

Internal Audit Function in State Agencies

Historical Perspective of OLA's and the Committee's Involvement

- On January 3, 1991, the Division of Audits (now the Office of Legislative Audits) issued the results of a performance audit on State agency internal audit units. That audit concluded that significant deficiencies and inconsistencies existed within and among the operations of the internal audit units in the State which significantly impaired their effectiveness and efficiency. (See Exhibit A for excerpts from that report).
- As proposed by the Joint Budget and Audit Committee (now the Joint Audit Committee), Senate Bill 205 was passed by the 1993 General Assembly (see Exhibit B).
- Senate Bill 205 was vetoed by the Governor. While agreeing with the Bill's concept, the Governor indicated that it was unnecessary and the same objectives could be accomplished by Executive Order. The Governor also expressed concern that the costs associated with the Bill were not addressed.
- During the 1994 Session of the General Assembly, the veto was sustained. On February 4, 1994, the Governor issued Executive Order .01.01.1994.06 on State Agencies – Internal Audits, which continues to be in effect.

Prepared by:
Office of Legislative Audits
September 2011



ANTHONY J. VERDECCHIA, CPA
LEGISLATIVE AUDITOR

Division of Audits
State Office Building
Baltimore, Md. 21201
(301) 225-1400

EXHIBIT A
Page 1 of 6

BRUCE A. MYERS, CPA
DEPUTY

THOMAS J. BARNICKEL, CPA
JOHN D. KENNEY, CPA
ROBERT C. KOSLOWSKI, CPA
GERALD W. MARTZ, CPA
AUDIT MANAGERS

January 3, 1991

Joint Budget and Audit Committee of the General Assembly
Mr. William S. Ratchford, II, Director, Department of Fiscal Services
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a performance audit of State agency internal audit units. Our audit also included an assessment of the applicability of the inspector general concept to the State of Maryland. This audit was conducted under the authority of the State Government Article, Section 2-1216 of the Annotated Code of Maryland. Our audit was performed in accordance with generally accepted government auditing standards and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

To help ensure the existence and proper operation of effective systems of internal controls, promote efficient State government operations, and provide agency management with the information necessary to effectively oversee agency operations, internal audit units have been established at 25 State agencies. We conducted this performance audit to evaluate the effectiveness and efficiency of these internal audit units. Our audit disclosed significant deficiencies and inconsistencies within and among the operations of the internal audit units in the State which, in our opinion, significantly impaired the effectiveness and efficiency of the units. For example, we noted that the units did not consistently comply with recognized auditing standards, did not adequately plan their operations and did not adequately follow-up on audit findings. Therefore, we believe that certain fundamental changes in the operation and organization of State agency internal audit units are necessary.

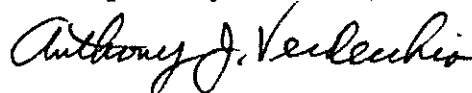
During January, 1990, an Office of the Inspector General was established in the State Department of Human Resources. (The concept of an inspector general includes responsibility for investigative as well as audit-related activities). This Office is currently performing only a minimum amount of investigative duties. Based on the results of our review of the applicability of the inspector general concept to the State of Maryland, we believe that there is no need to expand this concept in Maryland. Many of the services provided by inspector general offices in other states are already provided by existing agencies in Maryland (e.g., Office of the State Prosecutor) and improvements to and increased awareness of existing internal audit resources in conjunction with existing services would provide basically the same type of coverage in Maryland as provided by inspector general offices in other states.

A summary of our findings is contained on pages 3 to 5. The introduction, scope, objectives and methodology of our review as well as our detailed comments and recommendations begin on page 6.

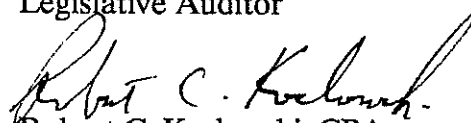
We wish to acknowledge the cooperation extended to us by the personnel of the agencies reviewed during the course of our audit.

Our audit reports and the related agency responses are maintained on file in the Department of Fiscal Services, 90 State Circle, Annapolis, Maryland and are available for public inspection.

Respectfully submitted,



Anthony J. Verdecchia, CPA
Legislative Auditor



Robert C. Koslowski, CPA
Audit Manager

SUMMARY OF FINDINGS

	<u>Pages</u>
INTERNAL AUDIT UNITS:	
<u>Professional Standards</u>	8
Six State agency internal audit units were reviewed in detail. These units had either not adopted, or did not consistently comply with professional auditing standards.	
<u>Hiring Qualifications</u>	9
Several instances were noted where State agency internal auditors had not demonstrated possession of auditing and/or accounting knowledge or skills at the time of their employment.	
<u>Planning and Audit Coverage</u>	9
Two of the internal audit units reviewed did not prepare periodic audit plans to carry out the responsibilities of the internal audit function. Additionally, at the other four units reviewed, the plans prepared were not based on agency wide assessment of financial exposure, potential loss and risk.	
<u>Independence</u>	9
One internal audit unit operated under the agency's Director of Finance. This situation could prevent the unit from objectively auditing matters involving finance and accounting.	
<u>Policies and Procedures Manual</u>	10
Two of the internal audit units reviewed did not have a policy and procedures manual.	
<u>Operational Duties</u>	10
Internal auditors at two of the units performed a significant amount of operational (non-audit related) duties.	
<u>Time Estimates</u>	10
Two internal audit units reviewed did not prepare estimates of the time necessary to perform audit assignments. Additionally, although one unit prepared such time estimates, the actual time spent to complete assignments was not subsequently compared to the estimates.	

SUMMARY OF FINDINGS
(CONTINUED)

	<u>Pages</u>
<u>Working Paper Preparation and Review</u>	10 - 11
Numerous deficiencies were noted regarding working paper preparation and review.	
<u>Audit Follow-up</u>	11 - 12
Five of the internal audit units reviewed had inadequate procedures for performing follow-up reviews of prior audit findings.	
<u>Training Programs</u>	12
Five of the internal audit units reviewed had not developed formal training programs, nor did these units require their auditors to receive a certain amount of training each year. Additionally, at all six units reviewed, training records indicating the amount, nature and dates of training provided to audit personnel were not maintained.	
<u>Peer Reviews</u>	12 - 13
None of the internal audit units reviewed has undergone a peer review or has plans to participate in a peer review program.	
<u>Internal Audit Law</u>	13
Unlike several other states, Maryland does not have a law governing the operation of State agency internal audit units to help ensure the effectiveness, efficiency and consistency of these units.	
<u>Job Classification</u>	13 - 14
The State Department of Personnel has not established a job classification series specifically for internal auditors.	

SUMMARY OF FINDINGS
(CONTINUED)

Pages

Allocation of Internal Auditors

14

We believe there are major inequities in the allocation of internal audit resources throughout State agencies.

INSPECTOR GENERAL OFFICES:

15 - 16

Five other states currently have statewide inspector general offices. However, many of the services provided by inspector general offices in other states are already provided by existing agencies in Maryland (i.e., Office of the State Prosecutor, Office of the Attorney General - Criminal Investigations Division, Legislative Auditor's Office and Internal Audit Units). Additionally, improvements to existing internal audit resources in conjunction with existing services would provide basically the same type of coverage in Maryland as provided by inspector general offices in other states.

APPENDIX A

MARYLAND STATE AGENCIES WITH INTERNAL AUDIT UNITS

<u>Name of Agency</u>	<u>Number of Budgeted Positions</u>
Department of Agriculture	1
University of Baltimore	1
Bowie State University	2
Comptroller of the Treasury - Data Processing Division	1
Comptroller of the Treasury - Income Tax Division	1
Comptroller of the Treasury - Office of the Comptroller	3
Coppin State University	1
Department of Economic and Employment Development	5
Department of Education	1
Department of the Environment	2
Frostburg State University	1
Department of Health and Mental Hygiene	4
State Highway Administration	5
* Department of Housing and Community Development	5
Department of Human Resources	18
* Judiciary	6
* University of Maryland Systems Administration	14
Mass Transit Administration	2
Morgan State University	3
* Motor Vehicle Administration	8
Department of Natural Resources	5
* Department of Public Safety and Correctional Services	8
Salisbury State University	1
Towson State University	3
* Department of Transportation	<u>10</u>
	<u>111</u>

* Agencies that were included within the scope of our detailed review.

SENATE BILL 205

P1

(3lr1323)

ENROLLED BILL

Introduced by Senator Lapides (Chairman, Joint Budget and Audit Committee)

Read and Examined by Proofreaders:

Proofreader.

Proofreader.

Sealed with the Great Seal and presented to the Governor, for his approval this
_____ day of _____ at _____ o'clock, _____ M.

President.

CHAPTER _____

1 AN ACT concerning

2 State Agencies – Internal Audits

3 FOR the purpose of requiring State agencies that perform internal audits to ~~employ~~
4 designate a chief internal auditor and certain staff and to establish a certain internal
5 auditing program; specifying the ~~manner of appointment, qualifications,~~
6 qualifications, and duties of the chief internal auditor; creating certain exceptions to
7 the qualifications of the chief internal auditor; prescribing the general content of an
8 agency's internal audit program and of internal audits; specifying the auditing
9 standards by which internal ~~audit~~ audits must be conducted; requiring the Chief
10 Internal Auditor and the internal audit staff to have access to certain personnel and
11 information and to maintain the confidentiality of certain records; providing a
12 certain penalty for violation of certain confidentiality laws; defining certain terms;
13 and generally relating to internal audits performed by certain State agencies.

14 BY adding to

15 Article – State Government

16 Section 10–1001 through 10–1007, inclusive, to be under the new subtitle “Subtitle
17 10. Internal Audits”

18 Annotated Code of Maryland

EXPLANATION: CAPITALS INDICATE MATTER ADDED TO EXISTING LAW.

[Brackets] indicate matter deleted from existing law.

Underlining indicates amendments to bill.

~~Strike-out~~ indicates matter stricken from the bill by amendment or deleted from the law by amendment.

Italics indicate opposite chamber/conference committee amendments.



2

SENATE BILL 205

1 (1984 Volume and 1992 Supplement)

2

Preamble

3 WHEREAS, A separate budgetary authorization is necessary to finance the
4 personnel and related costs for an internal audit function in a State agency; and

5 WHEREAS, The establishment of minimum qualifications, standards, and
6 operating procedures will help ensure that an authorized internal audit function is
7 effective; and

8 WHEREAS, The State of Maryland will benefit from effective internal audit
9 functions in State agencies; now, therefore,

10 SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF
11 MARYLAND, That the Laws of Maryland read as follows:

12

Article - State Government

13

SUBTITLE 10. INTERNAL AUDITS

14 10-1001.

15 (A) IN THIS SUBTITLE THE FOLLOWING WORDS HAVE THE MEANINGS
16 INDICATED.

17 (B) "AGENCY" MEANS EVERY AGENCY, BOARD, BUREAU, COMMISSION,
18 COUNCIL, DEPARTMENT, OR INSTITUTION IN THE EXECUTIVE BRANCH OF THE
19 STATE GOVERNMENT.

20 (C) "AGENCY HEAD" MEANS THE EXECUTIVE HEAD OF AN AGENCY.

21 (D) "CHIEF INTERNAL AUDITOR" MEANS THE PERSON ~~EMPLOYED~~
22 DESIGNATED BY AN AGENCY TO DIRECT INTERNAL AUDITS FOR THE AGENCY.

23 (E) "INTERNAL AUDIT" MEANS AN EXAMINATION AND EVALUATION OF THE
24 ADEQUACY AND EFFECTIVENESS OF AN AGENCY'S ~~SYSTEM OF~~:

25 (1) SYSTEM OF INTERNAL CONTROL;

26 (2) COMPLIANCE WITH THE LAW;

27 (3) COMPLIANCE WITH RULES AND REGULATIONS; AND

28 (4) QUALITY OF PERFORMANCE IN CARRYING OUT ITS
29 RESPONSIBILITIES.

30 10-1002.

31 (A) EACH AGENCY THAT PERFORMS INTERNAL AUDITS SHALL ~~EMPLOY~~:

32 (1) DESIGNATE A CHIEF INTERNAL AUDITOR; AND

33 (2) ~~AS THE AGENCY HEAD DETERMINES TO BE NECESSARY TO~~
34 IMPLEMENT AN EFFECTIVE PROGRAM OF INTERNAL AUDITS, ADDITIONAL THAT
35 INCLUDES, AS THE AGENCY HEAD DETERMINES TO BE NECESSARY, PROFESSIONAL

SENATE BILL 205

3

1 AND SUPPORT STAFF THAT HAVE THE TECHNICAL PROFICIENCY AND
2 EDUCATIONAL BACKGROUND APPROPRIATE FOR THE PERFORMANCE OF THE
3 AUDITS.

4 ~~(B) THE AGENCY HEAD SHALL APPOINT THE CHIEF INTERNAL AUDITOR.~~

5 ~~(C)~~ (B) THE CHIEF INTERNAL AUDITOR SHALL:

6 (1) PREFERABLY BE EITHER A CERTIFIED PUBLIC ACCOUNTANT OR A
7 CERTIFIED INTERNAL AUDITOR; AND

8 (2) HAVE AT LEAST 3 YEARS OF AUDITING EXPERIENCE.

9 10-1003.

10 THE CHIEF INTERNAL AUDITOR OF AN AGENCY SHALL:

11 (1) REPORT DIRECTLY TO THE AGENCY HEAD;

12 (2) DEVELOP AN ANNUAL AUDIT PLAN TO CARRY OUT INTERNAL
13 AUDITS;

14 (3) PROVIDE WRITTEN POLICIES AND PROCEDURES TO GUIDE THE
15 PERFORMANCE OF INTERNAL AUDITS;

16 (4) ESTABLISH AND MAINTAIN AN ONGOING INTERNAL QUALITY
17 ASSURANCE PROGRAM TO EVALUATE THE OPERATION OF INTERNAL AUDITS;

18 (5) PARTICIPATE IN PERIODIC EXTERNAL PEER REVIEW;

19 (6) BE FREE OF ALL OPERATIONAL AND MANAGEMENT
20 RESPONSIBILITIES THAT WOULD IMPAIR THE ABILITY TO MAKE INDEPENDENT
21 REVIEWS OF ALL ASPECTS OF THE AGENCY'S OPERATIONS;

22 (7) PREPARE INTERNAL AUDIT REPORTS THAT SHALL:

23 (I) BE SUBMITTED TO THE AGENCY HEAD; AND

24 (II) EXCEPT FOR ANY PART OF A REPORT THAT IS
25 CONSTITUTIONALLY PRIVILEGED, BE AVAILABLE TO THE LEGISLATIVE AUDITOR;

26 (8) CONDUCT FOLLOW-UP REVIEWS OF INTERNAL AUDIT FINDINGS TO
27 ASCERTAIN THAT APPROPRIATE ACTION HAS BEEN TAKEN ON FINDINGS
28 CONTAINED IN INTERNAL AUDIT REPORTS; AND

29 (9) MAKE AVAILABLE AND COORDINATE A CONTINUING
30 PROFESSIONAL EDUCATION PROGRAM:

31 (I) TO ENSURE THAT THE AGENCY'S INTERNAL AUDITORS HAVE
32 ACCESS TO CURRENT INFORMATION CONCERNING INTERNAL AUDIT POLICIES,
33 PROCEDURES, AND TECHNIQUES; AND

34 (II) TO PROVIDE GENERAL TECHNICAL AND AUDIT ASSISTANCE
35 TO THE AGENCY'S INTERNAL AUDITORS.

36 10-1004.

4

SENATE BILL 205

1 EACH AGENCY THAT PERFORMS INTERNAL AUDITS SHALL ESTABLISH A
2 PROGRAM THAT INCLUDES:

3 (1) AN ANNUAL INTERNAL AUDIT PLAN THAT:

4 (I) USES MATERIALITY AND RISK ASSESSMENT TECHNIQUES; AND

5 (II) IDENTIFIES THE INDIVIDUAL AUDITS TO BE CONDUCTED
6 DURING EACH YEAR; AND

7 (2) PERIODIC AUDITS OF THE AGENCY'S CONTROL ENVIRONMENT,
8 INCLUDING ALL MAJOR ELECTRONIC AND MANUAL DATA PROCESSING SYSTEMS.

9 10-1005.

10 EACH INTERNAL AUDIT SHALL INCLUDE WORKING PAPERS THAT:

11 (1) ARE PREPARED OR REVIEWED BY SUPERVISORY PERSONNEL;

12 (2) DOCUMENT THE AUDIT WORK;

13 (3) RECORD AUDIT INFORMATION AND ANALYSES; AND

14 (4) SUPPORT THE FINDINGS AND RECOMMENDATIONS OF THE
15 INTERNAL AUDIT REPORT.

16 10-1006.

17 (A) AN INTERNAL AUDIT SHALL BE CONDUCTED:

18 (1) IN ACCORDANCE WITH THE INTERNAL AUDITING STANDARDS
19 PUBLISHED BY THE INSTITUTE OF INTERNAL AUDITORS; OR

20 (2) WHERE APPROPRIATE, IN ACCORDANCE WITH GENERALLY
21 ACCEPTED GOVERNMENT AUDITING STANDARDS.

22 (B) EACH INTERNAL AUDIT REPORT THAT THE CHIEF INTERNAL AUDITOR
23 ISSUES SHALL INCLUDE A STATEMENT THAT THE AUDIT WAS CONDUCTED IN
24 ACCORDANCE WITH THE STANDARDS IN SUBSECTION (A) OF THIS SECTION.

25 10-1007.

26 THE CHIEF INTERNAL AUDITOR AND THE INTERNAL AUDIT STAFF SHALL:

27 (1) HAVE ACCESS TO ALL PERSONNEL AND ANY DATA, RECORDS, AND
28 OTHER INFORMATION OF A STATE AGENCY THAT THE CHIEF INTERNAL AUDITOR
29 DEEMS NECESSARY TO CARRY OUT AN INTERNAL AUDIT; AND

30 (2) (I) MAINTAIN THE CONFIDENTIALITY OF ANY PUBLIC RECORDS
31 THAT ARE MADE CONFIDENTIAL BY LAW; AND

32 (II) BE SUBJECT TO THE SAME PENALTIES AS THE CUSTODIAN OF
33 THE PUBLIC RECORDS FOR A VIOLATION OF A CONFIDENTIALITY LAW APPLICABLE
34 TO THE RECORDS.

35 SECTION 2. AND BE IT FURTHER ENACTED, That the qualifications for a
36 chief internal auditor in § 10-1002(c) of the State Government Article, as enacted by this
37 Act, do not apply to any person who, on the effective date of this Act:

SENATE BILL 205

5

- 1 (1) does not meet the qualifications of a chief internal auditor; and
2 (2) is employed by an agency to direct the agency's internal audits.

3 SECTION 3. AND BE IT FURTHER ENACTED, That this Act shall take effect
4 October 1, 1993.

Approved:

Governor.

President of the Senate.

Speaker of the House of Delegates.