sections 2.1-234.32.1 through 2.1-234.32.10 (Appendix A). As described in Code Section 2.1-234.29, the DSIA was:

> ". . . established to provide for the development and maintenance of internal audit programs in state agencies in order to ensure that the Commonwealth's assets are subject to appropriate internal management controls. Appropriate internal management controls assist in safe-guarding assets, ensuring accurate accounting and reporting of financial transactions, and in providing effective and efficient management."

The review of the duties of DSIA by the Secretary of Finance is mandated by Section 2.1-234.34 of the Code. The general purpose of the review will be to determine whether ". . . the duties of the Department [DSIA] should be restructured or eliminated." The period covered by this report is from July 1, 1985 through June 30, 1989.

To evaluate the appropriateness or need for each of the existing duties of DSIA, as outlined in Code Section 2.1-234.32 et al., each duty will be analyzed and evaluated by applying the following questions:

Need--Why was the duty initially established?

Accomplishment--What has DSIA done to fulfill the duty?

Relevancy--Is this duty still relevant? Why?

As a part of addressing these three questions, references will be drawn to DSIA's most recent Biennial Report to the Governor of Virginia (Appendix B).

The duties described in the Code that will be evaluated are as follows:

1.  To establish state policies, standards, and procedures which will ensure an effective internal audit program in all state agencies;

2.  To provide technical information to state agencies concerning trends and new techniques in internal auditing;
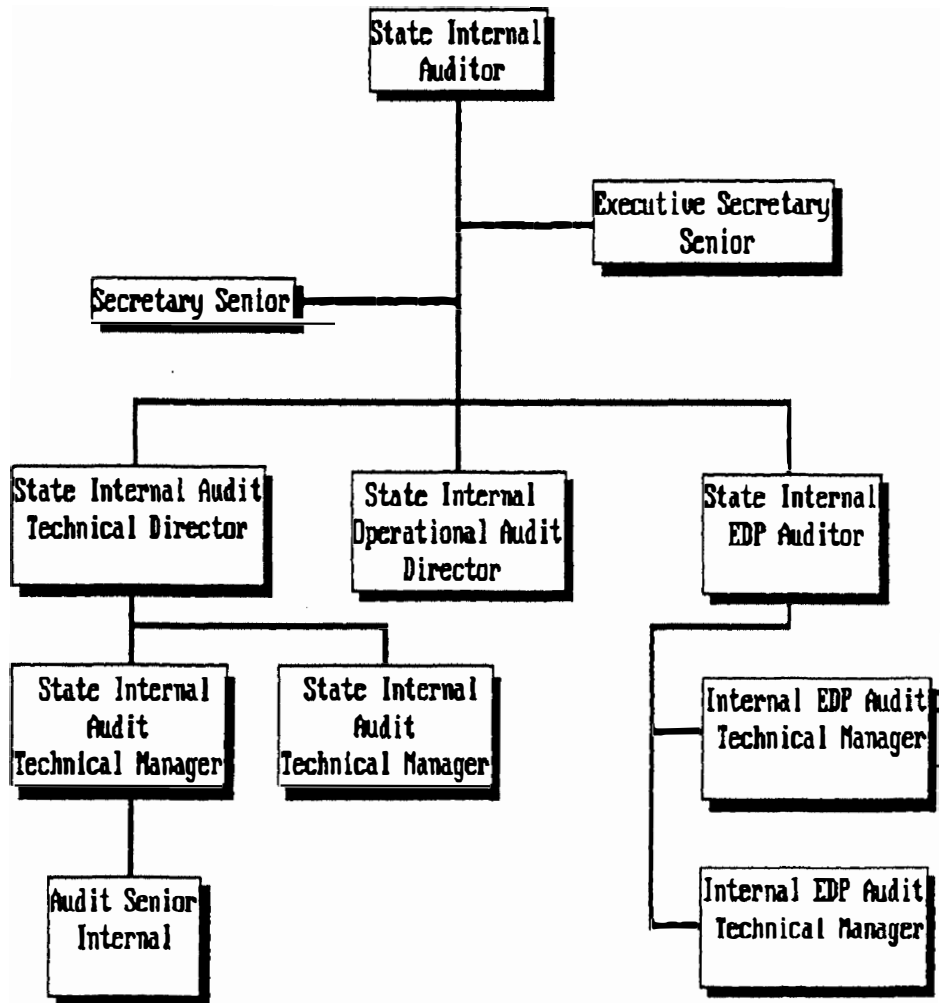
# INTRODUCTION AND PURPOSE

3. To develop evaluative tools and other modern methods to assist agency internal auditors in performing audits;

4. To assist state agencies in developing and implementing automated data processing internal audit programs in the Commonwealth;

5. To provide general technical and audit assistance to agency internal auditors and to the Auditor of Public Accounts and the Governor on request;

6. To assist agency heads and collegial bodies in establishing and operating internal audit organizations;

7. To assist in the professional development of agency internal auditors by developing and conducting training programs;

8. To examine the adequacy of agency internal audit programs through periodic assessments of such programs and provide Governor's Secretaries and agency heads with the results of such assessments;

9. To develop, in conjunction with the State Comptroller, the Auditor of Public Accounts, the Joint Legislative Audit and Review Commission, and other appropriate state officials, a plan for accommodating the internal audit needs of agencies that do not require full-time internal auditors; and

10. To prepare a biennial report for the Governor, Governor's Secretaries, Auditor of Public Accounts, and appropriate agency heads on the status of agency internal audit programs generally, and on agency adherence to other legislative requirements on internal auditing.

After the discussion and analysis of the individual duties, specific recommendations are included with regard to how the existing duties should be altered.

# BACKGROUND

The DSIA was established as a separate entity on July 1, 1985.
In accordance with <u>Code</u> Section 2.1-234.29, the DSIA is under
the direction of the Secretary of Finance.  To carry out DSIA's
mission, DSIA is staffed with nine professional and two
administrative support positions.

## DSIA Organizational Chart
## June 30, 1989

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                        ┌──────────────┐
                        │State Internal│
                        │   Auditor    │
                        └──────┬───────┘
                               │        ┌──────────────────┐
                               ├────────│Executive Secretary│
                               │        │      Senior       │
                               │        └──────────────────┘
           ┌──────────────┐    │
           │Secretary Senior├───┤
           └──────────────┘    │
         ┌─────────────────────┼─────────────────────┐
┌────────────────┐  ┌────────────────┐  ┌────────────────┐
│State Internal Audit│  │State Internal  │  │State Internal  │
│Technical Director  │  │Operational Audit│  │EDP Auditor     │
└────────┬───────────┘  │   Director      │  └────────┬───────┘
         │              └────────────────┘           │
    ┌────┴─────────────────┐                         │
┌──────────┐    ┌──────────┐          ┌───────────────────┐
│State Internal│ │State Internal│      │Internal EDP Audit │
│   Audit      │ │   Audit      │      │Technical Manager  │
│Technical Manager││Technical Manager│  └───────────────────┘
└──────┬───────┘ └──────────┘
       │                               ┌───────────────────┐
┌──────────┐                           │Internal EDP Audit │
│Audit Senior│                         │Technical Manager  │
│ Internal   │                         └───────────────────┘
└──────────┘
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## BACKGROUND

Prior to July 1, 1985, DSIA functioned as a program within the Department of Accounts. At that time DSIA was called the Office of the State Internal Auditor (OSIA). The director of the program, the State Internal Auditor, reported dually to the Secretary of Finance and the State Comptroller.

The OSIA's creation was prompted by a 1979 study titled Assessment of State Internal Audit Capabilities (1979 Study) conducted by the Management Consulting Division of the Department of Management Analysis and Systems Development (MASD). To summarize, the status of internal auditing in Virginia in 1979 was described by MASD as follows.

> "Internal audit functions in the executive branch of Virginia's State government deserve a significant increase in attention, support, and commitment from their respective organizations as well as central management. With few exceptions, the functions are neither staffed, structured, or conceptually understood well enough to become a vital part of the management control processes. A single top-level executive branch focal point does not now exist to assure consistent application and administration of the functions among the executive branch organizations."

Other problems cited in the 1979 Study included:

--underpaid and poorly qualified internal auditors;

--performance of a considerable number of external audits or general fiscal tasks by auditors, rather than internal audits;

--audit units reporting below the top levels of management, thereby limiting independence and authority; and

--a general lack of conformity with sound management practices and national auditing standards.

As a part of the Department of Information Technology's (DIT) March 25, 1985 Assessment of the Office of the State Internal Auditor and the Statewide Internal Audit Program (the 1985 Study), DIT recommended OSIA be established as an independent agency by legislation and report singularly to the Secretary of Finance. As a result, DSIA became a separate Department on July 1, 1985.

## BACKGROUND

In the 1985 Study, DIT recognized that considerable improvement
in the statewide internal auditing program had taken place
since 1979 and acknowledged that continued development was
needed if agency internal auditing programs were to more closely
adhere to national auditing standards.  Recommendations from
the 1985 study served as the basis for the duties established
for DSIA in July, 1985--Code Sections 2.1-234.29 et al.

## ANALYSIS AND EVALUATION OF DSIA'S DUTIES


**To Establish State Policies, Standards, and
Procedures Which Will Ensure an Effective
Internal Audit Program in All State Agencies**


### Need

In the 1979 Study, MASD recognized that agency internal auditing
functions were lacking direction, uncoordinated, and not likely
to have uniform standards. MASD summarized that "the absence
of State guidance may have contributed to weaknesses in the
performance of the functions, either to the extent that some
failed, or that some lost their effectiveness and disenchanted
the organization head."

The Institute of Internal Auditors (IIA), the professional body
responsible for promulgating standards for internal auditors,
advocates the Commonwealth's need for guidance in establishing
policies, standards, and procedures in its Code of Ethics and
Standards for the Professional Practice of Internal Auditing
(Standards). The IIA's Code of Ethics states, "members . . .
shall adopt suitable means to comply with the Standards." In
addition, the Standards require that written policies and
procedures be in place through its specific Standard No. 530.


### Accomplishments

On October 7, 1985 DSIA issued its first Directive, No. 1-85
(Appendix C), to heads of all State agencies and institutions
(herein agencies or agency) requiring the adoption and adherence
to the IIA's Standards. As a part of adopting the Standards,
agencies were directed to implement policies and procedures
that would allow them to conform to the requirements of the
Standards. To aid agencies in this endeavor, DSIA developed a
generic Internal Audit Policies and Procedures Manual (the
Manual).

The DSIA issued the Manual to all State agency internal
auditing programs on September 16, 1985. The Manual includes
23 sections which address all of the IIA's Standards. State
agency internal auditing programs have used the Manual as the
basis to comply with the policies and procedures requirements
of DSIA's Directive No. 1-85. The Manual is continually
updated by DSIA to reflect changes in auditing standards that
are promulgated by the IIA.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

In addition to the direct policy role DSIA has with agency internal auditing programs, DSIA also issues guidance to agency heads as changes in auditing standards affect them.  For example, DSIA issued a policy for investigating irregularities in July, 1988 to ensure that agency procedures, as well as internal auditing procedures, met the requirements of the IIA's Statement on Internal Auditing Standards No. 3--Deterrence, Detection, Investigation, and Reporting on Fraud.

According to information recently published by the IIA, Virginia is one of only six states to have adopted the IIA's Standards. The other five states which have adopted the IIA's Standards are California, Florida, Louisiana, Michigan and Tennessee.

## Relevancy

As the IIA adds to and modifies the Standards, the State's internal auditing programs must adopt these updates to be in compliance with the Standards.  Past experience indicates when left alone, without a central focal point, agencies have shown a general lack of conformity in adopting national auditing standards.  Therefore, a central focal point must continue to exist to take the leadership role and establish standards, policies and procedures for State agency internal auditing programs in order to ensure uniform, effective and timely compliance with these standards.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

### To Provide Technical Information to State Agencies Concerning Trends and New Techniques in Internal Auditing

## Need

In order to ensure that internal auditors are effective and efficient in the discharge of their responsibilities, internal auditors must be aware of and use generally accepted auditing techniques. As stated in the IIA's Standard No. 220.01, regardless of the size of internal auditing programs, all are expected to maintain proficiency in applying internal auditing standards, procedures and techniques. With the proliferation of technical requirements in the field of internal auditing, it is difficult for individual internal auditing programs to stay abreast of relevant technical information and trends in a cost-effective manner.

## Accomplishments

The DSIA disseminates technical information in many ways to agency auditors. It is a continuing process and is done in conjunction with other facets of DSIA's responsibilities. For example, DSIA's training programs include up-to-date internal auditing technical data and trends. Ways DSIA fulfills this responsibility include:

- The DSIA publishes a quarterly newsletter that includes topics relevant to professional updates, publications of interest, technical developments and auditing practice issues. The publication, titled _Navigator_, has been issued since April, 1986 to all of the State's internal auditors;

- The DSIA disseminates central State agency directives as they are issued and includes guidance to internal auditors relative to how they affect individual agency internal auditing plans;

- The DSIA hosts at least one annual internal audit directors and managers round table meeting to allow for the exchange of ideas relative to key operational, administrative and technical issues confronting Virginia's internal auditing community;

## ANALYSIS AND EVALUATION OF DSIA'S DUTIES

- The DSIA formed the Commonwealth of Virginia EDP Auditors' Group which meets quarterly. This group discusses and reviews technical information and trends related to:

    •• computer-assisted auditing techniques,

    •• data processing environments, and

    •• computer hardware and software;

- The DSIA maintains a technical reference library as a source of information for current trends and techniques for use by all the State's internal auditors; and

- The DSIA conducts at least one annual meeting with State internal audit directors to discuss and review current technical information from professional auditing groups such as:

    •• The IIA,

    •• The American Institute of Certified Public Accountants,

    •• The Comptroller General's Office of the United States,

    •• The National Association of State Auditors, Comptrollers and Treasurers, and

    •• The EDP Auditors Association.

In connection with its responsibility to provide technical leadership to the State's internal auditors, several members of DSIA hold prominent positions within national and local professional organizations which enable DSIA to be in the forefront of emerging technical developments relevant to internal auditing. Examples include:

- Co-authorship positions relative to the IIA's technical manuals titled: Systems Development Audit Review Guide; Management and Control of End-User Computing; and the Quality Assurance--Review Manual for Internal Audit; and

- Advisory Board position to Internal Auditing, a quarterly Warren, Gorham & Lamont, Inc. publication.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

## Relevancy

With the proliferation of standards in today's auditing
environment, it is very difficult for individual internal
auditing programs to keep abreast of evolving technical
information and trends.  In addition, methods to implement new
techniques and trends also present application difficulties to
individual internal auditing programs.

Through a more focused effort, such as central interpretation
and analysis, individual internal auditing programs receive
only the technical information they may need.  Thus, effec-
tiveness is accentuated.

Likewise, the cost to perform such interpretation and analysis
is decreased as these tasks are performed by one central group,
contrasted to the many internal auditing programs that exist in
the Commonwealth.  Consequently, redundancy and effort are
minimized.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

**To Develop Evaluative Tools and Other Modern
Methods to Assist Agency Internal Auditors in
Performing Audits**

## Need

This responsibility, like DSIA's duty to provide technical
information, resulted from the requirement that internal
auditors conform to generally accepted auditing standards.
Prior to OSIA's inception, internal auditors approached audit
issues independently without sufficient tools or advice to
guide them in the conduct of their audits.  Thus, audits were
not comprehensive, lacked critical focus and resulted in the
development of fragmented methods and tools not transferable
within the audit community.  In addition, any transferable
methods or tools that were available were not shared among the
State's internal auditing units.

## Accomplishments

Prior to 1985, OSIA disseminated certain evaluative tools to
the State's internal auditing programs.  These initial tools
were primarily internal control questionnaires encompassing
revenues, expenditures, general ledger controls and data
processing.

In the last four years, DSIA has developed the following
evaluative tools and methods to assist agency internal auditing
programs in the performance of their audit work.

- A Risk Assessment Model, which is a fully automated
  application written in a readily available personal
  computer software package, Lotus 1-2-3.  It provides a
  structured method to develop agency specific audit work
  schedules by taking into account:  (a) what activities are
  to be audited, (b) when they will be audited, and (c) the
  estimated time required to perform each audit, given the
  scope of the audit work planned and the nature and extent
  of audit work performed by others.  In addition, the model
  is used to fulfill IIA's Standard No. 520.04 regarding
  planning.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

- Two computer-assisted audit tools to aid and facilitate agency audits of the Commonwealth's centralized systems. These systems are:

  - Commonwealth Integrated Payroll/Personnel System, and

  - Commonwealth Accounting and Reporting System.

- Four specific guides to aid the State's internal auditing programs in the performance of their audit work. The guides are:

  - <u>Systems Development Audit Review Guide,</u>

  - <u>Management and Control of End-User Computing,</u>

  - <u>Quality Assurance--Review Manual for Internal Audit,</u> and

  - <u>Guidelines for Developing Personal-Computing (PC) Policies.</u>

- Internal control questionnaires and audit programs relative to data center controls, application controls and system security for specific data processing environments;

- Partitioned data set (PDS) files, maintained on an on-line system for access by State internal auditing programs, which contain various audit programs and audit tools that can be shared;

- A procurement audit program that delineates the audit steps necessary to evaluate the procedures and practices of agency purchasing functions and to evaluate their compliance to State purchasing policies, procedures and guidelines; and

- A time management and reporting system to aid the State's internal auditing programs in accounting for their audit effort, comparing budgeted and actual hours, and using historic audit effort in predicting future resource deployment.

DSIA continues to develop and update tools that will assist agency internal auditors in performing audits. Items currently being developed include:

- Generic accounts receivable, payroll and personnel audit programs;

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

- An Operational Audit Manual which aids in auditing entities for effectiveness, efficiency and economical use of resources; and

- Additional evaluative tools relative to data processing which reflect changes in technology. One example is the use of a data retrieval language, Easytrieve Plus, for personal computers. Previously, this widely used language was only available on large mainframe computers.

The vast majority of the evaluative tools and methods described above are supported and reinforced through several of DSIA's training courses. Examples of this training includes:

--Auditing the Systems Development Life Cycle;

--Evaluating Internal Controls;

--Virginia Procurement Laws and Regulations;

--Commonwealth's Central Financial Systems;

--Microcomputer Utilization, Applications, and Controls;

--Quality Assurance--Internal Review;

--Easytrieve Plus; and

--Identifying and Evaluating Audit Risks.

## Relevancy

As the Commonwealth's agencies continue to expand their automated and service delivery systems, the State's internal auditing community must rely more heavily on the development of modern techniques and corresponding audit applications to fulfill their obligations to the Commonwealth. To support the Commonwealth's system evolvement and the internal auditing programs' obligations to audit these systems, some central focal point must exercise technical leadership. A central focal point can facilitate this technical leadership by developing internal audit applications that are relevant to all State agencies, as well as providing the State's internal auditing programs with access to leading edge techniques and tools to assist them in performing audits.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

### To Assist State Agencies in Developing and
### Implementing Automated Data Processing
### Internal Audit Programs in the Commonwealth

## Need

During the early 1980's the Commonwealth began to accelerate
its efforts to take advantage of developments in information
technology.  Increasingly, State transactions were handled and
controlled by computers, and State agencies became highly
dependent on their automated systems.  In order to ensure these
systems operated effectively and efficiently, State agency
heads needed assurances from their internal auditors about the
reliability and integrity of information and the adequacy of
internal controls included in their systems.  They also needed
to know whether these systems were cost beneficial.

The IIA also recognized EDP as a discipline needed to support
effective internal auditing.  In its Standard No. 220.02, the
IIA states that internal auditing departments should have
employees qualified in disciplines such as electronic data
processing.

## Accomplishments

DSIA has worked with boards of visitors, agency heads and
internal audit directors to develop and implement automated
data processing internal auditing programs.  As a result, since
DSIA's inception, 20 internal auditing programs have developed
separate EDP auditing activities.  Prior to DSIA's inception,
only four such functions existed.  In addition, DSIA's most
recent Biennial Report to the Governor of Virginia (Appendix B,
page 12) indicates that 31 of 37 (83.8%) of the State's internal
auditing units surveyed had utilized data processing auditing
techniques during the biennium.  This was 20.2% more than in
the previous biennium--July 1, 1985 through June 30, 1987.

## Relevancy

The need to develop comprehensive EDP internal auditing
capabilities in the Commonwealth has never been greater.
Central information systems are now almost totally automated.
Individual agencies are linked electronically to the central

agencies and systems and must have the capabilities to audit their information which is processed by these central systems. They must also be able to audit the accuracy and completeness of the information processed by the local systems which drive and support agency operations.

Because of the high degree of reliance placed on both central and decentralized automated systems, agencies must be able to audit these systems. As a result, there is the need not only to continue development of EDP auditing programs in agencies where they do not currently exist, but also to technically support existing EDP internal auditing programs. With the diversity of automated systems in place, it is critical that there be a central focal point to provide direction and expertise on the appropriate use of EDP audit tools and techniques. The need for a central focal point relative to EDP internal auditing parallels the organizational concept recently implemented among State agencies vis-a-vis the Council on Information Management, i.e., one central focal point providing coordination, support and guidance relating to information technology.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

## To Provide General Technical and Audit Assistance to Agency Internal Auditors and to the Auditor of Public Accounts and the Governor on Request

### Need

This responsibility was originally developed to compensate for the lack of needed specialty skills in individual internal auditing programs and to serve in an advisory capacity for complex or unique audits conducted by agency internal auditors. In addition, Executive Branch expertise relative to internal auditing was needed to address special areas or situations that the Governor, the Governor's Cabinet, the Auditor of Public Accounts or other State officials deemed necessary.

### Accomplishments

DSIA, in its role as the technical focal point for internal auditing in the Commonwealth, provides continuous guidance and assistance to all levels of government. Since its inception, DSIA has conducted examinations or special assignments at the request of the Governor, the Governor's Cabinet, the Auditor of Public Accounts or other State officials for the following agencies:

- Department of Accounts
- Department for the Aging
- Office of the Attorney General
- Department of Correctional Education
- Frontier Culture Museum of Virginia
- Department of General Services
- Department of Information Technology
- Department of Mental Health, Mental Retardation and Substance Abuse Services
- Department of Personnel and Training
- Department of Planning and Budget
- Department of Rehabilitative Services
- Department of Social Services
- Department of the Treasury
- Virginia Commonwealth University
- Virginia Racing Commission

In many cases, multiple projects have been conducted for these agencies during the period.

## ANALYSIS AND EVALUATION OF DSIA'S DUTIES

In addition to serving these agencies, DSIA was actively
involved in the start-up of the State Lottery Department.
Also, the State Internal Auditor served as a member of the
Governor's Commission on Efficiency in Government.  Other
members of DSIA served in staff positions to the Commission.

The DSIA has also provided special technical and audit
assistance to 24 agency internal auditing programs, repre-
senting 43 individual projects, since its inception.  The
primary focus of DSIA's assistance to agency internal auditing
programs has primarily involved the EDP and operational
auditing disciplines.

As in the private sector, DSIA works with the Commonwealth's
external auditor, the Auditor of Public Accounts, to achieve
maximum audit coverage and efficiency in the Commonwealth.
These actions coincide with the IIA's Standard No. 550 relative
to coordinating internal and external audit efforts.


Relevancy

As indicated by the number and types of projects requested by
the Governor, the Governor's Cabinet and other State officials
for the period, there has been a demonstrated need for services
and internal auditing capabilities not currently available from
other agencies in the Commonwealth.  Access to comprehensive
and responsive internal auditing services must be available in
the Executive Branch of Government in Virginia, if the Governor,
the Governor's Cabinet and other State officials are to ensure
issues are addressed decisively and in the most cost efficient
and effective manner.

From the standpoint of providing general technical and audit
assistance to agency internal auditors, the proliferation of
standards and the resultant increase in requirements of the
State's internal auditing programs have reinforced the need for
central direction and assistance.  Without the availability of
professional assistance, many individual internal auditing
programs in the Commonwealth would be hard pressed to meet the
requirements of the IIA's Standards, particularly in the data
processing and operational auditing areas.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES


### To Assist Agency Heads and Collegial Bodies in Establishing and Operating Internal Audit Organizations


## Need

This responsibility emerged from the 1979 Study which concluded that State internal auditing programs needed to be expanded if the State's expenditures, revenues and assets were to be properly controlled and safeguarded. The 1979 Study went on to state that "With few exceptions, the functions are neither staffed, structured, or conceptually understood well enough to be a vital part of the management control processes."

In order to assist agency heads and collegial bodies in their responsibilities relative to effectively implementing sound internal auditing programs, first OSIA and now DSIA assists them in organizing and operating their internal auditing programs. As a part of the 1985 Study, DIT noted progress in that "over 60% of all Executive Branch expenditures are potentially reviewed by the State's internal auditors . . . ." This coverage was provided through 20 individual internal auditing programs at the time.


## Accomplishments

Since the 1985 Study, internal auditing coverage, when measured in terms of State appropriations, has increased to 95.2%--refer to Table II, page 3, Appendix B. Today, the State's internal auditing program is comprised of the DSIA and 39 individual agency units in the Executive Branch of government--refer to Table I, page 2, Appendix B. These 40 units serve 49 different Executive Branch agencies. In addition to the support provided Executive Branch agencies, DSIA also provides assistance to one independent agency, the State Lottery Department, one unit in the Judicial Branch, the Supreme Court of Virginia, and the Virginia Credit Union.

As a part of developing and organizing the 39 individual internal auditing programs, DSIA worked very closely with agency heads and collegial bodies to ensure that the programs were organized properly. In nearly all cases, before internal auditing programs were set up, studies were conducted by DSIA to determine whether a viable need existed for an internal auditing program. Among the elements DSIA considered in the studies were: appropriations; number of employees; revenues

received; liquidity of assets; statewide accounting and processing responsibilities; number of subprograms; and location and number of operating components.

After internal auditing programs were established, DSIA worked with agency heads and collegial bodies to ensure that programs were staffed with qualified individuals. As a measure of the quality of individuals currently serving the State in internal auditing positions, 92 (60.1%) individuals possess at least one professional certification--refer to Table VI, page 13, Appendix B. This compares to 33 individuals possessing professional certifications as noted in DIT's 1985 Study.

In conjunction with working closely with agency heads and collegial bodies, DSIA meets periodically with them to provide updates relative to the status and effectiveness of their respective internal auditing programs. This is accomplished primarily through DSIA's external review program, although efforts are made to meet more frequently.


Relevancy

The continued need to support existing internal auditing programs will be necessary to ensure that programs remain staffed and organized along the lines recommended by DSIA and the IIA. To accomplish this, continued involvement with agency heads and collegial bodies will be necessary.

Previous experience has shown, without a central focal point, internal auditing resources have been misapplied. The correct use of agency internal auditing programs needs to be continually reinforced to ensure that relapses do not occur. It is important that agency internal auditing programs continue their positive development in order to ensure that the State's expenditures, revenues and assets are properly controlled and safeguarded.

While the existing coverage rate for State appropriations of 95.2% is good, there remain agencies who have not yet established internal auditing programs. These agencies need to work with DSIA to determine whether there exists a need for establishing separate internal auditing programs.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

### To Assist in the Professional Development of Agency Internal Auditors by Developing and Conducting Training Programs

## Need

This responsibility originated from a recommendation in the 1979 Study. In the 1979 Study, it was recommended that "Extensive training for internal auditors in automated data processing and the elements of comprehensive audits is needed." This recommendation resulted directly from observations of the study team in 1979 regarding the lack of comprehensive auditing in the Commonwealth.

The 1979 Study recommendation did not specifically focus on continuing professional education requirements set forth by professional auditing standard setting bodies. These bodies mandate internal auditors to receive a certain amount of professional education each year to maintain certification. To illustrate, the IIA, through its Standard No. 270 relative to Continuing Education, mandates that "Internal auditors should maintain their technical competence through continuing education." Currently, the IIA requires that a minimum of 100 hours of professional training be received every three years.

The point to be derived from both the 1979 Study recommendation and the IIA's continuing education requirement is that internal auditors in the Commonwealth need a certain amount of training each year to maintain their certification status. In addition, the training should be at a level to ensure that they have the knowledge and skills necessary to conduct comprehensive audits of their agencies in an effective and efficient manner.

## Accomplishments

The DSIA, in support of professional education requirements and the 1979 Study recommendation, has developed a training curriculum designed to accommodate the needs of the State's internal auditors. While meeting professional education requirements, the training also is designed and developed to provide the knowledge and skills necessary to conduct comprehensive audits.

The training courses are initiated and developed based on DSIA's interaction with the State's internal audit directors, issues raised as a result of DSIA's periodic reviews of internal auditing programs and DSIA's role as it relates to representing the Commonwealth in professional organizations.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

DSIA's current curriculum (Appendix D) includes 24 separate course offerings. These course offerings are aimed at all internal auditing disciplines necessary to conduct comprehensive audits--a description of the courses is included in Appendix E.

During the period, DSIA has provided approximately 6,000 annual participant hours of training or an average of more than 40 hours per auditor. This level of training exceeds the IIA's minimum required level of 100 hours every three years.

In addition to the 24 training courses included in Appendices D and E, DSIA offers four additional courses every other year to the State's internal auditors. These are:

- Statistical Sampling

- Operational Auditing

- Advanced Easytrieve Plus, and

- Auditing Data Center Controls.

To complement DSIA's structured training base, elements of education are also included as a part of DSIA's annual State Internal Audit Directors' Meeting and the quarterly meetings of the Commonwealth of Virginia's EDP Auditors' Group.

## Relevancy

Because of the number of State internal auditors, there is a need for the Commonwealth to provide centralized audit training in order to control costs. The State's internal auditors need to maintain their professional certifications vis-a-vis meeting the continuing education requirements established by professional auditing standard setting bodies. In addition, it is important that the training be focused toward the needs of the Commonwealth's internal auditors. While many outside firms provide training, their training is more generalized and does not incorporate factors unique to internal auditing in the Commonwealth.

Future internal auditor training, as it is developed, should continue the focus toward comprehensive auditing. Also, the primary goal of future training should be to keep the State's internal auditors informed about improvements and current developments in internal auditing standards, procedures and techniques without losing the existing applicability to Virginia's auditing environment.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES


**To Examine the Adequacy of Agency Internal
Audit Programs through Periodic Assessments
of Such Programs and Provide Governor's
Secretaries and Agency Heads with the Results
of Such Assessments**


## Need

This duty was primarily established as a result of the IIA's
Standard on Quality Assurance, No. 560.04.  The Standard
states, "External reviews of the internal auditing department
should be performed to appraise the quality of the department's
operations."  In addition, the IIA recommends that these
reviews be conducted at least once every three years and that a
formal, written report be issued.  "The report should express
an opinion as to the department's compliance with the <u>Standards
for the Professional Practice of Internal Auditing</u> and, as
appropriate, should include recommendations for improvement."
In connection with these reviews, DSIA assesses the quality of
independence, professional proficiency, scope of work, perform-
ance of audit work and management of the internal auditing
program.

In addition to the requirements set forth by the IIA, it is
important that the Governor's Secretaries and State agency
heads have an outside agency's opinion about how effective and
efficiently their programs operate.  Unlike other functions
within State agencies, internal auditing programs are
comparatively independent, reporting directly to the agency
head or collegial body, as appropriate.  Since the Governor's
Secretaries, agency heads and collegial bodies are held
accountable for the adequacy and effectiveness of their
organizations' systems of internal control and quality of
performance, it is important their internal auditing programs
utilize effective methods and practices to assess and report
upon the status of agency operations.


## Accomplishments

The DSIA follows the guidelines published by the IIA with
regard to conducting external reviews.  To the extent prac-
ticable, these reviews of individual agency internal auditing
programs are conducted within the IIA's three-year timeframe.
In some cases, because of the results of a previous review,
DSIA may deem it necessary to conduct more frequent reviews.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

The DSIA also conducts follow-up reviews in certain cases to determine that agency internal auditing programs have properly implemented DSIA's previous external review recommendations. The results of DSIA's external and follow-up reviews are all formally sent to the applicable Governor's Secretary, the agency head and the collegial body where they exist.

During the period, DSIA conducted 52 reviews of 32 different agencies.

In addition to conducting these external reviews in the Commonwealth, DSIA's expertise in this discipline has also been recognized internationally by the IIA.  In this connection, the State Internal Auditor serves on the IIA's International Quality Assurance Committee.  During the most recent fiscal year, DSIA was instrumental in the revision of the IIA's Quality Assurance--Review Manual for Internal Auditing.

## Relevancy

The Commonwealth has made a significant commitment to internal auditing in order to ensure that the Commonwealth's revenues, expenditures and assets are appropriately controlled and safe-guarded.  As such, the Governor's Secretaries, agency heads and collegial bodies need periodic input from outside professionals regarding the performance of the independent mechanism they have established to monitor agency activities.

In addition, the IIA, through its Standard No. 560.04, recommends that periodic reviews be conducted to appraise the quality of internal auditing programs' operations.  This latter professional requirement, coupled with the Governor's Secretaries', agency heads' and collegial bodies' interest in maintaining sound agency financial systems and operations, will necessitate the continuance of these external reviews by a central, outside entity if the Commonwealth's internal auditing program is to be effective and meet professional standards.

## ANALYSIS AND EVALUATION OF DSIA'S DUTIES

> To Develop, in Conjunction with the State
> Comptroller, the Auditor of Public Accounts,
> the Joint Legislative Audit and Review
> Commission, and Other Appropriate State
> Officials, a Plan for Accommodating the
> Internal Audit Needs of Agencies that Do Not
> Require Full-Time Internal Auditors

### Need

This responsibility resulted from an issue raised by DIT in the
1985 Study.  The DIT indicated that while the audit needs of
larger State agencies were being addressed, there had been no
consensus reached with respect to smaller agencies' audit
needs.  Typically, smaller agencies have more difficulty main-
taining sufficient controls and systems because it is more
difficult to segregate duties properly among small staffs.  In
addition, these agencies generally find it more difficult to
attract high level technical expertise because of restrictions
on employment classes.  However, these agencies are held to the
same standards as larger agencies.

### Accomplishments

The DSIA, in congruence with the Auditor of Public Accounts and
the Secretaries of Education and Finance, initiated a pilot
program during 1988 to address the audit needs of smaller
agencies in the Education Secretariat.  Since the inception of
this pilot program, reviews have been conducted of the following
agencies:

- Jamestown-Yorktown Foundation;

- State Council of Higher Education for Virginia;

- The Science Museum of Virginia; and

- Virginia State Library and Archives.

During 1989-90, DSIA plans to conduct similar reviews of the
Gunston Hall, the Virginia Museum of Fine Arts, and the
Frontier Culture Museum of Virginia.

Because of the positive results and feedback received from
auditees concerning these audits, DSIA has submitted an
"Addendum Proposal" to initiate a similar program in the Health
and Human Resources Secretariat for the 1990-92 biennium.

## ANALYSIS AND EVALUATION OF DSIA'S DUTIES

Pending the similar success of the small agency audit services
in the Health and Human Resources Secretariat, DSIA plans to
expand its small agency audit services to the remaining
Secretariats.  This will be done through the cooperation of the
Auditor of Public Accounts, the Secretary of Finance, and the
respective Secretaries.

In addition to DSIA's longer range plan, it currently serves
smaller agencies which require immediate internal audit
services in connection with Code Section 2.1-234.32.5.  Also,
where possible, cooperative arrangements have been made to
serve the internal auditing needs of certain agencies.  Examples
of these cooperative arrangements are the internal auditing
services provided to the Treasury Board and the Compensation
Board by the Departments of the Treasury's and Taxation's
internal auditing programs, respectively.

### Relevancy

Agencies which do not require full-time internal auditors
should have their internal auditing needs met.  Past experience
has shown, without a central focal point to initiate and
coordinate strategies to provide internal auditing services to
agencies that do not require full-time internal auditors, the
internal auditing needs of these agencies will not be addressed.
The inherent difficulty of smaller agencies in maintaining
sufficient controls and systems, while being held to the same
standards as larger agencies, presents impediments to their
operations which are not readily rectifiable.  However, all
agencies to the extent feasible must have assurance that their
systems of internal control are in place and functioning as
intended.  This is being provided through internal auditing.

# ANALYSIS AND EVALUATION OF DSIA'S DUTIES

**To Prepare a Biennial Report for the Governor, Governor's Secretaries, Auditor of Public Accounts, and Appropriate Agency Heads on the Status of Agency Internal Audit Programs Generally, and on Agency Adherence to Other Legislative Requirements on Internal Auditing**

## Need

The DIT, in its 1985 Study, recommended that "The OSIA should report biennially on the status of internal auditing to the Secretary of Finance." During the enactment of Code Sections 2.1-234.29 et al., it was decided to expand the level of reporting to the Governor, Governor's Secretaries, Auditor of Public Accounts and appropriate agency heads. In its 1985 recommendation, DIT felt that "while the statewide status has improved, a biennial review would indicate if further progression or perhaps digression has occurred."

## Accomplishments

Since its inception, DSIA has issued two biennial reports relative to the status of internal auditing in the Commonwealth. The most recent biennial report has been included as Appendix B to this report.

In addition, because of the uniqueness of DSIA's first Biennial Report to the Governor of Virginia and the positive stature of Virginia's statewide internal auditing program, Warren, Gorham & Lamont, a national publishing company, reprinted the report in its Spring, 1989 periodical, Internal Auditing. In addition, the IIA, in its publication the IIA Today, discussed the 1985-87 Biennial Report in its January, 1988 edition.

## Relevancy

The Governor, the Governor's Secretaries, the Auditor of Public Accounts and appropriate agency heads need to be kept abreast of how the Commonwealth's agency internal auditing programs are operating. It is important these agency internal auditing programs continue to strive to reach the highest level of compliance with the IIA's Standards if they are to be effective. In addition, it is important periodic reports be rendered to the Governor, the Governor's Secretaries, legislative audit officials and appropriate agency heads so that any needed adjustments or fine tuning of the programs can be facilitated.

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## CONCLUSION AND RECOMMENDATIONS

While the current structure and legislation has brought the statewide internal auditing program to a much higher level of compliance with the IIA's Standards during the period, more is needed. Currently, DSIA works very diligently with all State agency internal auditing programs to improve their level of compliance with the Standards. However, the results and success of DSIA's efforts are directly related to the commitment of Cabinet Secretaries, agency heads and internal audit directors to improve their programs. To illustrate, if an external review conducted by DSIA discloses serious weaknesses in an agency's internal auditing program, DSIA is <u>totally</u> reliant on the internal audit director, the agency head, and the Cabinet Secretary to correct the deficiencies. If they chose not to make the recommended changes, <u>DSIA has no authority</u> to ensure that remedial action is taken.

As presented in Appendix B, pp. 34-36, the most recent <u>Biennial Report to the Governor of Virginia</u> by DSIA indicates that results from reviews of six of the twenty-five internal auditing programs (24%) reveal that these programs do not comply with the IIA's Standards. This means that these internal auditing programs had deficiencies so significant as to seriously impair or prohibit the programs from carrying out their responsibilities in accordance with the IIA's Standards.

The primary causes for these low ratings were:

- The ratio of audits completed to audits planned;

- The level of audit plans developed and based on the IIA's seven criteria for assessing audit risk;

- Planning and supervision at the internal audit director level; and

- The level of operational and programmatic audits being performed.

These issues, as well as similar issues raised in the 1987 <u>Biennial Report to the Governor,</u> hinder the State's internal auditing programs from more fully complying with the IIA's Standards and detract from the effective and efficient deployment of internal auditing resources in the Commonwealth.

If the DSIA was given more authority to take direct action with respect to these deficiencies, the overall level of the State's compliance with national auditing standards would be enhanced.

## CONCLUSION AND RECOMMENDATIONS

To effectively address these issues, it is recommended that
external review reports be provided to the Governor, the State
Comptroller, and the Director of the Department of Planning and
Budget, in addition to the Governor's Secretaries and agency
heads.  This should be performed so that:

--The Governor will have more timely information
   relative to the effectiveness of individual agency
   internal auditing programs;

--The Governor could intervene to ensure that essen-
   tial actions are taken to improve critical agency
   operations if situations are not appropriately
   addressed by an agency head and the respective
   Cabinet Secretary; and

--The State Comptroller and the Director of the
   Department of Planning and Budget should receive
   information to further aid their purposes of
   ensuring the effectiveness and efficiency of
   financial and management controls and of
   resources being strategically deployed within
   the Commonwealth.

This recommendation will require an amendment to existing law
in Code Section 2.1-234.32.

The distribution of the results of DSIA's external review
reports to the Governor, the State Comptroller, and the
Director of the Department of Planning and Budget, in addition
to the Governor's Secretaries and agency heads, will provide
the network necessary to ensure more timely and thorough action
is taken with regard to correcting deficiencies noted in
individual State agency internal auditing programs.

Pending the proposed change to the Code, the DSIA should draft
a directive addressing the requirements for agencies to provide
semi-annual progress reports and detailed work plans relative
to deficiencies noted during the most recent external review.
The detailed work plans provided to DSIA from the agencies
should outline the specific corrective actions to appropriately
address these deficiencies.  Additionally, the detailed work
plans should identify the responsible and accountable indi-
viduals, as well as the expected date for implementing the
corrective actions.

## CONCLUSION AND RECOMMENDATIONS

The directive should also require that DSIA prepare and provide summary semi-annual reports to the Governor and the Governor's Secretaries highlighting significant external review concerns that remain unaddressed.  This will enable the Governor to effectively address the significant issues with the Governor's Secretaries and agency heads.

In summary, the results of the accompanying review continue to reinforce the requirement of having a small central group responsible for directing internal auditing in the Commonwealth. When compared to other states, Virginia's internal auditing program serves as a model to emulate.  While being developed and monitored by a very small group of individuals, internal auditing in Virginia is effective when compared to recent studies from other states.  In addition, with the exception of making the minor legislative change noted in this report, DSIA's existing Code responsibilities remain relevant, appropriate and necessary to ensure efficient and effective management control functions in the Commonwealth's agencies and institutions.

Appendix A

# CHAPTER 14.1.

## DEPARTMENT OF THE STATE INTERNAL AUDITOR.

§ **2.1-234.29. Department created; appointment of State Internal Auditor.** — There is hereby created a Department of the State Internal Auditor. The Department shall be an agency under the direction of the Secretary of Finance. The State Internal Auditor shall be selected by and report directly to the Secretary.

The Department of the State Internal Auditor is established to provide for the development and maintenance of internal audit programs in state agencies in order to ensure that the Commonwealth's assets are subject to appropriate internal management controls. Appropriate internal management controls assist in safeguarding assets, ensuring accurate accounting and reporting of financial transactions, and in providing effective and efficient management. (1985, c. 72.)

§ **2.1-234.30. Qualifications and personnel status of the State Internal Auditor.** — The State Internal Auditor shall be either a certified public accountant or a certified internal auditor. The State Internal Auditor, in order

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to provide continuity to the state's internal audit program, shall be a classified position subject to the provisions of the Virginia Personnel Act (§ 2.1-110 et seq.). (1985, c. 72.)

**§ 2.1-234.31. General powers of the Department.** — The Department shall have the following general powers:

1. To employ such personnel as may be required to carry out the purposes of this chapter;

2. To make and enter into contracts and agreements necessary or incidental to the performance of its duties and execution of its powers under this chapter;

3. To accept grants from the United States government and agencies and instrumentalities thereof and any other source. To these ends the Department shall have the power to comply with such conditions and execute such agreements as may be necessary, convenient, or desirable; and

4. To do all acts necessary or convenient to carry out the purposes of this chapter. (1985, c. 72.)

**§ 2.1-234.32. Duties of the Department.** — The Department shall have the following duties:

1. To establish state policies, standards, and procedures which will ensure an effective internal audit program in all state agencies;

2. To provide technical information to state agencies concerning trends and new techniques in internal auditing;

3. To develop evaluative tools and other modern methods to assist agency internal auditors in performing audits;

4. To assist state agencies in developing and implementing automated data processing internal audit programs in the Commonwealth;

5. To provide general technical and audit assistance to agency internal auditors and to the Auditor of Public Accounts and the Governor on request;

6. To assist agency heads and collegial bodies in establishing and operating internal audit organizations;

7. To assist in the professional development of agency internal auditors by developing and conducting training programs;

8. To examine the adequacy of agency internal audit programs through periodic assessments of such programs and provide Governor's Secretaries and agency heads with the results of such assessments;

9. To develop, in conjunction with the State Comptroller, the Auditor of Public Accounts, the Joint Legislative Audit and Review Commission, and other appropriate state officials, a plan for accommodating the internal audit needs of agencies that do not require full-time internal auditors; and

10. To prepare a biennial report for the Governor, Governor's Secretaries, Auditor of Public Accounts, and appropriate agency heads on the status of agency internal audit programs generally, and on agency adherence to other legislative requirements on internal auditing.

The provisions included above shall not infringe upon responsibilities assigned to the Comptroller, the Auditor of Public Accounts, or the Joint Legislative Audit and Review Commission by other provisions of the Code of Virginia. (1985, c. 72.)

**§ 2.1-234.33. Responsibility for administrative support.** — The Secretary of Finance shall assign responsibility for the Department's administrative support services to one or more state agencies within the executive responsibility of the Secretary. (1985, c. 72.)

**§ 2.1-234.34. Review of these provisions.** — Five years from the effective date of this chapter, the Department of the State Internal Auditor shall be

reviewed by the Secretary of Finance to determine if the duties of the Department should be restructured or eliminated. A report of the Secretary of Finance's determination shall be provided to the Governor and the General Assembly. (1985, c. 72.)

Appendix B

DEPARTMENT OF THE STATE
INTERNAL AUDITOR'S

July 1, 1987 through June 30, 1989

Biennial Report
to the
Governor of Virginia

# COMMONWEALTH of VIRGINIA

JOHN H. HUSTON, C.P.A.
STATE INTERNAL AUDITOR

*Department of the State Internal Auditor*

September 25, 1989


The Honorable Gerald L. Baliles
Governor of Virginia
State Capitol
Richmond, Virginia   23219

Dear Governor Baliles:

In connection with the requirements of <u>Code</u> §2.1-234.32.10, I am submitting this Department's second biennial report to you pertaining to the status of the Commonwealth's agency internal auditing programs.  The period of the report is from July 1, 1987 through June 30, 1989.

The benchmark used to assess the status of agency internal auditing programs in this report centered on the Institute of Internal Auditors' (IIA) <u>Standards for the Professional Practice of Internal Auditing</u> (Standards).  The IIA is the professional body responsible for promulgating Standards for internal auditors.

In addition, survey instruments were designed and used to gather information from board chairpersons and agency heads who have oversight responsibility for internal auditing programs. State internal audit directors were also asked to provide information to this Department about their programs' activities. Lastly, the results from this Department's quality assurance reviews of 25 agency internal auditing programs were used to supplement the results provided by these board chairpersons, agency heads and State internal audit directors.

You will find that these board chairpersons, agency heads and State internal auditing directors are continuing to take steps to improve the level of their agencies' compliance with the IIA Standards.  These achievements are best highlighted by the following statements:

-- Agencies representing 95.2% of the State's appropriations based on Chapter 668 have internal auditing programs.

-- Internal auditor objectivity and independence within
   State agencies were rated nearly perfect. All internal
   auditing units report to the highest possible organi-
   zational level.

-- 60.1% of the State's internal auditors are professionally
   certified, which exceeds the most recent national rate
   published for governments by 27.3%.

-- 97.4% of the State's internal auditors are degreed
   individuals.

-- Board chairpersons and agency heads rate the cost
   effectiveness of their agency internal auditing programs
   as being "Very Good".

-- 83.8% of the State's internal auditing units indicated
   they utilized data processing auditing techniques for
   audits conducted during the biennium.

-- 76% of the agencies reviewed by the Department of the
   State Internal Auditor (DSIA) "Adequately Comply" with
   the IIA's Standards.

While many positive achievements were noted, there remain
areas where conditions must continue to be addressed. They are:

-- The annual ratios of audits completed to audits planned
   need to improve. Impediments to attaining higher rates
   of completion, such as time overruns on audit projects
   and time spent on special project and administrative
   categories in excess of planned amounts, need to be more
   closely monitored and reduced.

-- The disparity between the "Recommended" levels of
   auditor staffing and the "Approved-to-Fill" levels must
   be narrowed. Currently, there is a need for 29 addi-
   tional positions. In addition, the lowest possible
   vacancy rate between "Approved-to-Fill" and "Filled"
   positions should be a hiring objective. There are
   currently 18 vacant positions.

-- Agency programs that have not yet developed audit plans
   based on risk assessments need to complete them. In
   addition, agencies which have not considered all seven
   of the IIA's suggested criteria for assessing risk need
   to use the remaining elements.

-- Planning and supervision at the audit director level
   need to be improved if agency internal auditing programs
   are to achieve maximum efficiency and full compliance
   with the IIA's Standards.

The Honorable Gerald L. Baliles
September 25, 1989
Page Three


   -- The DSIA, agency heads, board chairpersons and
      internal audit directors need to work closely
      together to raise the level of operational and
      programmatic audits to 25% of overall audit effort
      during the next biennium.

   -- The use of technical tools and processes such as
      microcomputers and data processing auditing tech-
      niques must continue to be improved and used to
      keep pace with the State's evolving information
      systems environment.

   -- Agencies that have not established internal audit-
      ing programs need to work with DSIA to determine
      the viability of establishing separate programs.

     Overall, DSIA believes the Commonwealth of Virginia has
the foundation necessary to provide the high quality of
internal auditing expected.  However, the conditions enumerated
above must be dealt with decisively if State programs are going
to raise their level of compliance with the Standards.  Let me
assure you that the DSIA will continue to strive to assist
agency boards, management and internal auditors to increase
their level of compliance.

     I will be most pleased to discuss this report with you at
your convenience.

                              Sincerely,

                              John H. Huston

                              John H. Huston


JHH/bt

Enclosure

# Table of Contents

# Introduction

The Commonwealth's internal auditing program formally began in August, 1980. Prior to 1980, the Commonwealth's agency and institutional (herein agency) internal auditing programs were somewhat fragmented and lacked many of the characteristics advocated by such professional bodies as the Institute of Internal Auditors. These factors, and the status of internal auditing generally, were conveyed to administration officials in October, 1979 by the Management Consulting Division of the Department of Management Analysis and Systems Development in its report, <u>Assessment of State Internal Auditing Capabilities.</u>
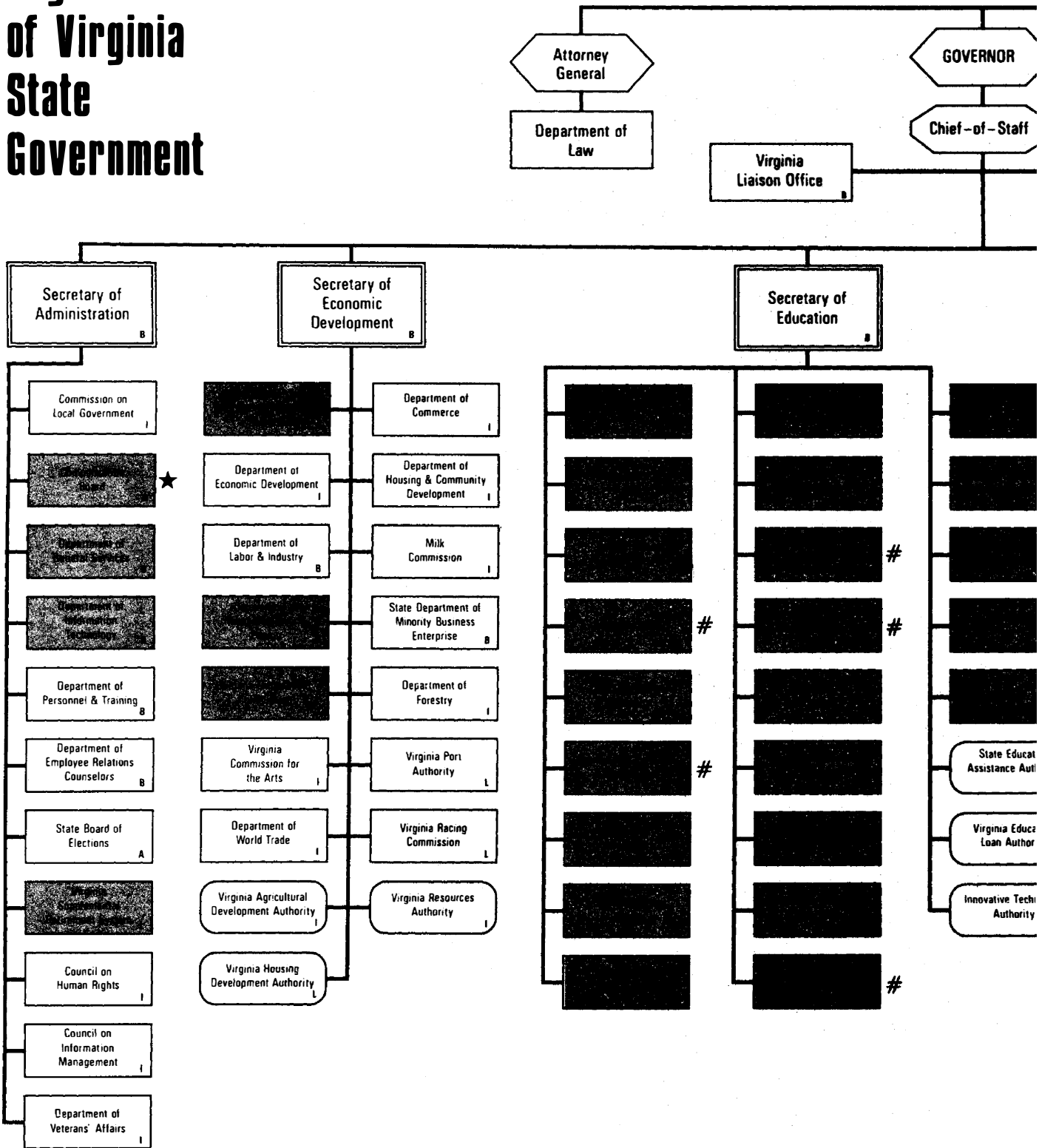
In August, 1980, the Commonwealth established an organization, the Office of the State Internal Auditor, which, with the assistance of State agency heads and collegial bodies, was to improve the professional nature of auditing in State agency internal auditing programs. The Office of the State Internal Auditor functioned as a program within the Department of Accounts until July 1, 1985 when it was established as a separate entity--Department of the State Internal Auditor (DSIA).

Today, the State's internal auditing program is comprised of the DSIA and 39 individual agency units in the Executive Branch of government (Table I). These 40 units serve 49 different Executive Branch agencies. In addition to the support provided to Executive Branch agencies, DSIA also provides assistance to one independent agency, the State Lottery Department, one unit in the Judicial Branch, the Supreme Court of Virginia, and the Virginia Credit Union. The potential coverage provided by the 40 Executive Branch programs, when measured in terms of appropriation amounts, equates to 95.2% of the Commonwealth's appropriations (Table II).

These latest figures reflect the continuing interest and expansion that has taken place within State agencies to address and improve operations through better monitoring and control. Since DSIA's previous Biennial Report in 1987, the State's internal auditing program has expanded from 33 to 39 individual agency units. The State agencies these programs serve have risen from 36 to 49. Potential coverage, when measured in terms of Commonwealth appropriation amounts, has also increased during the past two years from 89.1% to 95.2% (Table II).

TABLE I

**1 9 8 9**

# Organization of Virginia State Government

**Executive Branc**

Attorney General

Department of Law

GOVERNOR

Chief-of-Staff

Virginia Liaison Office ●

Secretary of Administration B

Secretary of Economic Development B

Secretary of Education ●

**Secretary of Administration**

- Commission on Local Government I
- [shaded] ★
- [shaded]
- [shaded]
- Department of Personnel & Training B
- Department of Employee Relations Counselors B
- State Board of Elections A
- [shaded]
- Council on Human Rights I
- Council on Information Management I
- Department of Veterans' Affairs I

**Secretary of Economic Development**

- [shaded]
- Department of Economic Development I
- Department of Labor & Industry B
- [shaded]
- [shaded]
- Virginia Commission for the Arts I
- Department of World Trade I
- Virginia Agricultural Development Authority I
- Virginia Housing Development Authority L

- Department of Commerce I
- Department of Housing & Community Development I
- Milk Commission I
- State Department of Minority Business Enterprise B
- Department of Forestry I
- Virginia Port Authority L
- Virginia Racing Commission L
- Virginia Resources Authority I

**Secretary of Education**

[shaded columns with # markers]

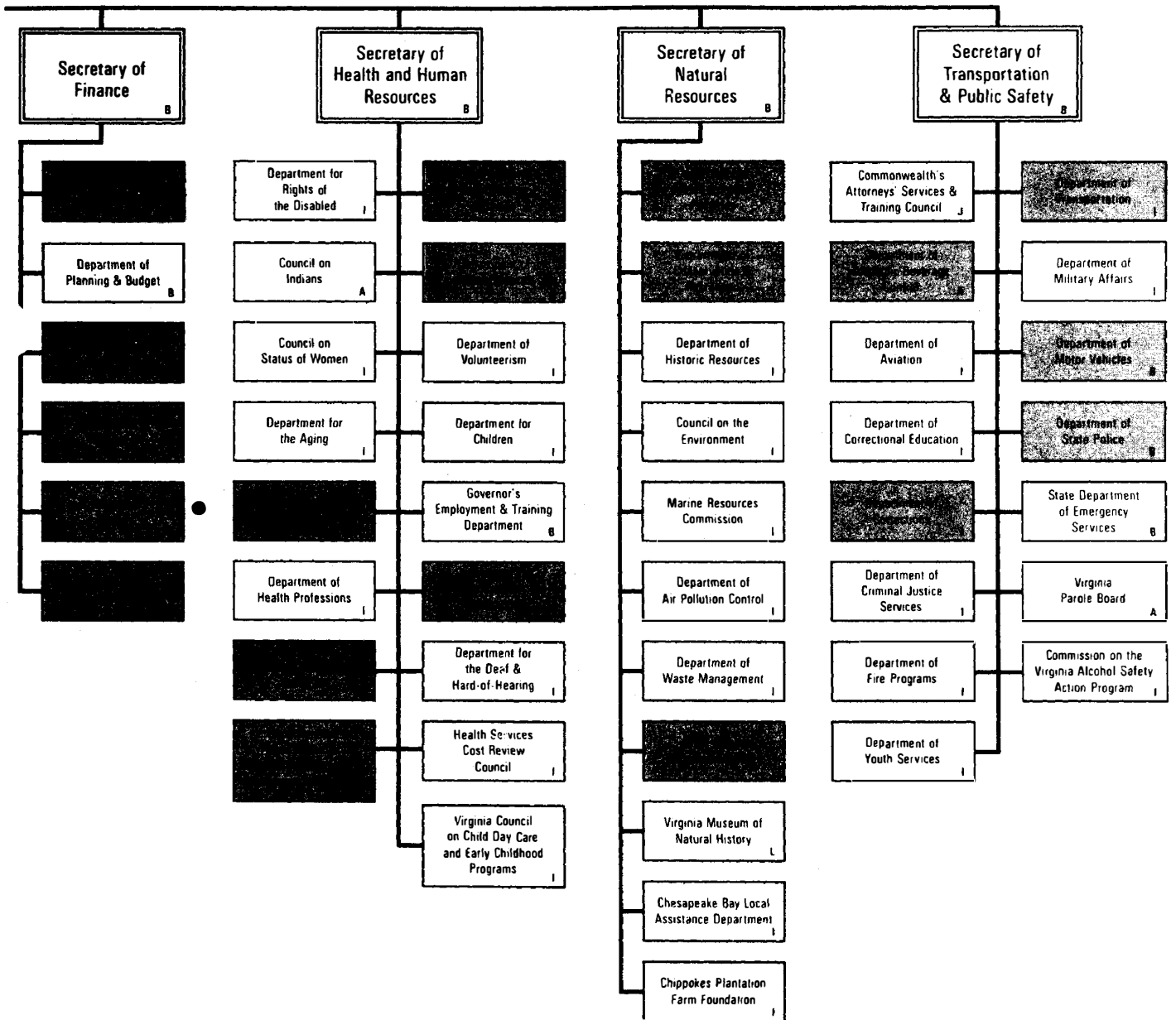- State Educat Assistance Autl
- Virginia Educa Loan Author
- Innovative Techi Authority

Shaded areas represent agencies with internal audit programs.

★ Served through a cooperative arrangement by the Department of Taxation.

\# Served through the Department of the State Internal Auditor.

● Served through a cooperative arrangement by the Department of Treasury.

Lieutenant
Governor

Secretary of
the Commonwealth

Secretary of
Finance

Secretary of
Health and Human
Resources

Secretary of
Natural
Resources

Secretary of
Transportation
& Public Safety

Department of
Planning & Budget

Department for
Rights of
the Disabled

Council on
Indians

Council on
Status of Women

Department for
the Aging

Department of
Health Professions

Department of
Volunteerism

Department for
Children

Governor's
Employment & Training
Department

Department for
the Deaf &
Hard-of-Hearing

Health Services
Cost Review
Council

Virginia Council
on Child Day Care
and Early Childhood
Programs

Department of
Historic Resources

Council on the
Environment

Marine Resources
Commission

Department of
Air Pollution Control

Department of
Waste Management

Virginia Museum of
Natural History

Chesapeake Bay Local
Assistance Department

Chippokes Plantation
Farm Foundation

Commonwealth's
Attorneys' Services &
Training Council

Department of
Aviation

Department of
Correctional Education

Department of
Criminal Justice
Services

Department of
Fire Programs

Department of
Youth Services

Department of
Military Affairs

State Department
of Emergency
Services

Virginia
Parole Board

Commission on the
Virginia Alcohol Safety
Action Program

Table II
Percentage of Auditor Coverage
Based on Appropriations
1987 versus 1989

| Cabinet Secretariat | Percentage of Appropriated $'s Where Internal Audit Departments Exist | | Percentage Increase (Decrease) |
|---|---|---|---|
| | 1987 | 1989 | |
| Administration | 95.7% | 94.5% | (1.2)% |
| Economic Development | 7.1 | 69.1 | 62.0 |
| Education | 96.4 | 99.1 | 2.7 |
| Finance | 72.2 | 94.4 | 22.2 |
| Human Resources | 95.9 | 96.5 | .6 |
| Natural Resources | 25.7 | 74.7 | 49.0 |
| Transportation and Public Safety | 89.0 | 93.6 | 4.6 |
| Overall | 89.1% | 95.2% | 6.1% |

While these statistics, both individually and comparatively, are very positive, the purpose of this report is to analyze to what degree agency internal auditing programs meet professional standards and thereby effectively fulfill their overall audit responsibilities. Since DSIA, through its Directive No. 1-85, endorsed and adopted the use of the Institute of Internal Auditors' (IIA) <u>Standards for the Professional Practice of Internal Auditing</u> (Standards) for all agency internal auditing programs, these Standards will be used as the benchmark through-out this report and all references and assessments made in this report will be against these Standards.

A summary of each of the IIA's general Standards follows:

| Standard Title | Definition |
| --- | --- |
| Independence | Internal Auditors Should Be Independent of the Activities They Audit. |
| Professional Proficiency | Internal Audits Should Be Performed with Proficiency and Due Professional Care. |
| Scope of Work | The Scope of the Internal Audit Should Encompass the Examination and Evaluation of the Adequacy and Effectiveness of the Organization's System of Internal Control and the Quality of Performance in Carrying Out Assigned Responsibilities. |
| Performance of Audit Work | Audit Work Should Include Planning the Audit, Examining and Evaluating Information, Communicating Results, and Following Up. |
| Management of the Internal Auditing Department | The Director of Internal Auditing Should Properly Manage the Internal Auditing Department. |

Introduction
(continued)


Within each of the general Standards, specific standards, as
appropriate, will be evaluated through responses received from the
State's 37 internal audit directors--responses were not solicited
from Mary Washington College and the Department of Game and Inland
Fisheries since both programs have recently initiated operations.
In addition, the directors' responses will be compared to the
results of independent quality assurance reviews conducted by DSIA
during the past two years.  The objective of the latter comparison
will be to arrive at an overall conclusion with respect to where
agency programs perceive themselves with regard to achieving
compliance with the Standards as compared to the evaluations of
an independent body (DSIA).

To further analyze the service and performance of State
internal auditing programs, DSIA independently solicited responses
from agency heads and board chairpersons to supplement DSIA
reviews.

Table III indicates the responses agency heads and board
chairpersons provided about internal auditor performance.

TABLE III
Agency Heads' and Board Chairpersons'
Perceptions of Their Internal Audit Units

| Category | Ranking |
|---|---|
| Professional Competency of Staff | 3.3 |
| Thoroughness of Audit Work | 3.2 |
| Quality of Audit Reports | 3.2 |
| Cost Effectiveness | 3.1 |
| Objectivity | 3.5 |
| Independence | 3.7 |
| Audit Plan's Coverage by Organization's Risk | 3.0 |
| Effectiveness in Dealing with the Detection and Reporting of Fraud | 3.2 |
| Responsiveness to Organization's Changing Audit Needs | 3.2 |
| Satisfaction with Reporting of Audit Plan Accomplishments | 3.2 |

RANKINGS

| Poor 0 | Below Average 1 | Average 2 | Very Good 3 | Excellent 4 |

## Introduction
## (continued)

Since the authority and credibility of successful internal auditing programs depend heavily on the support and direction from the board chairperson and/or agency head, positive impressions are important. Correspondingly, internal auditing programs are in place primarily to serve boards and agency heads since these two groups are increasingly held accountable for the adequacy and effectiveness of their organizations' systems of internal control and quality of performance. Therefore, their assessments or impressions are extremely critical to any evaluation process.

## Independence


The Institute of Internal Auditors (IIA), in its Professional Standards Bulletin (PSB) No. 88-4, describes independence as ". . . the starting point for an effective audit function . . . ." The PSB goes on to state "the organizational reporting structure of the internal auditing department probably has the greatest impact on both its actual and perceived independence."


### Organizational Status

In Virginia, this same emphasis has been directed toward ensuring that the organizational status of agency internal auditing is sufficient to permit the accomplishment of audit responsibilities.  In all State agency internal auditing units, the directors of the programs indicated they reported to either the agency head or board/audit committee chairperson.

While the organizational placement of the auditing unit, reporting to the highest authority within the agency, may provide the perception of independence on paper, it is important, as PSB No. 88-4 indicates, that true independence be present, not only in perception but also in actuality.  Results from DSIA's quality assurance reviews confirm that State internal auditing programs are actually reporting to the highest authority within their organizations.

In addition to the organizational element of this Standard, the IIA recommends that auditing units communicate, at least annually, to management and the board their audit plans, significant audit findings and recommendations, staffing plans and other matters of mutual interest.  Recently, the IIA issued further authoritative guidance relative to this Standard by requiring directors of internal auditing programs to report scope limitations, along with potential effects and risks, in writing to their boards and/or agency heads.  This latter change is aimed at ensuring that agency heads and/or boards are aware of all conditions that may impact the independence and scope of an internal auditing program.

To gauge how satisfied agency heads and board chairpersons were with the quality of status reporting, DSIA asked them to rate their auditors on this factor.  As Table III indicates, they rated the quality of status reporting 3.2 on a scale of 4.0. Surveys of agency management during DSIA's quality assurance reviews resulted in a slightly lower rating.  However, significant improvements have been noted during more recent quality assurance reviews.

To further enhance organizational independence, the IIA
recommends that the purpose, authority and responsibility of the
internal auditing department be defined in a formal, written
document (Charter).  The IIA recommends that the Charter be
approved by the board and management, as appropriate, and include
provisions pertaining to the department's position within the
organization as well as access to records, personnel and physical
properties relevant to the performance of audits.

The DSIA's analysis of how well Virginia's agency internal
auditing programs meet these recommended Charter provisions are
included in Table IV.

**TABLE IV**
**Charter Analysis**
**June, 1989**

        ⊠ No
        ■ Yes

| | Agencies |
|---|---|
| Agencies with Formal Charters Defining Purpose, Authority and Responsibility | 37 |
| Reporting Relationship Described | 37 |
| Provision for at least One Annual Meeting | 37 |
| Approved by Proper Organization Authority | 37 |
| Provision with Respect to Unrestricted Access to Records, Personnel and Properties | 1 / 36 |
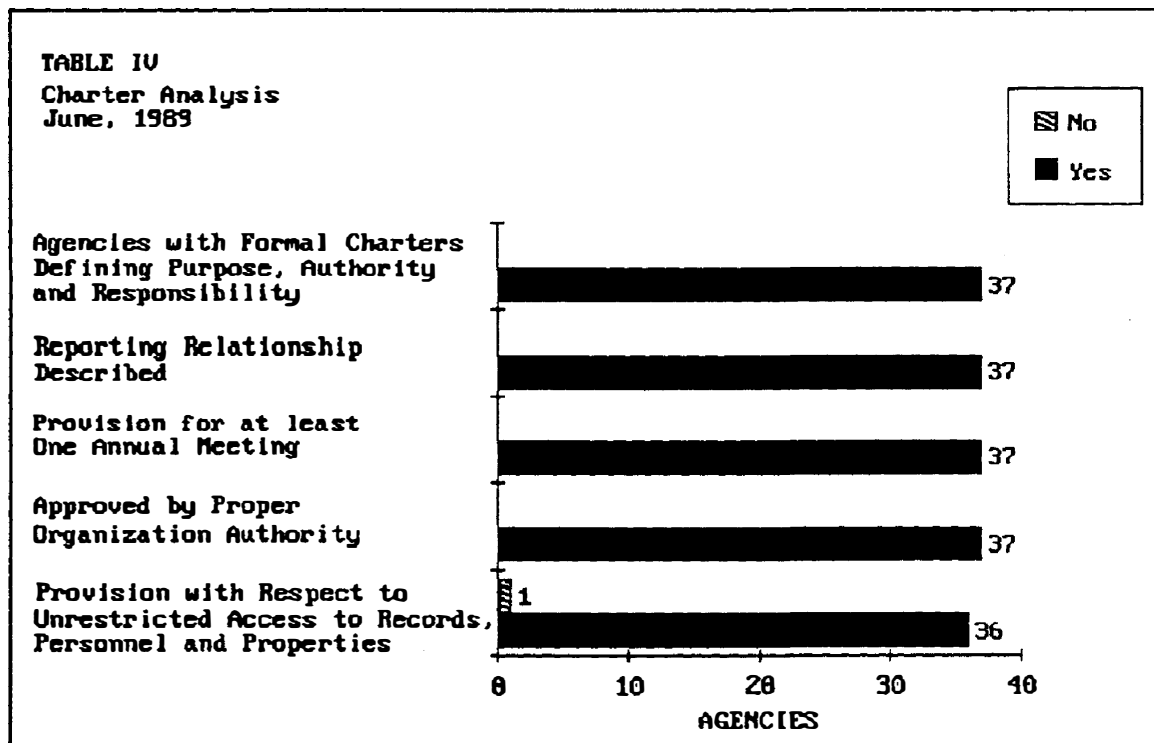
The results in Table IV, with one exception, indicate all the
State's internal auditing units include the basic elements of a
Charter as recommended by the IIA.  Concerning the one exception
relative to the unrestricted access to records, personnel and
properties, the internal audit director indicated "this has never
been a problem; nevertheless, the Charter will be updated to
include the change."

Changes have been made during this biennium to improve the
completeness of audit charters.  To illustrate, in 1987 only
57.6% of the audit directors indicated their Charter included a
provision for at least one annual meeting.  During the current
biennium, all signified they included this provision.

Objectivity

The IIA's Standard relative to objectivity requires that auditors not be prejudiced in performing audits. It also states that internal auditors not subordinate their judgment on audit matters to that of others.

To avoid situations that might impair objectivity, the IIA suggests that:

- Staff assignments be made so that potential and actual conflicts of interest be avoided;

- Auditors report to the directors any situations in which conflict of interest or bias is present or may reasonably be inferred;

- Assignments be rotated periodically; and

- Internal auditors not assume operating responsibilities.

In order to evaluate the objectivity of the State's internal auditing units, DSIA requested internal audit directors to identify instances where their departments' personnel acted in operating capacities during the past two years.

Of the 37 respondents, only 7 (18.9%) indicated any involvement in agency operations. Further investigation indicated that 5 of the instances noted were insignificant and, in DSIA's opinion, should not impair objectivity or independence.

In the remaining situations, one internal auditor assumed direct operating responsibility for a major activity of an agency for a period of three months. The other instance involved an internal auditor establishing reconciliation procedures for a group of accounts within an agency. Both situations could presumably impair objectivity. Discussions with both audit directors, where these instances occurred, indicated they will consider these situations when supervising the audit work and reporting audit results in these areas in the future.

In addition to determining how frequently the State's internal auditors were put into operating positions within their agencies, DSIA requested information concerning the reporting of conflicts of interest. Thirty-two internal audit directors reported they have a specific departmental policy regarding conflict of interest. The remaining five directors indicated they comply with the provisions of the State and Local Government Conflict of Interests Act.

As represented in Table III, agency heads and board chairpersons rated their audit units' independence and objectivity at 3.7 and 3.5, respectively, on a 4.0 scale. To further measure whether the ratings of agency heads and board chairpersons represented the proper degree of auditor compliance with the Independence Standard, DSIA reviewed the ratings from quality assurance reviews it had conducted. The average rating received from DSIA was between "Very Good" and "Excellent".

In summary, it can be concluded that there is a very high level of compliance with the IIA's Independence Standard in Virginia state government. One key area of the Standard that must receive continued scrutiny is the question of assigning internal auditors operating responsibilities within their organization. This should not be done.

# Professional Proficiency

The second general IIA Standard centers on the knowledge, skills and disciplines necessary to perform effective audits. It focuses not only on the individual attributes of each audit team member but also the overall departmental qualifications. In addition, the Standard embraces the following concepts:

- Sufficient departmental staffing;

- Continuing education;

- Compliance with professional standards of conduct;

- Due professional care; and

- The need for supervision, human relations and communications skills.

Compliance with all these components is aimed at ensuring professional audits.


## Knowledge, Skills, and Disciplines

Much effort has gone into attracting individuals with superior professional auditing skills into Virginia state government. To support this effort, the Commonwealth's Department of Personnel and Training (DPT) has developed separate job classifications for internal auditors. The classifications are maintained and updated periodically by DPT, in consultation with DSIA, to remain competitive with the private sector.

As a part of exposing and attracting non-State internal auditors to the State internal auditing environment, members of the State internal auditing community are encouraged to participate in various professional capacities at the local and national levels of the IIA and the EDP Auditors Association. Currently, nine State internal auditors hold either officer or board positions at the local IIA level, while one person holds a committee position at the international level. Besides the benefits that accrue to the Commonwealth from being able to attract top-notch internal auditors from the private sector, the individuals involved in these leadership positions also receive excellent continuing education opportunities as well as exposure to new evolving technologies.

This IIA Standard also recommends that internal auditing departments have employees who are qualified in disciplines such as electronic data processing. Having individuals qualified in this discipline in the Commonwealth is important, since greater

amounts of information are being automated.  Virginia has such
individuals.  As an indication of the impact these individuals
have had, of 37 internal auditing units surveyed, 31 (83.8%)
indicated they had conducted audits utilizing data processing
auditing techniques during the biennium.  This is 20.2% more than
in the previous biennium.

The efforts to attract top-notch internal auditors to the
Commonwealth have resulted in the employment of highly qualified
professionals.  Table V illustrates the current level of academic
accomplishment by individuals within the State's internal audit-
ing community.

TABLE V

Summary of State Internal Auditor Education
June, 1989

2.6%

22.2%        75.2%

- BS/BA
- MBA/ADV Degree
- Less Than College Degree
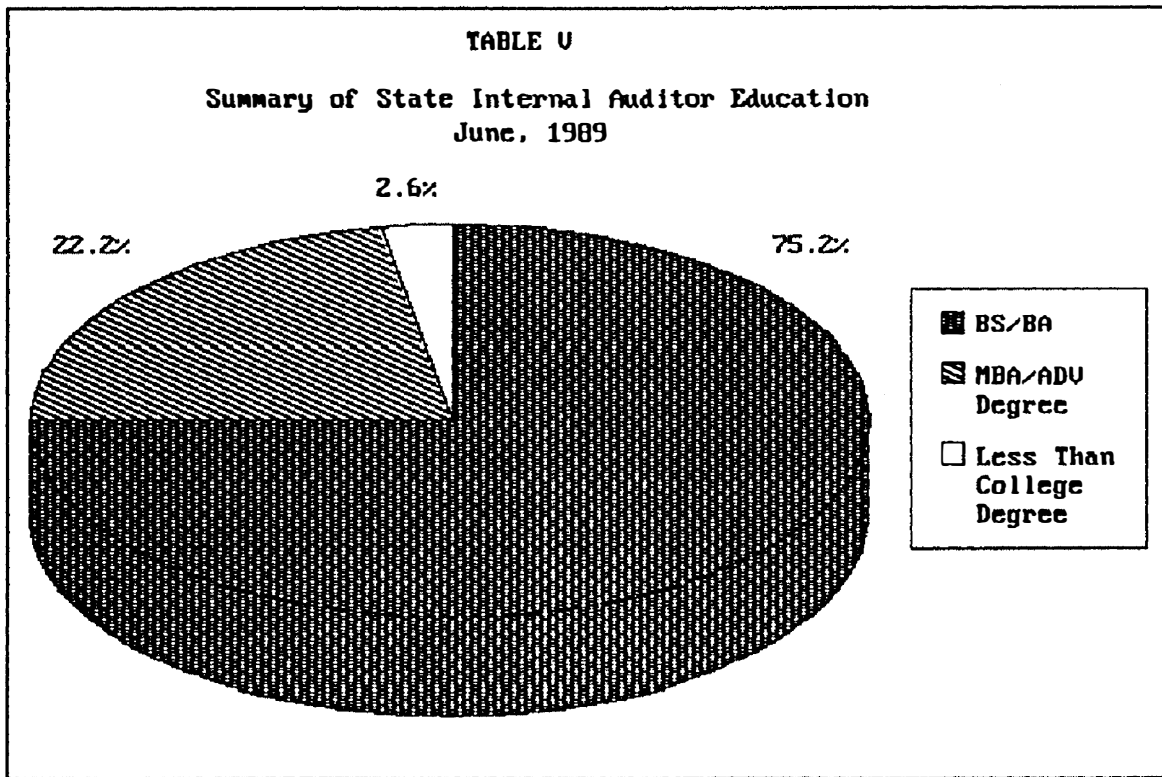
## Staffing

Table VI has been developed to show the number of positions that have been provided within agencies for internal auditing--"Approved To Fill". This Table also indicates the number of "Filled" positions by Cabinet area and the number of individuals who are professionally certified. The column titled "Recommended Level" is the estimate, based on DSIA's assessments, of the number of positions needed to provide full internal auditor coverage to all significant agencies in Virginia. The primary criteria used to establish these estimates were individual agency:

- Appropriations;

- Number of employees;

- Revenues received;

- Liquidity of assets;

- Statewide accountability and processing responsibilities;

- Number of subprograms; and

- Location and number of operating components.

TABLE VI
Status of Internal Auditor Staffing
June, 1989

| | RECOMMENDED STAFFING LEVEL | APPROVED TO FILL | FILLED | NUMBER OF CERTIFIED AUDITORS |
|---|---|---|---|---|
| Cabinet Secretary: | | | | |
| Finance | 10 | 7 | 7 | 7 |
| Administration | 12 | 10 | 10 | 7 |
| Transportation and Public Safety | 35 | 34 | 29 | 16 |
| Human Resources | 47 | 35 | 30 | 18 |
| Education | 85 | 78 | 71 | 40 |
| Economic Development | 7 | 4 | 3 | 3 |
| Natural Resources | 4 | 3 | 3 | 1 |
| Totals | 200 | 171 | 153 | 92 |

A comparison of the "Recommended Staffing Level" to the
"Approved to Fill" levels indicates that 29 additional internal
auditing positions are needed to bring the overall program up to a
level commensurate with identified criteria.  The 29 positions are
relatively consistent with the number needed in June, 1987--27.

Table VII indicates the status of agency efforts to fill new or
previously established internal auditing positions.  Since July,
1987, "Filled" positions have increased 15.0%.  In addition, the
difference between the "Approved to Fill" and "Filled" positions
(vacancy rate) has decreased by 1.4% to 10.5%.

While the percentage of "Filled" positions has increased
overall, this increase has been somewhat offset by the identi-
fication of the need for additional positions (22) in new or
expanding internal auditing programs--primarily in Education and
Human Resources.  As a result, a comparison of the ratio between
"Recommended Staffing Level" to "Filled" in 1989 versus 1987
reflects only a slight improvement.



TABLE VII
Comparative Internal Auditor Staffing
and Certification Growth
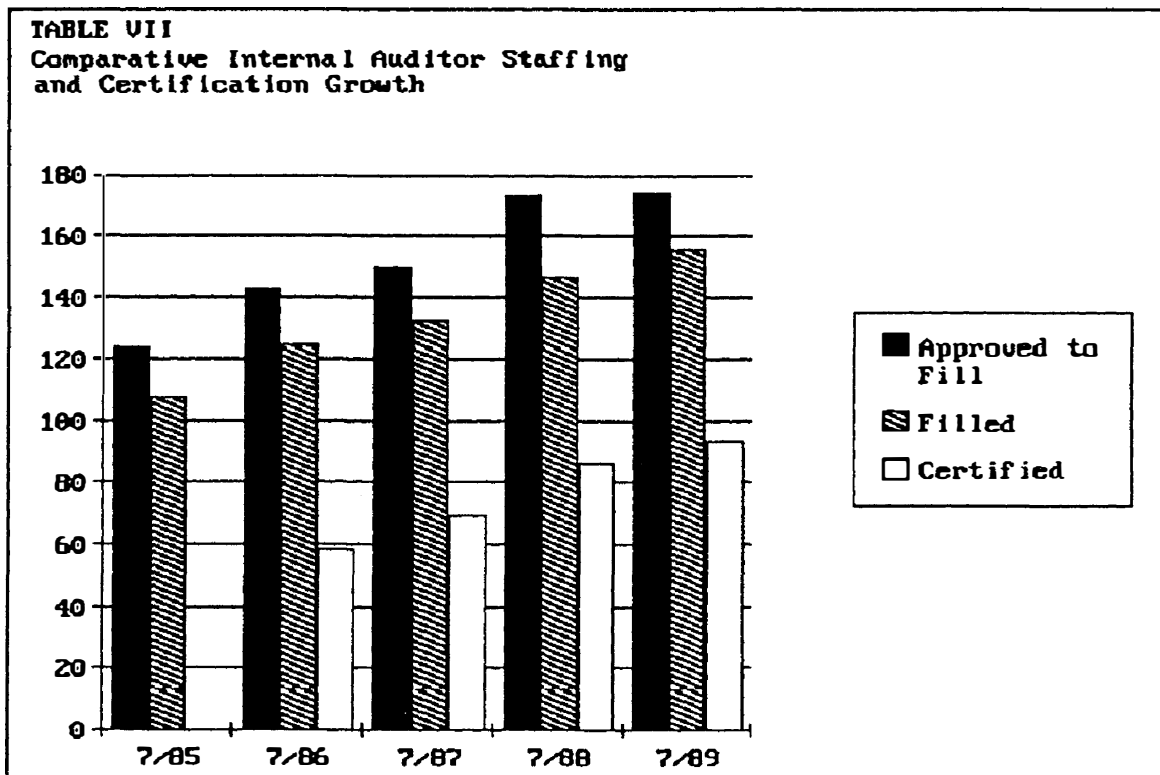
Note:  Certification information for July, 1985 was not available.

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During the biennium, individuals possessing professional certifications increased 7.5% to a level of 60.1% overall.  The most recent national rate for governments published by the IIA is 32.8%.


## Continuing Education

In connection with attracting and retaining top-notch professionals, mechanisms need to be in place to keep them in touch with changing internal audit technology.  DSIA provides approximately 6,000 hours of annual training to the State's internal auditors.  The 24 training courses range in topics from basic internal auditing to specific courses on the application and use of audit software.  Based upon the training hours offered by DSIA, each auditor receives an average of 40 training hours per year.  One hundred hours of continuing professional education every three years is the established standard recommended by the IIA.

In addition to training received through DSIA, some individuals also obtain needed specialty training through such organizations as the IIA, the American Institute of Certified Public Accountants (AICPA) and the Association of College and University Auditors (ACUA).  The DSIA has determined that it is neither cost-effective nor practical to develop separate training courses for the special needs of very small groups of auditors.


## Compliance with Standards of Conduct

A distinguishing mark of a profession is acceptance of responsibility to the interests of those it serves.  The IIA, through its Code of Ethics (the Code), provides basic principles for internal auditors to follow.  In summary, the Code calls for high standards of honesty, objectivity, diligence and loyalty to which internal auditors should conform.  To date, through DSIA's quality assurance assessments of internal auditing programs, auditor compliance with the Code has been rated between "Very Good" and "Excellent".

The two instances which most greatly affected this category from being at a higher level of compliance had to do with two internal auditing departments not adopting suitable means to comply with the IIA's Standards over the time period covered by the quality assurance reviews.  In one instance, the director of the program was terminated from employment.  Subsequently, an individual was hired who possesses the skills and experience necessary to properly direct the program.  In the other instance, the agency

head has committed the internal audit director to more extensive
training in order to improve his level of technical competence.
The DSIA will soon be conducting a follow-up review to determine
whether conditions have improved in this latter instance.


## Due Professional Care

Another element critical to professional proficiency is the
exercise of due professional care.  As stated by the IIA, "due
professional care calls for the application of the care and skill
expected of a reasonably prudent and competent internal auditor in
the same or similar circumstances.  Due care implies reasonable
care and competence, not infallibility or extraordinary perform-
ance.  Professional care should, therefore, be appropriate to the
complexities of the audit being performed.  In exercising due
professional care, internal auditors should be alert to the
possibility of intentional wrongdoing, errors and omissions,
inefficiency, waste, ineffectiveness, and conflicts of interest.
They should also be alert to those conditions and activities where
irregularities are most likely to occur."

As a way to measure Virginia's auditor compliance with this
aspect of the IIA's Standards, DSIA requested agency heads and
board chairpersons to rate their audit units' effectiveness with
respect to dealing with information and issues regarding the
detection and reporting of waste, fraud and abuse (see Table III).
Overall, the audit units received a rating of 3.2 on a scale of
4.0.  This rating, in DSIA's opinion, is very good since many users
tend to judge the effectiveness of their internal auditing programs
solely by this criterion, regardless of other auditing standards
promulgated by the IIA.

In addition to the efforts made by the State's internal audit
directors to comply with the provisions of this Standard, DSIA sent
guidelines to all State agency heads in July, 1988 to improve the
consistency and processes for reporting and investigating frauds
and irregularities by State internal auditors.  This action and
DSIA's course offerings relative to fraud and abuse should enable
internal auditors to become more proficient in this Standard in
the future.

## Supervision

A major means of ensuring proficient work in any professional field is proper supervision.  As the IIA describes in this Standard, "Supervision is a continuing process, beginning with planning and ending with the conclusion of the audit assignment."  Based on the results of DSIA's quality assurance reviews, the supervision aspect of the Professional Proficiency Standard received a satisfactory rating, up from a "Needs Improvement" rating in June, 1987.  While supervision needs to be improved to enhance the overall efficiency and effectiveness of agency internal auditing programs, it is important to note that the rating resulted from supervision that was insufficiently documented or not timely, not from an absence of supervisory involvement.

While the current assessment of this Standard reflects some improvement during the biennium, internal audit directors need to continue their efforts to better both the documentation and timeliness of the supervision of audit assignments.

## Human Relations and Communications

The last component of this Standard relates to the ability to deal with people and communicate effectively; it requires auditors to understand the dynamics of human relations.  It also obliges auditors to be skilled in both "oral and written communications so they can clearly and effectively convey such matters as audit objectives, evaluations, conclusions, and recommendations."

The DSIA's quality assurance reviews indicate that audit units rank between "Good" and "Very Good" in this Standard.  While the overall rating remained static since the prior biennium, the past year's assessments of internal audit units indicate a predominant rating at the "Very Good" level.  In DSIA's opinion, this moderate improvement can be attributed to a greater emphasis by internal audit directors to ensure their auditors communicate effectively.  Together, the audit directors' efforts and DSIA's training sessions titled "Audit Report Writing" and "Communications Skills for Auditors" should improve ratings during the next biennium.

In summary, the internal auditing profession in the Commonwealth continues to improve the level of its proficiency. This progress is evidenced by the high professional certification rate in Virginia, the quality of education available to the

internal auditing community and the confidence management and board chairpersons show with respect to the auditors' record of dealing with information and issues regarding the detection and reporting of waste, fraud and abuse. In addition, from the results of the questionnaire sent to agency heads and board chairpersons-- Table III, the professional competency of staff was rated high-- 3.3 on a scale of 4.0. Except for the need to continue to improve the supervision element, these factors and ratings lead one to feel very confident about the level of professional proficiency within the State's internal audit community.

# Scope of Work

The third general IIA Standard requires that audits "encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities." While this Standard is broad, the IIA defines what is encompassed by this general Standard in the related specific Standards.

The specific elements of the Standard focus on the following aspects of the organization subject to audit:

1. Reliability and integrity of information;

2. Compliance with policies, plans, procedures, laws and regulations;

3. Safeguarding of assets;

4. Economical and efficient use of resources; and

5. Accomplishment of established objectives and goals for operations or programs.

The goal of any internal auditing program, whether in the public or private sector, is to focus internal auditing attention on all five of these specific components.

There are, however, external factors that must be considered in the achievement of this goal. One factor that the IIA recognizes is the influence management and the board exercises over the scope of work and the activities to be audited. Other factors include the levels and composition of the audit staff, their competency and the overall agency control environment. Also, audit coverage provided by other auditors, such as the Auditor of Public Accounts (APA), must be considered.

To measure the influence management and boards have in determining the scope of their audit program's work, DSIA asked agency heads and audit committee chairpersons, as appropriate, in a previous survey to indicate their level of preference with respect to the specific elements of this Standard. Table VIII summarizes the results of the survey.

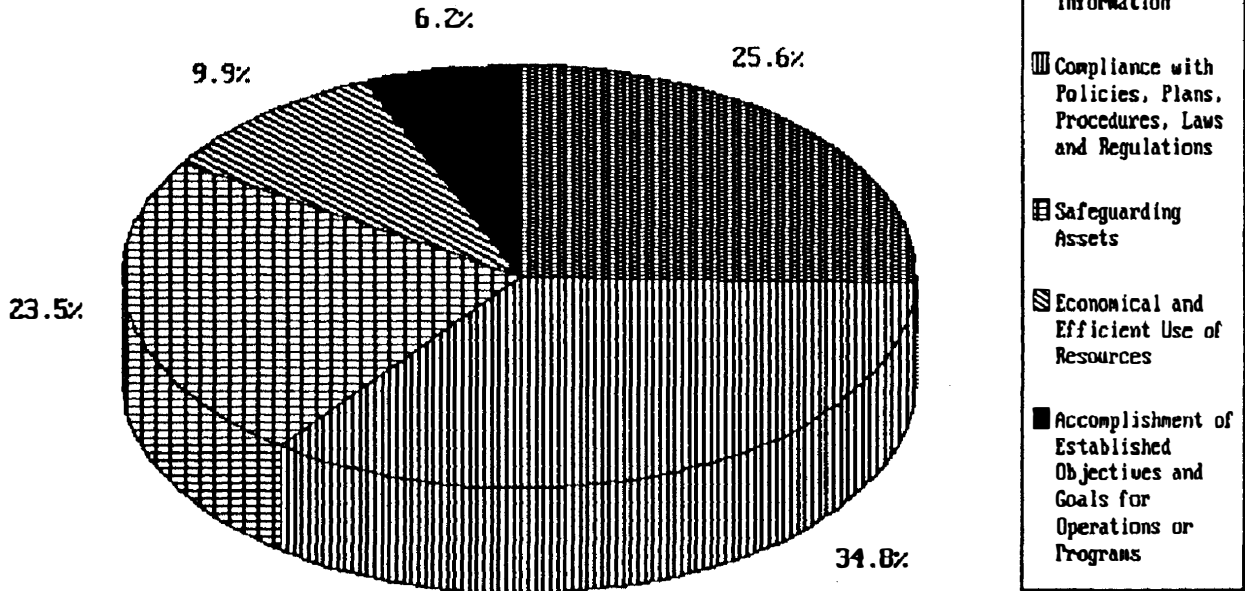Table VIII
Commonwealth of Virginia
IIA Standards Survey Results

| Scope of Work Standard | Audit Committees | Agency Management |
|---|---|---|
| Reliability and Integrity of Information | 22.6% | 24.5% |
| Compliance with Policies, Plans, Procedures, Laws and Regulations | 19.7 | 23.0 |
| Safeguarding of Assets | 25.5 | 21.8 |
| Economical and Efficient Use of Resources | 17.1 | 15.8 |
| Accomplishment of Established Objectives and Goals for Operations or Programs | 15.1 | 14.9 |
| | 100.0% | 100.0% |

As discussed in the section of this report dealing with the planning component of the Management of the Internal Auditing Department Standard, 94.6% of the State's internal audit directors indicated they used a structured risk assessment process to develop their audit plans. By using a standardized risk assessment methodology, individual preferences are minimized. As a result, initially the audit plan is developed objectively. However, as the IIA indicates in this Standard, management and the board can exercise general direction as to the scope of work and activities to be audited. As a result, initial audit plans can be modified.

In an attempt to measure the degree of correlation between what management and/or boards prefer in relation to audit scope and the actual effort expended by internal auditors in each of the five elements, audit directors were asked to analyze the allocation of their efforts. Table IX illustrates the percentage of audit effort dedicated to each of the five elements as reported by the State's internal audit directors.

**TABLE IX**

**Allocation of State Auditing Units Work**

6.2%

9.9%

25.6%

23.5%

34.8%

Legend:
- ▦ Reliability and Integrity of Information
- ▥ Compliance with Policies, Plans, Procedures, Laws and Regulations
- ▤ Safeguarding Assets
- ▨ Economical and Efficient Use of Resources
- ■ Accomplishment of Established Objectives and Goals for Operations or Programs

## Financial and Compliance Auditing

Tables VIII and IX and the results of DSIA's quality assurance reviews clearly show that both from a preference and performance standpoint the first three elements of this Standard receive the greatest attention. As a result, agency internal auditing programs are most involved in reviewing:

- The reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information;

- The systems established to ensure compliance with those policies, plans, procedures, laws and regulations which could have a significant impact on operations and reports, and determining whether the organization is in compliance; and

- The means of safeguarding assets and, as appropriate, verifying the existence of such assets.

It should be noted that the allocation of effort to these three areas during the current biennium is consistent with the previous biennium.  While the IIA has not provided any specific guidance relative to the percentage of effort that should be directed to the various elements, it does appear auditing programs in Virginia are responding to the preferences of agency heads and/or audit committee chairpersons in the areas of financial and compliance audits.

Operational and Programmatic Audits

As indicated by the proportions of effort directed toward operational and programmatic audits by internal auditing units (Table IX), the percentages fall short of the preferences indicated by agency heads and audit committee chairpersons (Table VIII).

The causes for this situation, in DSIA's opinion, can be attributed to several factors.  One factor is the difficulty in precisely separating the amount of effort directed to operational and programmatic auditing objectives contrasted to financial and compliance objectives.  Current agency reporting systems do not facilitate such differentiation.  In addition, audit objectives are usually developed singularly, combining financial and compliance elements and operational and programmatic elements.

Another factor that makes analyzing the amount of effort directed to the different types of audits difficult is the continuing development of the State's internal auditing program. Experience has shown newer programs tend to focus almost entirely on financial and compliance issues during their early stages.  With State programs growing by 18.2% in terms of new auditing units during the current biennium, gains experienced in operational and programmatic audits in more established programs have been somewhat offset by minimum contributions from newer organizations.

Lastly, until this past year, DSIA focused the majority of its training and assistance toward the financial and compliance elements.  Because of situations reported by the Auditor of Public Accounts and others, DSIA felt basic fiscal systems and controls needed to be dealt with first, before embarking on a more expanded program.

During 1988-89, DSIA established a position dedicated to operational auditing.  Much like the program previously instituted by DSIA to address statewide EDP audit matters, the new Operational Audit Director is working with State agency internal auditing directors to promote and expand individual agency operational and programmatic audit activities.

While DSIA has provided ongoing training relative to the application of basic operational auditing techniques, it will also be offering two more advanced courses during 1989-90. This effort, in conjunction with providing more "hands-on" direction and assistance, should result in a greater number of operational and programmatic audits being performed.

Although the percentage of effort directed to this area has fallen short of the preference expressed by agency heads and/or audit committee chairpersons, DSIA, as a result of its quality assurance review process, has noted increased levels of effort directed toward operational and programmatic audits during the past year. To illustrate, one internal auditing department focused 45% of its efforts to these elements while two others spent 35%.

## Audit Plan Accomplishment

IIA Standards provide no guidance relative to the percentage of planned audits that an internal auditing program should complete. ' wever, since this is a relevant measurement of efficiency and :fectiveness, DSIA evaluates the degree to which internal auditing programs meet their audit plans.

It is important that audit plans developed for and approved by agency heads and boards be completed. Internal auditing is defined as ". . . an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization." Thus, if an appropriate level of audits is not completed, by definition, the internal auditing department's value to the organization becomes uncertain.

Results from DSIA's quality assurance reviews conducted during the past year found that 65.4% of the projects included in agencies audit plans were either completed or near completion as of the end of the periods reviewed. Impacting the completion rate of audits were staff vacancies, time overruns on audit projects and time spent on special project and administrative categories in excess of planned amounts. It should be noted that the time planned for special projects may be exceeded if unanticipated problems, such as frauds or irregularities, occur during the period. Thus, factors beyond the auditor's control can sometimes influence the audit completion rate.

In summary, greater efforts must be made in this Standard to raise the level of compliance. Specifically, audit project completion rates need to be significantly improved. Audit directors must reduce personnel turnover and vacancies. They must also plan and

monitor audits, special projects and administrative categories better in order to offset the effects overruns have in relation to accomplishing their audit plans.

DSIA has set a goal to raise the percentage of effort directed toward operational and programmatic audits for the 1990-92 biennium to 25%.  While this goal is achievable, it can only be accomplished through cooperation and initiatives of DSIA, agency heads, boards and internal audit directors.

## Performance of Audit Work

According to the IIA, "audit work should include planning the audit, examining and evaluating information, communicating results and following up."  The Performance of Audit Work Standard, therefore, encompasses all factors directly related to the actual performance of audit work.

### Audit Planning

The quality of the final audit product is heavily determined by the level and nature of audit planning.  Planning facilitates the distribution of audit tasks, the thoroughness of the audit coverage and the efficiency of audits conducted.

Nearly every auditor training course offered by DSIA and private vendors emphasizes the importance of proper planning and the effect it has on the successful outcome of an audit.  Despite this emphasis, DSIA's assessments only reflect an overall rating of "Good" for this factor during the recent biennium.

In its 1987 biennial report, DSIA recommended that general planning and supervision at the audit director level needed to be improved if agency internal auditing programs were to achieve maximum efficiency and full compliance with the IIA's Standards. While the overall rating for the current biennium is "Good", quality assurance reviews conducted during the last year of the 1987-89 biennium rated this aspect of the Performance of Audit Work Standard as near "Very Good".  What this demonstrates, in DSIA's opinion, is a growing recognition by internal audit directors of the importance of planning to the total audit process.

While recent quality assurance results reflect very positively on the steps being taken by internal audit directors to improve the compliance ratings for this Standard, greater attention is needed. Within its capacity, DSIA will continue to stress the importance of planning as it develops and presents training to the State's internal auditors and advises them, vis-a-vis the quality assurance process, about ways to improve the timeliness, the effectiveness and the methods used to conduct audits.

### Examining and Evaluating Information

Examining and evaluating information includes the auditor's collection, analysis, interpretation and documentation of evidence to support audit results.  For the Performance of Audit Work Standard, examining and evaluating audit information received an overall rating of "Good" from DSIA.  The rating could have been higher if more attention had been given by internal audit directors to the completeness of documenting audit work and, as previously discussed, supervision.

As with the planning aspect, there was a notable increase in compliance with this facet of the Performance of Audit Work Standard based on the results from quality assurance reviews conducted during the last year of the 1987-89 biennium.  For the last year of the biennium, a rating near "Very Good" was achieved.


## Communicating Results

The next aspect of the Standard--communicating the results of audits or the audit report--usually represents the most tangible aspect of an audit from a user's perspective.  Because of the agency-wide impact of audit report results, communication of results must be totally factual, must be easily understood and must present recommendations for improvements that are not only logical (given the circumstances) but also practical and cost-justified.

Since the audit report, in many cases, is the most visible product by which agency heads and board chairpersons can judge the quality of their agency's auditing program, DSIA queried those individuals about the quality of the audit reports they received.  As Table III shows, the auditors received a rating of 3.2 on a scale of 4.0.

The DSIA's quality assurance ratings show this aspect being rated the highest within the Performance of Audit Work Standard.  DSIA's ratings from the past year closely compare to those provided by agency heads and board chairpersons.  Thus, improvements are being made to raise the level of compliance with this Standard.


## Following Up

The final aspect of this Standard, following up, represents the last step in the examination process for the auditor.  Follow-up reviews determine whether appropriate action has been taken to resolve previously reported audit findings.

The DSIA's quality assurance reviews show that this aspect of audit work is given the lowest priority.  While nearly all State agency internal auditing units have formal policies outlining their responsibilities to conduct follow-up reviews, the demand on the auditors to complete regular audit projects in a timely manner and staff shortages continue to result in follow-up reviews being delayed or incorporated into the next scheduled audit.

## Performance of Audit Work
## (continued)


While DSIA noted in its 1987 biennial report that follow-up reviews needed to be given greater attention, ratings in this Standard remained about the same until recently. During the past year, ratings have increased to near the "Very Good" level. In order to raise the ratings to "Excellent", DSIA believes agency heads and board chairpersons must require that all annual audit plans include an appropriate allotment of time for follow-up reviews. Correspondingly, given the time to complete follow-up reviews, the internal auditors must accomplish them to ensure the examination process is concluded.

In summary, there have been significant improvements noted in compliance with this Standard during the past year. Indicative of this trend are rankings given by agency heads and board chairpersons regarding the overall thoroughness of audit efforts--Table III. They rated thoroughness at 3.2 on a 4.0 scale. This momentum must be maintained to raise the overall level of compliance with all aspects of this Standard in the future. In particular, there must be continued emphasis directed at more complete planning and the final phase of the audit process--following up.

The fifth IIA Standard considers the audit director's responsibility to properly manage the internal audit department. The Standard establishes the following criteria as the basis for proper management:

"1. Audit work fulfills the general purposes and responsibilities approved by management and accepted by the board.

2. Resources of the internal auditing department are efficiently and effectively employed.

3. Audit work conforms to the <u>Standards for the Professional Practice of Internal Auditing</u>."

## Purpose, Authority, and Responsibility

This Standard, which requires the State's internal auditing directors to establish statements of purpose, authority, and responsibility for their auditing units, was addressed from a slightly different aspect in the previous discussion of independence. That evaluation concluded that <u>all</u> the State's internal auditing units have established Charters that define their purpose, authority, and responsibilities. This fact, and evaluations conducted by DSIA of the quality of these statements, reflect between a "Very Good" and "Excellent" rating. This specific component was rated the highest within the Management Standard for the current biennium. In addition, ratings in this Standard increased over the previous biennium.

## Planning

The next element of this Standard deals with planning--the Standard calls for the internal audit director to "establish plans to carry out the responsibilities of the internal auditing department." The planning process, as defined by the IIA, involves establishing:

"● Goals;

● Audit work schedules;

● Staffing plans and financial budgets; and

● Activity reports."

## Management of the Internal Auditing Department
## (continued)

Within the context of goals, the IIA states they should be established for all internal auditing programs. Further, the IIA recommends that goals be: approved by the authority to which the program reports; measurable; and communicated at least annually. More frequent communication is encouraged.

The DSIA's review of responses received from the State's internal audit directors regarding goals indicates that 94.6% of the units have formalized goals. With respect to approval, measurability and communication, 91.9% indicate they meet the guidelines of the IIA. In the two cases where goals had not yet been established, both units indicated formal goals were in the process of being developed.

Staffing plans and financial budgets are typically developed along with work schedules. Therefore, discussion of these topics are combined. The IIA recommends that audit work schedules ". . . include (a) what activities are to be audited; (b) when they will be audited; and (c) the estimated time required, taking into account the scope of the audit work planned and the nature and extent of audit work performed by others." The primary matters to be considered in establishing and developing work schedules are:

"a. the date and results of the last audit;

b. financial exposures;

c. potential loss and risk;

d. requests by management;

e. major changes in operations, programs, systems, and controls;

f. opportunities to achieve operating benefits; and

g. changes to and capabilities of the audit staff."

The process used to consider and evaluate these factors is referred to as risk assessment. Results from the risk assessment process are used to develop the initial audit plan.

In 1989, 94.6% of the State's internal audit directors indicated they used a risk assessment process to develop their audit work plans. This percentage, while not indicative of total compliance with this aspect of the Standard, is an improvement over the previous biennium. In 1987, the percentage was 81.8%.

The audit directors were also asked whether they considered the seven criteria suggested by the IIA. Of the audit directors who conducted risk assessments, 80.0% indicated they considered all seven criteria; 5.7% indicated they considered at least six; and 14.3% considered fewer than six. The two most prominent factors of the seven criteria not considered were opportunities to achieve operating benefits and changes to and capabilities of the audit staff. Results from DSIA's quality assurance process confirm that nearly all internal auditing units have completed a risk assessment and annual audit plan.

The final element of this Standard deals with activity reporting to management and the board. Reporting includes comparing "performance with the department's goals, and expenditures with budgets." As shown within the organizational element of the Independence Standard, responses received from agency heads and board chairpersons, Table III, indicate they are relatively pleased with the level and quality of reports relative to reporting audit plan accomplishments.

While agency internal audit directors' responses to DSIA's questionnaire indicate a high level of compliance with respect to planning, agency heads and board chairpersons indicate a lower level of certainty. When asked to rate the comprehensiveness of their unit's audit plan in providing audit coverage relative to their organization's risks, they rated it at 3.0 on a 4.0 scale. Likewise, DSIA's ratings from its quality assurance process indicated improvements are needed.

The primary reasons for the differences between DSIA's ratings and the degree of compliance indicated by the audit directors have to do with the exclusion of some components of organizations during the risk assessment and audit planning processes and not addressing all seven of the criteria suggested by the IIA. Therefore, while efforts have been made to improve compliance with this Standard since the previous biennium, internal audit directors need to further improve the comprehensiveness of their assessments of risk and audit planning.

## Policies and Procedures

To manage any organization efficiently and effectively, it is important that there be written policies and procedures to guide personnel. Accordingly, the IIA recommends written policies and procedures be in place within internal auditing units.

From the results of DSIA's reviews, nearly all the State's internal auditing units have adopted appropriate policies and procedures. In most cases, State internal auditing units have adopted DSIA's Internal Audit Policies and Procedures Manual, which is a comprehensive set of policies and procedures that meets the IIA Standards. As a result, it is DSIA's opinion that this aspect of the IIA's Management Standard is substantially complied with by State agency internal auditing programs.

## Personnel Management and Development

Another major responsibility of audit directors is establishing a program for selecting and developing the human resources within their auditing units. As was previously discussed in the section, Professional Proficiency, the Commonwealth has been able to attract and retain very high caliber auditing professionals. Much of the credit for the retention of these individuals can be attributed to the agency audit directors' abilities to provide the environment and opportunities necessary for the retention of these individuals. As stated previously, the Commonwealth has done extremely well in complying with this aspect of the Standard.

## External Auditors

The Standard states that ". . . internal auditing should coordinate internal and external audit efforts." In the fall of 1987, the IIA issued more expanded guidance with respect to complying with this Standard through its Statement on Internal Auditing Standards No. 5--Internal Auditors' Relationships with Independent Outside Auditors.

In addition to the IIA's expanded guidance, the AICPA is currently re-evaluating its current Statement on Auditing Standards (SAS) No. 9--The Effect of an Internal Audit Function on the Scope of the Independent Auditor's Examination. This year, the AICPA is expected to publish a study intended to go a step further than the current SAS No. 9. The study titled "The Independent Auditors' Use of the Work of Internal Auditors" will:

- Describe how independent auditors evaluate the internal audit function in an audit;

- Explain how the use of the internal auditor's work contributes to the restriction of audit risk; and

- Describe efficient coordination of the work of independent auditors and internal auditors.

As can be concluded from both the IIA's and AICPA's recent efforts to more fully describe and integrate the activities of internal and external auditors, it is important both groups work together to ensure audits are conducted efficiently and effectively.

As in the private sector, much effort has gone into coordinating internal and external auditors' work in the Commonwealth. State agency internal auditing programs work with the APA, and vice versa, to achieve maximum audit coverage and efficiency in the Common- wealth. Results from DSIA's quality assurance reviews pertaining to this Standard during the past year indicate between a "Very Good" and "Excellent" rating. While some improvements can be made in this Standard, efforts to date by the State's internal audit directors and staff of the APA are effective.

## Quality Assurance

The last aspect of this Standard addresses the audit directors' responsibilities with respect to quality assurance. It requires the director to "establish and maintain a quality assurance program to evaluate the operations of the internal auditing department." The Standard is divided into three elements: supervision, internal reviews and external reviews.

Since the first element, supervision, was assessed within the context of the Professional Proficiency Standard, no further discussion of supervision will be made here.

With regard to the second element of this Standard, internal reviews, the IIA recommends that "internal reviews be performed periodically by members of the internal auditing staff to appraise the quality of the audit work performed." During the previous biennium, there was little progress noted toward meeting this Standard. In January, 1988, DSIA introduced a training course relative to conducting internal reviews. Since that time, DSIA, as a part of its quality assurance process, has noted increased efforts to meet the internal review Standard. Some larger internal auditing units have conducted full-scope internal reviews while others have performed various elements of the process. It should be noted these adaptations of the full internal review process are acceptable by the IIA, especially in smaller internal auditing departments where the internal audit director has more involvement in individual audits.

The third element of this Standard, external review, is performed by the DSIA to independently appraise the quality of individual internal auditing units.  These reviews are conducted of all State internal auditing units on average once every three years.  This three-year time period complies with the guidance set forth by the IIA.  All facets of an agency's internal auditing operations are examined.  In conducting these reviews, the DSIA follows the procedures issued by the IIA's International Quality Assurance Committee.

As a part of DSIA's external review process, individual reports, rating the quality and performance of individual internal auditing units, are issued to agency heads, board chairpersons and Cabinet Secretaries, as appropriate.  In addition to the rating that is given, DSIA also makes recommendations to improve the internal auditing function.  In all cases, agencies prepare an action plan aimed at resolving issues raised by DSIA.

In June, 1989, the IIA's International Quality Assurance Committee adopted new rating guidelines for reporting the results of these reviews.  Prior to this revision, the IIA recommended the use of a system that included five possible ratings.  Many practitioners, including DSIA, found the five-rating scale awkward to apply.  As a result, a three-rating system has been adopted.  The three possible ratings that internal auditing units can receive and a definition of the ratings follow:

"FULLY COMPLIES - Policies, procedures, and an internal auditing charter existed and were judged to be in accordance with the Standards.  Any deficiencies found in applying the policies, procedures, or the provisions of the audit charter were deemed minor.

ADEQUATELY COMPLIES - Policies, procedures, and an internal auditing charter existed but need improvement to be in complete conformance with the Standards, and/or some deficiencies in practice were found that deviated from the Standards.  The deviations, while significant, did not prohibit the department from carrying out its responsibilities.

DOES NOT COMPLY - Policies, procedures, and an internal auditing charter, where present, were judged not to comply with the Standards, and/or deficiencies in practice were found that were considered so significant as to seriously impair or prohibit the department from carrying out its responsibilities."

Management of the Internal Auditing Department
(continued)

To conform to the new rating system, DSIA analyzed the ratings it
had given to internal auditing units and converted the ratings to
the new system.  Table X identifies the results of DSIA's quality
assurance reviews.  Based on the new rating system, 36% of those
reviewed by DSIA fall into the "Fully Complies" category while 40%
and 24% fall into the "Adequately Complies" and "Does Not Comply"
categories, respectively.

Table X
Summary of Ratings

|  | Universities | Agencies | Total |
| --- | --- | --- | --- |
| Fully Complies | 4 | 5 | 9 |
| Adequately Complies | 5 | 5 | 10 |
| Does Not Comply | 2 | 4 | 6 |
|  | 11 | 14 | 25 |

In conclusion, while the Management of the Internal Auditing
Department Standard received the second highest overall rating of
the five general Standards, improvements need to be implemented in
certain areas by agencies.  In particular, more attention needs to
be placed on the planning and supervision elements.  While risk
assessments and audit plans are being developed by a greater
percentage of audit units, more attention needs to be directed to
the comprehensiveness of both.  In addition to these factors, as
mentioned in the Scope of Work Standard, audit plan accomplishment
must likewise be improved if the percentage of "Fully Complies" is
to be increased.

## Additional Observations and Conclusion


Agency internal auditing programs in the Commonwealth are continuing to progress in a positive way to fully conform with the IIA's Standards. This report includes numerous examples and illustrations of how, over the past two fiscal years, agency boards, management and internal audit directors have taken steps to improve their internal auditing programs. Probably the best examples are the increase in audit departments using a risk assessment process to develop their audit work plans--94.6%, and the increase in potential audit coverage when measured in terms of Commonwealth appropriations--95.2%.

While the primary focus of this report has been to assess the level of compliance with the IIA's Standards, DSIA did go beyond these Standards to measure how cost effective and responsive individual programs are to agency boards and management. From the standpoint of cost effectiveness, agency heads and boards rated their programs 3.1 on a scale of 4.0 (Table III). As to responsiveness, internal auditing programs were rated 3.2 on a scale of 4.0 (Table III).

Both these ratings, in DSIA's opinion, are important since internal auditing units, like the agency functions they examine, should serve their organizations effectively and be cost beneficial.

The DSIA believes, to continue the positive development of the State's internal auditing programs, the following conditions must be addressed:

- The annual ratios of audits completed to audits planned need to improve. Impediments to attaining higher rates of completion, such as time overruns on audit projects and time spent on special project and administrative categories in excess of planned amounts, need to be more closely monitored and reduced.

- The disparity between the "Recommended" levels of auditor staffing and the "Approved-to-Fill" levels must be narrowed. Currently, there is a need for 29 additional positions. In addition, the lowest possible vacancy rate between "Approved-to-Fill" and "Filled" positions should be a hiring objective. There are currently 18 vacant positions.

- Agency programs that have not yet developed audit plans based on risk assessments need to complete them. In addition, agencies which have not considered all seven of the IIA's suggested criteria for assessing risk need to use the remaining elements.

## Additional Observations and Conclusion
## (continued)

- Planning and supervision at the audit director level needs to be improved if agency internal auditing programs are to achieve maximum efficiency and full compliance with the IIA's Standards.

- The DSIA, agency heads, boards and internal audit directors need to work closely together to raise the level of operational and programmatic audits to 25% of overall audit effort during the next biennium.

- The use of technical tools and processes such as microcomputers and automated auditing techniques must continue to be improved and used to keep pace with the State's evolving information systems environment.

- Agencies that have not established internal auditing programs need to work with DSIA to determine the viability of establishing separate programs.

In closing, agency internal auditors are accepted and supported by both agency boards and management. The DSIA believes the Commonwealth of Virginia has the basic foundation necessary to provide the high quality of internal auditing expected.

Appendix C

# COMMONWEALTH of VIRGINIA

JOHN H. HUSTON
STATE INTERNAL AUDITOR

*Department of the State Internal Auditor*

## Department of the State Internal Auditor Directive No. 1-85

**Subject:** Policies, Standards, and Procedures for Agency and Institutional Internal Auditors.

**Purpose:** This directive is to ensure that internal auditors establish and follow generally accepted auditing standards in the conduct of their work.

**Applicability:** This directive applies to all State agencies and institutions with an internal audit function.

**Effective Date:** October 15, 1985.
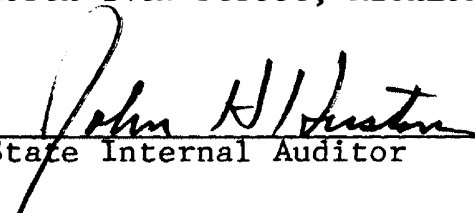
**Authority:** Section 2.1-234.32 of the **Code of Virginia.**

**Policy:** All State agencies and institutions with internal audit functions shall adopt and prescribe to the "Standards for the Professional Practice of Internal Auditing" and "Statements on Internal Auditing Standards" promulgated by the Institute of Internal Auditors. This is not intended to restrict internal auditors from adopting additional standards from other authoritative bodies, such as the Comptroller General of the United States or the American Institute of Certified Public Accountants, as appropriate.

When developing agency or institutional policies and procedures to meet the standards included in this directive, agency and institutional internal auditors will be expected to follow the guidance provided in the State Internal Auditor's **Internal Audit Policies and Procedures Manual.**

**Exceptions:** If an agency or institution believes that adherence to the policy set forth above will create an undue hardship, an agency head may request that the State Internal Auditor amend or modify the requirements. Such requests should be in writing and include reasons for the request and the exact nature of the proposed modification. The State Internal Auditor will provide written response to the agency or institutional head.

Assistance: Requests for assistance in complying with this Directive should be forwarded to the State Internal Auditor, James Monroe Building, 101 North 14th Street, Richmond, Virginia 23219.

_John H. Huston_     10/7/85
State Internal Auditor     Date

Distribution:     Governor
Lieutenant Governor
Attorney General
Governor's Secretaries
Heads of State Agencies
    and Institutions
Auditor of Public Accounts
Director, Joint Legislative Audit
    and Review Commission
State Agency and Institutional
    Internal Audit Directors
Agency Fiscal Officers

Appendix D

DEPARTMENT OF THE STATE INTERNAL AUDITOR
OVERALL TRAINING SCHEDULE
1989-90

| Course | Dates |
|---|---|
| Managerial and Leadership Skills for Auditors | July 10-12, 1989 |
| Auditing the Systems Development Life Cycle | September 13-15, 1989 |
| Evaluating Internal Controls | October 10, 1989 |
| Virginia Procurement Laws and Regulations | October 16, 1989 |
| Audit Report Writing | October 18-20, 1989 |
| Basic Internal Auditing Seminar | October 25-27, 1989 |
| Data Flow Diagrams in Auditing | November 6, 1989 |
| Understanding the Disc Operating System (DOS) | November 20-21, 1989 |
| Senior-Level Internal Auditing Seminar | December 6-8, 1989 |
| Microcomputer Utilization, Applications, and Controls | December 14-15, 1989 |
| Internal Audit Director and Manager Round Table | December 18, 1989 |
| Auditing Agency Effectiveness | January 17-19, 1990 |
| Quality Assurance--Internal Review | February 2, 1990 |
| Auditing Standards Update | February 9, 1990 |
| Easytrieve Plus | February 14-16, 1990 |
| Introduction to the Commonwealth's Central Financial Systems | March 15-16, 1990 |
| Communications Skills for Auditors | March 23, 1990 |
| Fraud, Abuse and Illegal Activities | April 9, 1990 |
| Identifying and Evaluating Audit Risks | April 16, 1990 |
| Auditing in an EDP Environment | April 18-20, 1990 |
| Understanding the Disc Operating System (DOS) | May 3-4, 1990 |
| Auditing the Efficiency of Operations | May 16-18, 1990 |
| Auditing in a Data Base Environment | May 23-25, 1990 |
| Commonwealth's Directives | June 8, 1990 |
| Audit Team Building through Effective Supervision | June 11-15, 1990 |

Appendix E

**Managerial and Leadership Skills for Auditors**

A contemporary three-day program for internal auditing directors and managers focusing upon the personal qualities and administrative skills necessary for providing strong leadership and management within the audit function.  Topics include an analysis of leadership styles, situational leadership, and the auditor's role as a communicator.  Participants will work in a highly interactive workshop setting while sharing experiences and exploring proven concepts and ideas.

**Auditing the Systems Development Life Cycle**

A three-day course designed to provide the criteria and techniques for auditing the Systems Development Life Cycle process.  Descriptions of the methodology include the phases, purpose, responsibilities, outputs, and controls of each phase.  Different types of SDLC models are discussed.  Auditor involvement in the SDLC is examined, and suggestions about the type and depth of involvement for each phase of the process are discussed.  Other audit tools and techniques are also explored in this seminar.

**Evaluating Internal Controls**

A one-day course directed toward internal auditors with limited experience in reviewing internal control systems.  The objectives of the session include:

- Gaining an understanding of internal controls and control objectives;

- Developing an understanding of specific control measures such as segregation of duties, rotation of duties, etc.; and

- Developing a grasp for the techniques necessary to gather information needed to understand and evaluate internal control systems.

The objectives of this session will be achieved by walking through cash studies and exercises.

**Virginia Procurement Laws and Regulations**

A one-day course presented by the Division of Purchases and
Supply which explains the provisions of the "Agency Procurement
Manual." This "Manual" delineates the practices agencies are
to follow when contracting for goods or services and incor-
porates the provisions of the Virginia Public Procurement Act.

In addition, the "State Procurement Audit Program" and updates
that have occurred during the current year will be discussed.

**Audit Report Writing**

A three-day course to provide expert analysis of your existing
writing style and instruction in easy-to-apply methods for
deciding upon the most appropriate style, approach, and formal
organization for your internal auditing unit's report writing.

In addition to the course instruction, each participant will
receive the text, Writing Audit Reports, by Mary C. Bromage.

**Basic Internal Auditing Seminar**

A three-day course directed toward staff auditors. Objectives
of the course include providing tools to plan and conduct an
internal audit; teaching techniques to evaluate internal con-
trols such as interviewing, flow charting, and the use of
internal control questionnaires; identifying recommendations
and writing internal audit reports; and understanding the role
of other State offices.

**Data Flow Diagrams in Auditing**

A one-day course explaining data flow diagrams and how they can
be used in the audit process to document systems and to facili-
tate the analysis of internal controls. The discussion will
address the use of data flow diagrams in auditing existing
information systems and in performing control analyses for new
systems under development.

## Understanding the Disc Operating System (DOS)

A two-day course designed to provide participants with an understanding of the uses and limitations of the Disk Operating System (DOS). "Hands-on" experience with the MS-DOS environment will be provided. At the conclusion of the course, participants should know how to interact with this operating system and the techniques needed to manage your personal computer.

## Senior-Level Internal Auditing Seminar

A three-day course designed to provide a senior-level auditor with the techniques necessary to effectively manage the field-work portion of an audit. Objectives include developing an understanding of the role of the senior internal auditor, providing tools to assist the senior auditor in promoting staff development, properly planning and assigning work and appropriately reviewing staff work. Discussions and exercises also focus on communication between the audit team as well as with the auditee.

## Microcomputer Utilization, Applications, and Controls

A two-day course designed to apply micro technology to the needs of internal auditors, both as users and reviewers. No prior data processing knowledge is required. Topics include a technical introduction, planning issues, feasibility determination, configuration, and software and hardware selection. Acquisition in State agencies, sources of support and training, freeware and public domain software will be discussed. The use of micros by auditors, and auditing of users' microcomputers are key features. Among the uses examined are:

- Spreadsheets;
- Graphics;
- Databases;
- Statistical Sampling;
- Risk Analysis;
- Audit Software;
- Internal Audit Packages;
- Micro-Mainframe Links;
- Security;
- Project Management; and
- Data Communications.

## Internal Audit Director and Manager Round Table

A one-day forum that provides internal audit directors and managers with an opportunity to exchange ideas on key operational, administrative, and technical issues confronting Virginia's internal auditing community.

This round table enables directors and managers to meet with other key internal audit professionals in Virginia government to collectively discuss how to improve or change their internal audit departments.

## Auditing Agency Effectiveness

A three-day course for internal auditors with limited operational auditing experience. The objectives of this course are to provide the participant with an initial knowledge base to:

- Identify potential "high-return" audit involvement activities, which provide the best opportunities for applying operational audit techniques, when performing the preliminary survey;

- Evaluate how effectively management attains goals and objectives;

- Evaluate the effectiveness of policies and procedures;

- Evaluate and analyze the congruence of goals, objectives, policies, procedures, job descriptions, and activities; and

- Evaluate the effectiveness of program results and service delivery.

The course provides participants with practical applications through class discussion, class problems, and case studies.

## Quality Assurance--Internal Review

The purpose of this one-day session is to focus upon the Institute of Internal Auditors' (IIA) Standard 560.03--"Internal reviews should be performed periodically by members of the internal auditing staff to appraise the quality of the audit work performed. These reviews should be performed in the same manner as any other internal audit."

**Quality Assurance--Internal Review (continued)**

In addition to reviewing the IIA's Standards, participants will also be taken through the Internal Review Section of the IIA's Quality Assurance--Review Manual for Internal Auditing and the applicable aspects of "Statement on Internal Auditing Standards No. 4--Quality Assurance."  This session is recommended for director and manager levels and those designated as responsible for quality assurance within individual internal auditing units.

**Auditing Standards Update**

A one-day session directed to reviewing certain elements of the Institute of Internal Auditors' (IIA) Standards for the Professional Practice of Internal Auditing (Standards).  Also, changes to the Standards during the past year as a result of new IIA pronouncements will be discussed.

**Easytrieve Plus**

This three-day course is intended for all auditors.  No prior knowledge in data processing is required.  "Hands-on" programming experience, using Pansophic's report writer, Easytrieve Plus, will be provided.  Class participants will have the opportunity to write programs, enter the programs through a terminal, submit the programs for execution, and verify the output. Limited training in IBM Job Control Language (JCL) and the text editor, TSO, will be included.  This experience will make it easier for the general auditor and EDP auditor to obtain information from the computer.

**Introduction to the Commonwealth's Central Financial Systems**

This two-day seminar will provide participants with the following:

> Budgeting System--Overview of the system from a financial and legislative standpoint.  Particular budget reports that support the detailed budgeting system will be discussed. A special discussion of the Department of Planning and Budget's role as it relates to the development of the State's budget and interaction with individual agencies and institutions will also be presented.

**Introduction to the Commonwealth's Central Financial Systems (continued)**

> Accounting System—An overview of CARS.  Discussion of CARS reports and optional CARS reports useful for auditors.  In addition, agency-based systems, reconciliations to CARS and the limitations of CARS will be explored.

> Payroll System—Overview of CIPPS (Commonwealth Integrated Payroll and Personnel System) with reports, options and information useful for auditing purposes will be presented.

**Communications Skills for Auditors**

A one-day seminar that concentrates on the auditor-auditee relationship beginning with the opening conference and working through audit scenarios to the exit conference.  Illustrations and group discussions will focus on professional communication and behavioral techniques.  Exercises will be aimed at skills such as listening, presenting, persuading, negotiating, and selling.

**Fraud, Abuse and Illegal Activities**

This day-long program will focus on the Institute of Internal Auditors' Statement on Internal Auditing Standards No. 3—"Deterrence, Detection, Investigation, and Reporting of Fraud."  An in-depth discussion of Statement No. 3 and the internal auditors' responsibility for deterring, detecting, investigating, and reporting of fraud will be presented.  Specific examples of irregularities will be discussed in order to provide internal auditors with an understanding of fraud, as well as techniques for detecting and preventing fraud.

The seminar will be supplemented by a presentation from representatives of the Bureau of Criminal Investigations of the Department of the State Police who will discuss the legal differences between fraud, embezzlement, etc., in Virginia.  Their presentation will focus on State statutes applicable to this subject area, and will include a review of actual cases they have investigated and prosecuted.  Finally, they will discuss how different State agencies interface in the investigation process.

**Identifying and Evaluating Audit Risks**

This is a one-day course for Internal Audit Directors, Managers, and Supervisors.  The participants will be introduced to a risk analysis model developed jointly in 1988-89 by the Department of the State Internal Auditor and a group of the Commonwealth's internal audit directors.

This model will assist in determining both the frequency and scope of audits by evaluating certain characteristics such as operating environment, design of controls, human resources, etc. and magnitude factors (annual revenue and expense, information disclosure, valuables, etc.).

The participants will "walk thru" the model application and learn how to use the results to develop audit plans and frequency intervals.

**Auditing in an EDP Environment**

Auditing in an EDP Environment is a must for the entire audit staff.  This three-day course covers the approach for auditing an EDP application.

It provides techniques for:

    o    Planning an EDP Application Audit;
    o    Gaining an Understanding of the Application;
    o    Recording that Understanding;
    o    Evaluating the Controls;
    o    Testing the Controls; and
    o    Reporting the Findings and Recommendations.

**Auditing the Efficiency of Operations**

A three-day course for internal auditors with limited to moderate operational auditing experience.  The objectives of this course are to provide the participant with the ability to:

    •    Evaluate and determine the productivity of operations through work measurement tools and techniques;

    •    Evaluate the work flow through an entity for possible improvement;

### Auditing the Efficiency of Operations (continued)

- Evaluate, analyze, and determine the correct expertise and number of employees required to perform procedures and activities; and

- Identify ways to reduce backlogs and enhance turn-around time for requests while reducing errors.

The practical application of these objectives will be provided through class discussion, class problems, and case studies.

### Auditing in a Data Base Environment

This three-day seminar addresses the specific control concerns relative to the aspects of data base supported information systems. The course includes obtaining an understanding of appropriate concepts and terminology, identifying and describing audit and control issues, and preparing an audit plan for data base systems.

### Commonwealth's Directives

A one-day course designed to review the content of central agency directives and their impact relative to internal audit activity. Specific attention will focus on directives issued by the Comptroller, the Treasurer, the Department of Planning and Budget, and the Department of Information Technology. In addition, relevant Executive Orders will be discussed.

### Audit Team Building through Effective Supervision

This four-and-a-half-day course is of real benefit to those who have never had formal supervisory or managerial training and who want a solid foundation in techniques for dealing with the day-to-day challenges they face. The course offers specific help in role definition, planning techniques, establishing priorities, dealing with staff, time management, motivation, delegation, oral communication, performance management, and situational leadership.