Internal Control Task Force

Internal Audit Peer Review

ACKNOWLEDGEMENTS

About the Report

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

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

About the Authors

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

Research Groups

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

Stakeholder Groups

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

For More Information

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

DOB - Tom Lukacs	(518) 402-4158
OSC - John Buyce	(518) 474-3271
NYSICA - Mark Mitchell	(518) 862-1090

Peer Review Workgroup

Task Force Liaison

Mark B. Mitchell, MBA, CIA, CGFM
Energy Research & Development Authority

Co-Chairs

Robert Curtin, CPA
Office of General Services

John S. Samaniuk, CIA, CGFM
Department of Transportation

Workgroup Members

Gail Berley and Ginny Santos
Parks, Recreation and Historic Preservation

James Conway
State Education Department

Randall Griffin
Department of Health

Mike Ostermann
Division of Parole

Paul Tucci
State University of New York

Melissa Warner
Office of the State Comptroller

BACKGROUND

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

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

RESULTS IN SUMMARY

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

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

RESULTS OF REVIEW

Cost Comparison of Various Approaches

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

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

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

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

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

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

Develop a Plan to Assist Agencies In Obtaining External Assessments

For Agencies Contracting Out

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

For Agencies Opting to Participate in a Cooperative Effort

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

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

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

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

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

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

Monitoring

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

Need for a Resource to Coordinate External Assessments

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

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

Action Items

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

RECOMMENDATIONS

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