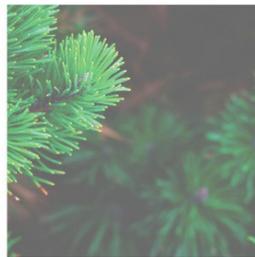




Secretary of State Oregon Audits Division



Department of Administrative Services
**Opportunities Exist to Increase the Impact of State
Agency Internal Audit Functions**

August 2018
2018-25

Secretary of State Dennis Richardson
Audits Division Director Kip Memmott

This page intentionally left blank



Secretary of State Audit Highlights

August 2018

Department of Administrative Services

Opportunities Exist to Increase the Impact of State Agency Internal Audit Functions

Report Highlights

When internal audit functions are properly structured and resourced, they are a valuable asset for mitigating risks and improving agency performance and accountability. However, internal auditing has not been a priority in Oregon. Although the Department of Administrative Services (DAS) has the authority to create policy and a legal requirement to support audit functions, the agency has not strategically promoted the role of internal audit functions due to a number of factors. DAS has not effectively monitored, coordinated, or reported on internal audit function impacts, challenges, and resource needs to state legislators and other stakeholders.

Background

Internal audit functions help organizations achieve their objectives and improve performance. The Oregon Legislature determined internal audit activities within state government should be coordinated to promote effectiveness, and directed DAS to adopt rules and set standards to ensure the integrity of internal auditing.

Purpose

The purpose of this audit was to determine the steps DAS should take to more effectively coordinate state internal audit functions, and what actions can be taken to increase the impact of these critical functions.

Key Findings

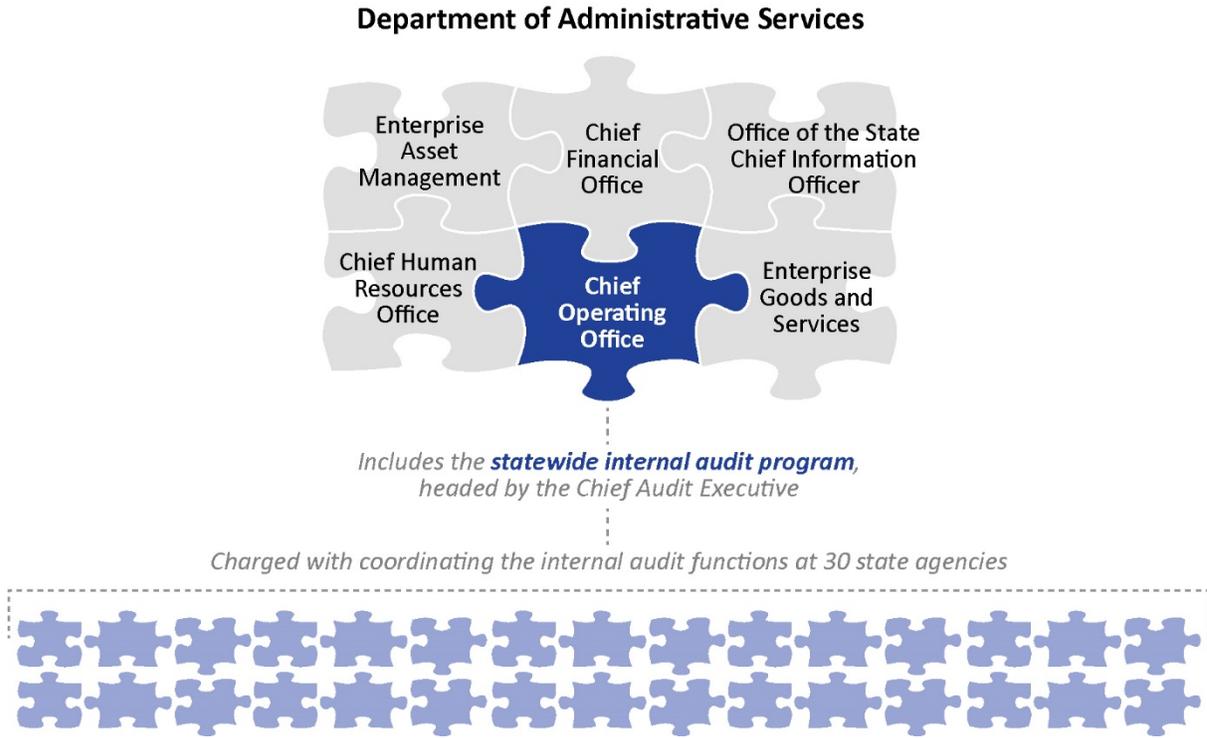
1. The effectiveness of an agency's internal audit function is defined by the tone at the top. In general, the internal audit function at state agencies in Oregon is not prioritized or well understood by agency management and the Legislature. Many current challenges and deficiencies have persisted for more than two decades.
2. Internal audit independence and impact is directly influenced by the effectiveness of the audit committee and the committee's relationship with agency leadership. Internal audit functions in some state agencies do not follow important elements of professional audit standards that ensure independence from management. These deficiencies reduce the effectiveness of the functions and leave agencies more vulnerable to fraud, wasted taxpayer dollars, and other substantial risks.
3. Poor guidance and a lack of strategic management and effective coordination from DAS has contributed to internal audit challenges at state agencies. DAS reporting on statewide internal audit activities and impact could be a valuable tool for both internal auditors and policymakers, but DAS reports are often inaccurate, confusing, and uninformative.
4. Many internal audit functions are staffed by well-trained, qualified professionals who make contributions to the agencies they serve despite governance and resource challenges. With additional emphasis and resources they could increase their value and return on investment potential.

Recommendations

Our report includes 16 recommendations to DAS intended to enhance the value and impact of state agency internal audit functions. DAS agreed with 13 of 16 recommendations. The agency declined to say whether it agreed or disagreed with three recommendations.

Introduction

Internal auditors help state agencies identify risks and resolve challenges so that these agencies may provide the best possible service to Oregonians. State law requires agencies that meet specific criteria to maintain internal audit functions. The purpose of this audit was to determine the steps the Department of Administrative Services (DAS) needs to take in order to more effectively coordinate, promote, and publicly report on state internal audit functions, and to determine what state agency internal audit functions need to be more effective.



Internal auditing helps manage risk and improve performance

Auditing occurs in private sector companies, nonprofit organizations, and every level of government. In government, auditing advances principles that are critical to managing public resources, such as accountability, transparency, integrity, and equity.

Recent polls have found Americans' trust in federal and state government is in decline. In 2016, Gallup found over 40% of Oregonians did not have confidence in their state government, a number that ranks it lower than most other states.¹ Auditors' work can increase public trust by providing analysis and recommendations related to effectiveness of governance, programs, and services; compliance with rules, laws and legal agreements; assessment of risks and threats; and investigations of potential fraud and abuse.

¹Gallup. (2016). 2015 Gallup 50-State Poll. Retrieved from <http://news.gallup.com/poll/189281/illinois-residents-least-confident-state-government.aspx>

Agency management benefits from the services internal auditors can provide. Internal auditors can help organizations identify, understand, and mitigate a variety of risks related to internal controls, which helps agencies achieve their objectives and improve performance.² Audit work can lead to positive outcomes including:

- improved programs and services;
- cost savings;
- increased revenue;
- improved accountability for performance;
- improved awareness of risks; and
- prevention of future problems.

Organizations without strong internal audit functions or those that do not heed auditor advice run the risk of adverse circumstances. For example, in early 2018, an internal audit warned the City of Atlanta of key information technology vulnerabilities. City officials did not address the risk, and shortly after, city information systems were held at ransom by hackers. Services were incapacitated for more than a week before city officials agreed to pay over \$50,000 to unlock the computer systems.

The Association of Local Government Auditors describes internal auditors as a wise investment, citing audits that led to significant public savings, increased revenue, improved performance, or discovery of fraud:

- Auditors in the Nevada Department of Health and Human Services identified \$19 million in annual savings;
- An internal audit in Arizona made recommendations to improve case management and family investigations; and
- An internal audit in Massachusetts identified potentially widespread fraud and abuse related to overtime claims for shifts not worked, and led to investigations of 42 state troopers.

There are some key differences between internal and external auditors

There are two types of audit functions, internal and external. While there are a number of similarities between the two types, such as the expectation auditors remain independent and objective and adhere to professional auditing standards, there are also key differences. In Oregon, the Secretary of State's Audits Division performs external audits of the executive, legislative, and judicial branches while internal audit functions serve within state agencies.

Internal auditors develop a thorough understanding of their organization's governance structure, programs and services, and risks. If properly structured and resourced, they provide critical and timely ongoing support and advice to management. They can also find areas to increase efficiency and effectiveness and proactively identify potential negative issues and outcomes. In the private sector, the director of internal audit is often considered an integral part of a company's management team. At the federal level, the Offices of Inspector General essentially serve as the internal audit function. They are structured to be highly independent and sometimes release reports critical of their agencies.

The importance of internal auditing in the private sector

National legislation has increased reporting and monitoring requirements in reaction to corporate and accounting scandals. In 2017, a number of senior executives were held personally liable in cases of corporate fraud, including executives at Wells Fargo and Volkswagen. In order to be listed in major stock exchanges, such as the New York Stock Exchange, companies must establish and maintain an internal audit function.

² Internal control is defined as a process, effected by an entity's board, management, or other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

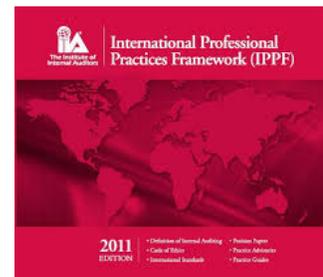
Internal Auditors	External Auditors
Employees of the organization being audited	Employees of an outside organization
Independent from the activities they audit	Independent from the organizations they audit
Primary customers are agency management and governing boards	Primary customers are elected officials, the public, and audited agencies
Usually responsible for auditing one organization/agency	Responsible for auditing multiple organizations/agencies
Provide ongoing monitoring	Provide intermittent audits

While government external auditors provide recommendations for agencies to improve operations, they also serve the public and oversight groups such as state legislatures. At the federal level, the U.S. Government Accountability Office (GAO) is the external auditor of the executive and judicial branches on behalf of Congress, and an Inspector General within the GAO has the authority to audit Congress. In Oregon, this role is provided by the Secretary of State’s Audits Division. Our state audit function is somewhat unique among state agencies in that the Secretary of State is an independent agency and has the authority to audit the legislative branch as well as the executive and judicial branches.

In a system where internal and external audit functions are both operating well, government leaders receive objective information and forward-looking advice from internal auditors in order to make decisions, and external auditors provide assessments of whether those decisions were made in the public’s best interest.

Professional standards govern internal and external auditors

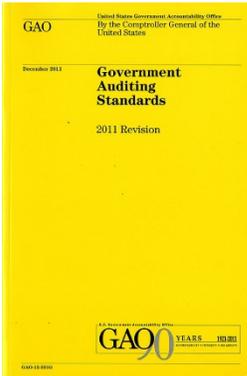
Many professions — such as medicine, law, education, and public safety — have developed standards to guide the work of practitioners and ensure the consistent delivery of quality services. For auditors, standards are not simply guidelines but provide a formal framework for the auditing profession.



Public internal and external auditors in Oregon generally follow one of two sets of professional standards that provide guidance on the nature of audit services and how they should be provided. The two sets of standards contain similar principles, but have some differences.

The Institute of Internal Auditors³ (IIA) developed the International Professional Practices Framework for internal auditing, commonly known as the IIA Red Book standards. External governmental auditors typically follow the Generally Accepted Government Auditing Standards established by the United States Government Accountability Office, commonly known as the GAO Yellow Book standards. The Secretary of State’s Audits Division adheres to GAO Yellow Book standards, while most of the state’s internal audit functions have adopted the IIA Red Book Standards.

³ The Institute of Internal Auditors is an international professional association of more than 170,000 members.



Shared subjects include audit independence, competency, access to personnel and records, sufficiency of evidence, reporting, ethics, and quality control. Periodic peer reviews are a key part of audit quality control.⁴ These ensure audit functions are in compliance with auditing standards.

While most internal audit functions in state agencies strive to follow the IIA Red Book standards, applying them in a public setting is often challenging given the differences between operations in the public and private sectors.⁵ See the Other Pertinent Information section in this report for more detail on these challenges.

External auditing has a long history in Oregon

Oregon's territorial statutes of 1854 called for an auditor to report recommendations "for lessening the public expenses; for using public money to the best advantage; for promoting frugality and economy in public offices; and generally, for the better management and more perfect understanding of the fiscal affairs' of the state." One such recommendation was made by territorial auditor B.F. Bonham in 1857. He stated, "The amount appropriated by the Legislative Assembly (\$2,500) annually for the support of the penitentiary department, is wholly inadequate for that purpose, and must be increased unless a reorganization can be effected."

WEIGHING PAPER PURCHASED FOR THE STATE.

Soon after taking charge of this office I bought a pair of scales for the purpose of weighing paper which is purchased by weight for the public printing. The first lot of paper received for the state printer after the scales were obtained fell short of the weight charged in the bill several hundred pounds, amounting in value to about nineteen dollars (\$19), which sum was deducted from the bill. Since then full weight has been required. This has no doubt saved to the state many times the cost of the scales. Previous to the time mentioned thousands of dollars worth of paper had been received and paid for every year on bills of shippers without being weighed here to verify the correctness of the weight charged in the bills.

Drafted that same year, the Oregon Constitution calls for the Secretary of State to be the "auditor of public accounts." Beginning then and continuing to today, our office provides external auditing for the state. The Oregon Audits Division's work includes performance audits, which focus on what agencies can do to meet their mission more efficiently and effectively. In 1897, the earliest known performance audit in Oregon was released. This audit examined the weight of paper the office received and compared it to what was charged, then reported the discrepancy.

DAS serves a key role for state internal auditing

In 1991, DAS first established optional guidance in the Oregon Accounting Manual that suggested when agencies should establish and maintain an internal audit function.⁶ An external audit conducted by the Oregon Audits Division in 1996 noted that this policy became mandatory in 1993. That audit, and a follow-up audit in 2003, found many of the agencies that met the criteria had not established internal audit functions, and some of the established internal audit functions failed to meet expectations in professional standards and state policy.

⁴ IIA Red Book standards require peer reviews every five years. GAO Yellow Book standards require peer reviews every three years.

⁵ OAR 125-700-0135 requires agencies to "select appropriate professional auditing standards to follow."

⁶ The Oregon Accounting Manual is established by DAS to ensure consistency in the application of accounting principles, provide guidance on internal controls, and provide guidance on compliance with laws and policies.

In 2005, the internal audit function requirement became state law.⁷ The Oregon Legislature determined internal audit activities within state government should be coordinated to promote effectiveness and directed DAS to adopt rules and set standards to ensure the integrity of internal auditing. These and other key dates in the history of the Oregon's internal auditing function are shown in Figure 1.

DAS developed the criteria for which agencies should be required to establish, maintain, and support an internal audit function:⁸

- Agencies with at least \$100 million in biennial expenditures; or
- \$10 million in annual cash or cash equivalent processed; or
- 400 or more full time equivalent staff (FTE).

For the agencies that meet this criteria, DAS developed rules⁹ that require these agencies to:

- Select appropriate professional auditing standards;
- Develop an internal audit charter;
- Establish and maintain an audit committee;
- Develop an audit committee charter;
- Include a member of the agency governing board or commission on the audit committee, if applicable;
- Prepare an audit plan based on the most recent agency risk assessment;
- Select and perform at least one audit from the risk assessment annually;
- Audit a topic related to the agency's governance and risk management process at least once every five years;
- Submit a report covering internal audit activities in the preceding fiscal year to DAS; and
- Obtain an external peer review in accordance with chosen professional auditing standards.

DAS prepares an annual report on internal audit activities, which it submits to the Joint Legislative Audit Committee.¹⁰ In the fiscal year 2017 report, DAS reported 30 agencies were determined to have met one or more of the three criteria of the requirement.

The Chief Audit Executive Council supports DAS in coordinating internal audit activities

The Chief Audit Executive Council, with representation from all state agency internal audit functions, supports DAS in their task of coordinating internal audit activities. Although the Council does not have the authority to carry out all the responsibilities delegated to DAS by the Legislature, DAS considers them a valuable partner. The council meets quarterly to collaborate, share information, promote effective internal auditing, and advise DAS on internal audit matters.

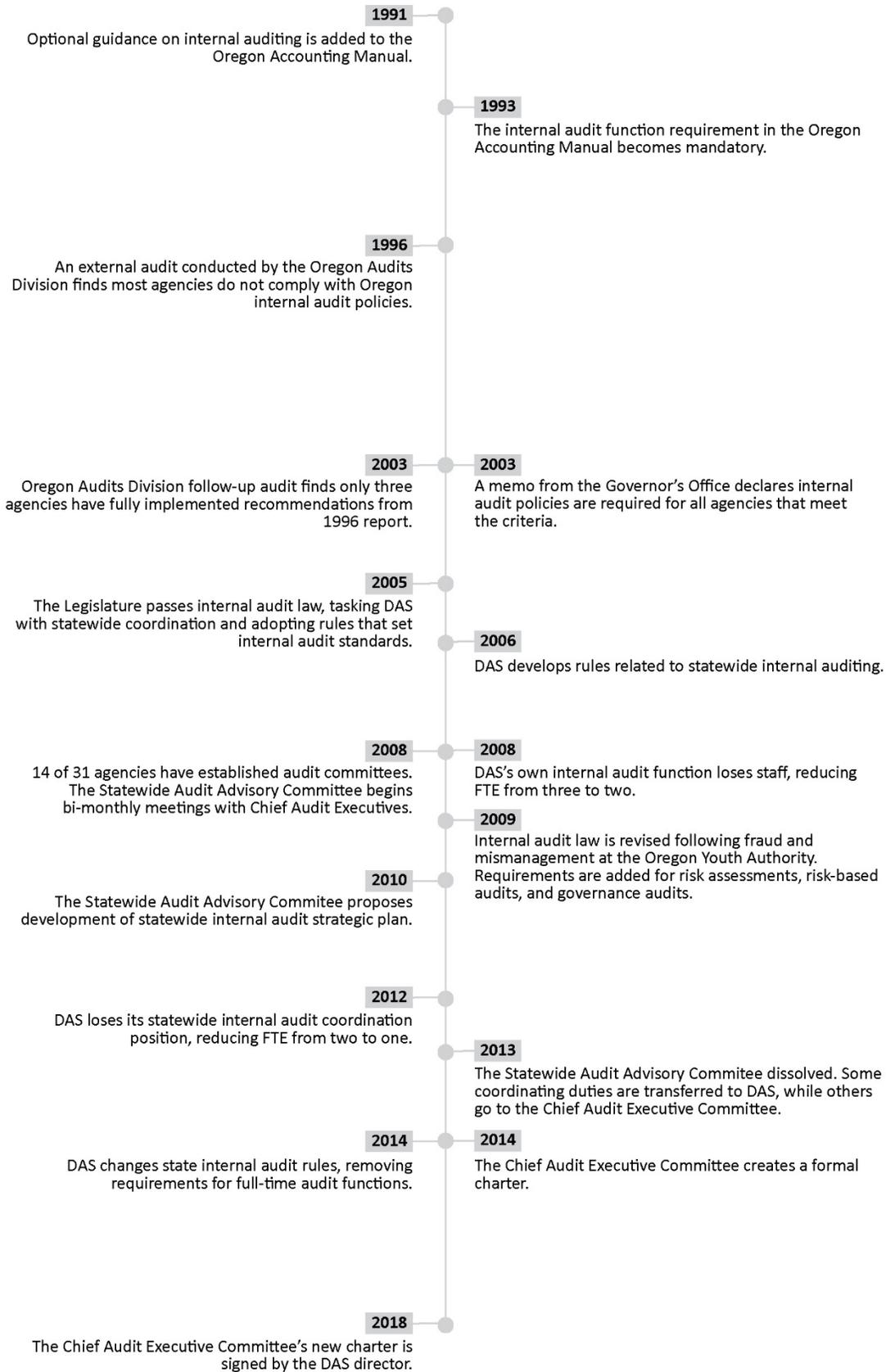
⁷ ORS 184.360.

⁸ Oregon is one of many states that requires agencies meeting particular criteria to establish and maintain an internal audit function.

⁹ OAR 125-700.

¹⁰ Members of the Joint Legislative Audit Committee include the co-chairs of the Joint Committee on Ways and Means, members of the House of Representatives as appointed by the Speaker of the House, and members of the Senate as appointed by the Senate President.

Figure 1: Timeline of the internal audit function in Oregon state agencies



Objective, Scope, and Methodology

Objective

This audit had two objectives. The first was to determine the steps DAS needs to take in order to effectively coordinate and promote the internal audit function at state agencies. Our second objective was to determine what state agency internal audit functions need to be effective. The audit focuses primarily on statewide governance and internal audit resources. While we provide examples of specific state agency audit function successes and challenges, these examples are meant to illustrate larger themes. All recommendations are written to DAS with the intent of addressing both statewide and individual internal audit function risks and opportunities.

Scope

This audit focused on DAS's efforts to coordinate and promote internal auditing throughout the state and on internal audit activities at the 30 state agencies known to meet criteria requiring them to establish and maintain an internal audit function. A complete list of such agencies can be found in Appendix A.

Methodology

To address our objectives, we used a methodology that included, but was not limited to: conducting interviews, administering an online survey and analyzing results, and reviewing documentation.

We conducted interviews with agency directors, the co-chairs of the Joint Legislative Audit Committee, and representatives of auditing organizations and other state auditing entities. We also met with each agency's Chief Audit Executive or equivalent during the course of our audit. To learn about the views, opinions, and perspectives of major stakeholders, we administered online surveys to agency heads, audit committee chairs, and internal audit staff at the 30 state agencies known to meet criteria requiring them to establish and maintain an internal audit function. We received a 100% response rate for each of the three surveys.

We reviewed Oregon state laws, administrative rules, and Oregon Audits Division audit reports related to internal auditing. We also requested and reviewed available internal audit documentation from each of the state agencies within our scope. Internal audit documentation included risk assessments, audit plans, internal audit reports, internal audit function charters, audit committee charters, and related policies and procedures.

To gain an understanding of practices in other states, we interviewed state officials and reviewed supporting documentation or legislation from the following states: Illinois, Louisiana, Michigan, Minnesota, New York, North Carolina, Tennessee, Texas, and Utah. To gain an understanding of standards and best practices in the field of internal auditing, we interviewed representatives and reviewed materials from professional auditing organizations such as the GAO, IIA, and Association of Local Government Auditors.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe the evidence obtained and reported provides a reasonable basis to achieve our audit objective.

We sincerely appreciate the courtesies and cooperation extended during the course of this audit by officials and employees of DAS and within each of the internal audit functions we reviewed.

Audit Results

While there are examples of individual functions performing effectively, overall there is a substantial opportunity to increase the value and impact of state agency internal audit functions. When properly structured and resourced, audit functions can provide a substantive return on investment. Agency audit functions are particularly critical during periods of financial or operational challenges and risks, as Oregon state government often faces.

The state's historical governance and oversight framework for state agency internal audit functions has been ineffective and several state agencies lack basic elements of an internal audit function. Other agencies have many or some elements of an effective internal audit function in place but can further strengthen their role with additional enhancements.

Internal audit functions at state agencies generally need to strengthen efforts to meet professional auditing standards, state requirements, and best practices — specifically in areas around internal audit independence, productivity, resources, professional development and training, and compliance with state policy. Despite these challenges, internal auditors have provided significant and positive contributions to state government, and have the potential to provide even greater value. Examples of specific positive impacts are cited later in the report.

While individual state agencies are ultimately responsible for following professional standards and complying with state requirements, DAS should spearhead efforts to maximize internal audit impact. DAS can provide improved guidance, identify and advocate for resource needs, support training and professional development and produce an accurate and informative annual report to promote the value of audit to key stakeholders.

Internal auditing has been persistently undervalued and neglected by state leadership

In general, the internal audit function is not prioritized or well understood by agency management and the Legislature. Many current challenges and deficiencies have persisted for more than two decades. While agency directors consistently reported the internal audit function provides a valuable service to them and their agencies, directors were largely unaware of the specific activities of their own audit functions. This lack of understanding and prioritization has led to a significant decrease in internal audit staffing.

Internal auditing is not a priority in the state

Internal audit deficiencies identified more than twenty years ago persist today. An audit conducted in 1996 by the Secretary of State found most agencies required to establish and maintain an internal audit function had not done so.¹¹ For those agencies that had established functions, the audit identified issues similar to those described in this audit. The deficiencies were in such areas as audit charters, audit committees, external quality assurance reviews, audit follow-up, performance measures, risk assessments, information system audit training, and formalized audit products.

Auditors in 1996 found the primary cause for issues identified was the low priority given to internal auditing on the part of agency management. This issue of prioritization persists today, more than twenty years after the initial report. We found this lack of prioritization for internal auditing occurs on several levels. Some agencies have requested resources to establish the internal audit function multiple times, but they have not been approved by either the Governor's

¹¹ Oregon Audits Division Report No. 1996-53.

Office or the Legislature. In addition, some agencies have held approved internal audit positions open for years at a time to create budget savings.

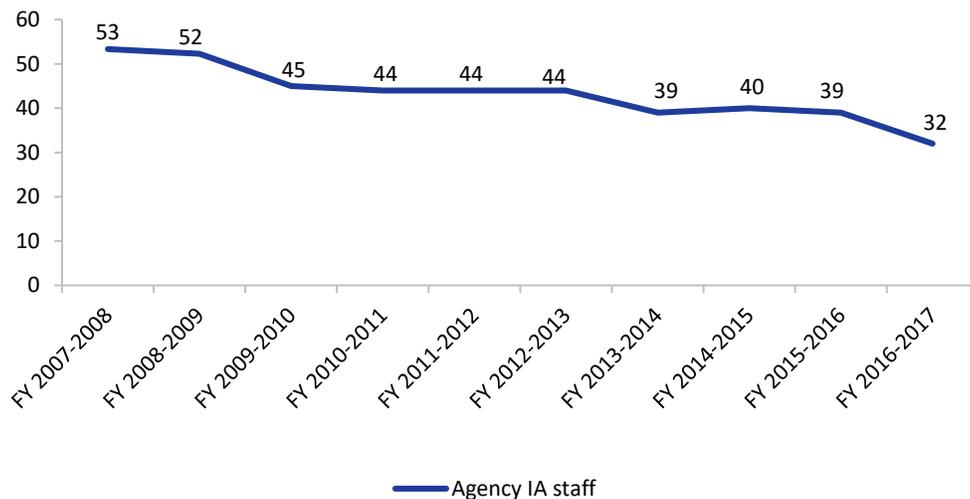
Legislative denial of additional funds for internal auditing does not absolve the agency of its responsibility to establish the audit function, as agencies are required to do so “within existing resources.”¹² Some agencies, such as the Oregon Department of Fish and Wildlife, repurposed other funds for the internal audit function. However, this may be difficult for some agencies that face chronic resource shortages in areas that provide direct service to Oregonians and are fundamental to fulfilling core missions. For example, recent Secretary of State audit reports have found shortages in caseworkers at the Department of Human Services,¹³ lab technicians at Oregon State Police,¹⁴ and permit technicians at the Department of Environmental Quality.¹⁵

These issues stem in part from the consistent budget shortfalls the state has experienced. Policymakers face intense, competing demands for limited resources, and the priority of internal auditing in the state has diminished over time. Oregon is not alone in this regard, as internal auditing and investigations are among the first areas cut by agencies in many states facing fiscal challenges. However, this practice is counter-productive, as auditors are especially helpful to management in finding opportunities for agency improvement, cost savings, and additional revenues — opportunities that become especially valuable in times of budget shortfalls.

Internal audit staffing has declined to an all-time low

Internal audit staffing in Oregon is at its lowest level ever recorded, as depicted in Figure 2. Of the 30 agencies we examined for this audit, all but six have only a single auditor, and some of the single audit positions are vacant. Within the 30 agencies, the number of internal audit staff has decreased approximately 40%, from 53 staff a decade ago to 32 today. Internal auditors and other stakeholders are nearly unanimous in their opinion that internal audit functions within the state are under-resourced. As a result, many agencies face challenges in recruiting and retaining auditors and meeting professional standards.

Figure 2: Statewide internal audit staff has decreased significantly over the last decade



Note: This chart includes only the 30 agencies reviewed as part of this audit.

¹² OAR 125-700-0125.

¹³ Oregon Audits Division Report No. 2018-05.

¹⁴ Oregon Audits Division Report No. 2015-30.

¹⁵ Oregon Audits Division Report No. 2018-01.

Reductions in internal audit staffing over time have compounding negative effects. Agencies struggle to hire and retain auditors due to the lack of developmental positions for early-career candidates, inflexible minimum qualifications for audit experience, and few opportunities for promotion. Internal auditors are often recruited from other agencies in the state, resulting in another vacancy elsewhere.

The 2017 DAS annual internal audit report to the Legislature identified five vacancies among the 32 budgeted internal audit FTE. Past reports document multi-year internal audit position vacancies. Agencies have experienced difficulty finding qualified internal audit candidates, resulting in a number of failed recruitments that contributed to long vacancies. Also, past DAS annual reports have noted that internal audit positions were often held open for budget savings.

Smaller audit functions may have additional challenges. Single-person audit functions struggle to meet all aspects of professional auditing standards as they cannot review their own work. Some have agreements to review each other's work, but many do not. As such, internal audit functions would benefit from enhanced central coordination to ensure audit work complies with standards despite limited resources.

Historically, DAS has failed to take a strong leadership and oversight role of state internal audit functions. For example, DAS has reduced its own internal audit staff from three FTE to a single auditor. This one person is responsible for assessing risks in the agency that provides centralized administrative services to many other agencies, as well as coordinating internal audit activity statewide. Despite this significant responsibility, the sole DAS position is classified at the same level or below other Chief Audit Executives (CAEs)¹⁶ in the state. Due to the lack of DAS support for the internal audit function, additional state coordination duties of the DAS Chief Auditor, and a classification and compensation lower than peers in the state, many of the top internal auditors in the state declined to apply for the DAS audit position during its most recent recruitment.

Position classifications and organizational placement of Chief Audit Executives diminishes internal audit influence

In the private sector, internal auditors are often considered an integral part of a company's management team. They typically report administratively to the company Chief Executive Officer or Chief Financial Officer and functionally to the organization's audit committee.

Each state agency internal audit function is led by a CAE, but the classification and compensation of this position varies. Some agencies classify their CAE as a mid-level manager, which pays at a higher rate than the classification used by other agencies, but is still lower than is generally found in the private sector. While this is not inherently problematic, it may undermine opportunities auditors have to inform and influence their agency's senior management. Nearly a third of CAEs (29%) responded that they are not a member of their agency's executive leadership team and do not have a "seat at the table" for important strategic conversations.

State rules require that CAEs report administratively to an agency head or their executive designee. Many state agencies satisfy this rule by placing this responsibility with a deputy director, and only the Department of Environmental Quality reported the internal audit function reports at a lower level of management. Regardless of where the audit function reports, it is still important for the agency director to understand the work, impact, and challenges of their audit function. This is because agency directors determine the budget priorities of the agency, and are

¹⁶ The CAE is the highest-ranked auditor in any given organization, though they may vary in title and job classification.

ultimately responsible for implementing the recommendations of auditors and ensuring adequate controls within the agency.

Some state agency directors lack understanding of internal audit operations

While agency directors consistently noted the value of internal auditing and are generally informed on its purpose and role, many are not knowledgeable about aspects of the operations of their audit functions. Some agency directors were unaware of significant elements of the audit function, such as how audit results are communicated, whether their audit function conforms to professional standards, or if their audit function has performance metrics and a strategic plan.

Elements that agency directors were least likely to be informed about included:

- 22 out of 30 (73%) did not know both the timing and results of the most recent external review;
- 15 out of 30 (50%) could not describe the methods used for risk assessment;
- 19 out of 30 (63%) could not provide information about their agency's use of contracted services;
- 19 out of 30 (63%) did not know whether the internal audit function used interns and rotational staff;
- 15 out of 30 (50%) did not know the professional standards used in their agency;
- 17 out of 30 (57%) could not describe how fraud risk is considered in the agency risk assessment;
- Four agency directors did not know whether they had a vacancy in the CAE position in the last five years; and
- Of the 14 agency directors that reported vacancies, seven (50%) did not know both the duration and reason for the vacancy.

Some of these areas, including external reviews, risk assessments, and vacancies in audit positions, are among the issues highlighted in this report.

Improperly structured and resourced internal audit functions have limited impact and face increased financial and performance risks

While there are examples of individual functions performing effectively, overall there is a substantial opportunity to increase the value and impact of state agency internal audit functions. We examined 30 state agencies required to maintain an internal audit function and found several critical issues that threaten the independence or objectivity of many of these functions. Audit functions face threats from lack of clear dual-reporting structures, lack of audit committee independence from agency management, insufficient audit committee charters, or audit staff performing non-audit operational responsibilities.

Many of these agencies also do not consistently meet state requirements for risk assessments, audit planning, mandated audits, and external quality assurance reviews. Further, agencies that contract audit work may not be receiving optimal value for these services. Currently, there is a lack of analysis to determine whether replacing permanent audit staff with contracted services offers savings to agencies. DAS does not track use of audit contracting to determine if agencies are complying with state procurement rules and to assess cost-effectiveness of these services. As a result of the internal audit function weaknesses we have identified, many agencies may incur opportunity costs in the quality and efficiency of their services, and face increased risk of fraudulent activity or misuse of public resources.

Internal audit functions face threats to independence and objectivity

Organizational independence from agency management is a critical requirement for a successful internal audit function. Without such independence, agencies may, intentionally or unintentionally, cultivate an environment that discourages transparency, prevents internal auditors from identifying and reporting risks, and creates conflicts of interest when internal auditors are required to perform non-audit function operational duties. In extreme circumstances, an internal auditor can be threatened and intimidated by managers who wish to hide unfavorable findings, or prevent auditor access. More commonly, auditors who lack independence may have limited access to and cooperation from agency personnel. They may not be able to gain traction in implementing their recommendations, making the value and impact of their work minimal.

In order to achieve independence and promote objectivity, state agencies should set a dual-reporting structure for the internal audit function, establish an independent audit committee, develop an audit committee charter describing the role and authority of the committee, and ensure auditors do not have responsibilities in areas they are also responsible for auditing.

Within a dual-reporting structure, CAEs report to the agency director or their executive designee for administrative issues such as work schedules, leave time, and logistical concerns. Conversely, the internal auditor reports functionally to the audit committee, which makes personnel decisions related to the CAE including performance evaluation and dismissal. While this structure promotes auditor independence from management, it can be problematic in the public sector for external members of the audit committee to be responsible for dismissing a public employee. The Oregon Department of Transportation addressed this issue by allowing the removal of the internal auditor by the director, but only after a majority vote of the transportation commission.¹⁷

Some agencies in Oregon blur the dual-reporting structure by including the administrative report position on the audit committee, sometimes as the audit committee chair. These practices can pose a direct threat to internal audit independence. While Oregon state rules require a dual-reporting relationship, the rules do not define the elements of “functional” and “administrative” reporting.

The structure and composition of audit committees are important components of effective internal audit functions. Oregon requires agencies with governing boards and commissions to include at least one member on the audit committee.¹⁸ Although state rules say that agencies are “encouraged” to include members external to their organizations, there is no other state guidance on audit committee composition.¹⁹ We found audit committee structure and composition is inconsistent across agencies.

Audit Committee Independence

Recent academic studies have determined that in the private sector, companies with audit committees that have greater independence from the company are:

- less likely to be sanctioned for fraudulent practices;
- more likely to implement audit recommendations; and
- less likely to experience internal control problems.

¹⁷ The Oregon Transportation Commission, made up of five commissioners, establishes state transportation policy by guiding the planning, development, and management of statewide transportation networks.

¹⁸ OAR 125-700-0135(C) – “If the agency has a governing board or commission, the audit committee must include one or more board or commission members.”

¹⁹ OAR 125-700-0135 (C) – “If there is no board or commission, agencies are encouraged to include qualified individuals from outside the agency on the audit committee, to enhance public accountability and transparency, and increase independence of the internal audit function.”

Of the 30 agencies required to have an internal audit function, 14 are further required to have at least one member of their board or commission on the audit committee. However, three of these 14 — the Public Utility Commission, Business Oregon, and the Department of Environmental Quality — currently do not.

Six agencies have audit committees composed entirely of agency management and internal staff, and an additional 13 are more than two-thirds internal members, undermining the dual-reporting structure and threatening internal audit independence. At Business Oregon, the only members external to the agency on the audit committee are representatives from the private audit firm contracted to perform internal audit services, a serious conflict of interest.

Independent internal audit functions:

- have a dual-reporting structure;
- have unrestricted access to all personnel, systems, processes, operations, functions, and activities;
- do not have operational responsibility over non-audit roles;
- establish and maintain an audit committee whose role is stated in a formal, written charter;
- include at least one member of the agency's governing board or commission on the audit committee, where applicable; and
- include a majority of external audit committee members.

A small number of agencies, including the Department of Education, the Parks and Recreation Department, and the Public Employees Retirement System are made up entirely or mostly of external members. In order to enhance audit committee influence within the agency, executive leadership team members of the Public Employees Retirement System are required to attend all audit committee meetings.

Furthermore, many agency audit committee charters lack requirements to ensure independence, including a conflict of interest policy, a formal CAE oversight process, and authority to review the adequacy of internal audit budget and staffing information.²⁰ Additional information about which elements exist in each agency's audit committee charter can be found in Appendix B.

Finally, internal auditors should have no direct operational responsibility over activities they audit. In at least two of the agencies we examined, the sole internal auditor also served as an operational program manager. During the course of our audit, one of these agencies removed those additional responsibilities. CAEs who serve as the sole internal auditor for an agency are not able to objectively audit areas where they have operational responsibilities. Simply stated, auditors cannot audit their own work. Additionally, time spent performing operational duties decreases the time for internal audit activity.

An independent, objective, and well-resourced internal audit function increases the likelihood of discovering workplace issues, such as a culture of harassment and discrimination, and bringing these issues to the attention of agency leadership and the audit committee. An effective internal audit function also encourages strong ethics controls, both preventive and detective, on the part of management. Internal audit functions that lack sufficient independence from management and that have audit committees not aligned with standards and best practices will struggle to be effective.

Given DAS's responsibility for promoting internal audit effectiveness, DAS should assess the independence of internal audit functions and the structure and composition of audit committees. Historically, DAS has not evaluated if existing governance structures meet requirements set in

²⁰ An audit committee charter is a document describing the authority, responsibilities, and structure of the audit committee.

state rule, law, or professional standards, and has only provided partial reporting on the specific internal audit structures agencies use.

Some agencies do not consistently meet state internal audit requirements

We found some agencies are failing to meet state requirements for completing mandated audits and audit-related work. As a result, the state may face higher risks of financial and programmatic weaknesses.

DAS set criteria for the internal audit requirement to correspond with risks associated with agency size, spending, and revenue. State policy requires agencies to perform risk assessments,²¹ which provide the foundation for internal audit activities. Using the risk assessment, internal auditors are expected to create an audit plan and complete at least one risk-based audit every year.²² They are also required to produce a governance audit every five years and undergo periodic external quality assurance peer reviews. These provide independent assurance that internal audit functions generally conform to auditing standards and answer the question, “who audits the auditors.”

Requirements Outlined in Oregon Revised Statute 184.360

1. Must conduct a risk assessment of the entire agency conforming to professional auditing standards.
2. Must conduct an annual risk-based audit, based on risk assessment.
3. Must audit a component of its governance and risk management processes at least once every five years and file the audit with DAS.
4. By December 31, DAS shall prepare a report describing internal audit activities within the past calendar year.

Nearly a third of agencies were not able to provide a risk assessment from the last two fiscal years. Of those agencies, the Departments of State Lands and Environmental Quality indicated they last completed risk assessments in 2012. Oregon Housing and Community Services believes the last risk assessment was completed in 2009, but the agency is currently exempted from internal audit requirements. The Higher Education Coordinating Commission has never performed a risk assessment, and the agency has never had funding approved for an internal audit function. Without a risk assessment, these agencies are less able to avoid potential problems. While auditors play a key role in assessing risk, it is ultimately the responsibility of management to identify and mitigate unacceptable risks.

CAEs are required to prepare an audit plan based on the most recent risk assessment. Four agencies did not provide evidence of an audit plan from either of the last two years. Eight agencies used their annual report to DAS as their audit plan, but this document contains limited information. It is unclear why some audit functions use this as their audit plan, as the annual reporting process has often been noted as difficult and unhelpful. Further, these documents do not indicate whether they are approved by agency audit committees, as required.

We asked each agency to provide an example of the most recently completed risk-based audit, as required annually. Of the internal audit functions that provided at least one audit from 2017 or 2018, some did not identify the topic as high risk in their risk assessment, and two agencies did not identify the topic in the risk assessment at all. These agencies may not be addressing their most significant risks with the limited internal audit resources available. In addition to the agencies under exemption or without an audit function, the Department of Energy was not able to provide an example of a risk-based audit.

²¹ A risk assessment is a process of identifying, analyzing, and prioritizing risks to the achievement of an agency’s mission, goals, or objectives.

²² IIA Red Book standard 2010: “The chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization’s goals.”

Additionally, some agencies have delayed or not completed external quality assurance reviews required by auditing standards. There have been vacancies in CAE positions and turnover in single-person audit shops, which has an effect on the institutional knowledge of an audit function and complicates these reviews. Contracting for organizations to perform these reviews can be costly, which can place a burden on resource-strapped agencies. DAS has not provided sufficient guidance to agencies in this area. For example, some agencies that primarily use contractors to perform internal audit work reported incorrectly they are exempt from external peer review requirements. Figure 3 summarizes recent internal audit function compliance challenges, and a case study on the Department of Environmental Quality illustrates what can happen when an agency is not able to timely identify and mitigate risks.

Figure 3: Some agencies are not meeting requirements and best practices for risk assessments, audit plans, audit reports, and external reviews

Perform a risk assessment	Nine of 30 agencies (30%) did not provide evidence of a risk assessment for FY 2017 or FY 2018.
Develop an audit plan	Four of 30 agencies (13%) did not provide evidence of an audit plan for FY 2017 or 2018, and an additional eight (27%) agencies only provided limited audit plan information in a report to DAS.
Perform a risk-based audit every year	Seven of 30 agencies (23%) did not provide a risk-based audit from FY 2017 or 2018. Of these, five did not provide any risk-based audit.
High risk audit topics should be prioritized	Eleven of 30 agencies' (37%) risk-based audits were performed on topics not identified high-risk in their risk assessments.
Perform a governance audit every five years	Nine of 30 agencies (30%) were unable to provide governance audits performed in the last five years.
Obtain external review as required by standards	Sixteen of 30 agencies (53%) appear to be out of compliance with the requirement for an external quality assurance review, as specified in standards and state rules.

DAS should provide clear guidance to agencies to ensure compliance with state requirements, including conformance to professional auditing standards. DAS should also support agencies in overcoming the resource challenges in obtaining external reviews. Recently, several state internal auditors obtained the necessary training and successfully completed a review of another state agency. Expanding this work would be a benefit to all agencies with audit functions and the state as a whole. North Carolina's internal audit coordinating body, for example, offers this training at a low cost to any government auditor in the state.



Case Study: Department of Environmental Quality

In July 2018, the Willamette Week published a series of articles detailing the events leading to a massive fire in a north Portland auto scrapyard. The fire required 30 fire engines and 170 firefighters to put out. Willamette Week reported citizens, including children in Cully neighborhood schools, were exposed to toxic smoke.

The Department of Environmental Quality had received a complaint about the scrapyard in December of the previous year. A staff member from the Oregon Occupational Safety and Health Administration sent information to the department about the site exhibiting many concerning environmental conditions, but the department did not follow up on the complaint or the OSHA information until after the fire.

A department spokesperson pointed to gaps in the agency's complaint system as the cause of the lack of timely follow-up. Testing such system controls and bringing gaps to the attention of management would be common activities of an internal auditor. The Department of Environmental Quality currently uses 0.25 FTE for a non-audit staff member to act as the agency's internal auditor. While greater internal audit resources would not guarantee prevention of this situation, a full-time audit function would at least be more likely to detect the system gaps that the agency identified were a root cause of its late response.

The agency does not have an active audit committee, and regularly does not meet state requirements related to internal auditing, including the development of risk assessments consistent with professional standards.

Agencies may not be receiving sufficient value from contracted audit services

Some agencies use contracted audit services to supplement the internal audit work completed by agency staff, while other agencies fully outsource all audit work. Agencies that use audit contractors are required by state rule to contract for a level of services that is equivalent to an internally established function, but DAS has not evaluated whether agencies meet this requirement.²³ Examples of questionable use and impacts of contracted audit services include the following:

- In the 2015-17 budget, the internal auditor position within the Department of Justice was eliminated, as it had been held vacant for several years. The \$250,000 budgeted for the position was replaced with \$200,000 for contracted audit services. Best practices indicate maintaining an internal audit function is preferable to contracting audit services if expenditures are similar.
- Some agencies that contracted audit services did not meet state requirements for risk-based audits in recent years, including the Public Utilities Commission, Business Oregon, the Oregon Liquor Control Commission, and the Department of Justice.

DAS maintains price agreements with several audit firms. According to the agency, these price agreements benefit agencies through discounts, volume purchases, and reduced procurement burden. These contractors are required to provide an annual report that can show how much agencies are using contracted services. Although we are aware of agencies that have used the services of these firms, DAS has never received this report from any of the internal audit vendors. Without this information, DAS cannot report on the cost of contracting or the value agencies receive from contracted audit services. Additionally, the lack of information prevents DAS from performing a cost-benefit analysis of using third party contractors versus hiring permanent internal audit staff.

²³ OAR 125-700-0125.

According to professional auditing standards, while organizations can contract for internal audit work, management of the internal audit function cannot be outsourced. An agency must adequately manage contracted audit services in order to follow professional audit standards. Agencies that do not are at risk of failing external reviews. This threatens the credibility of the internal audit function, both within the agency and statewide. The state of Mississippi allows an agency to contract internal audit work to private firms, but first requires that the agency complete a cost analysis that shows projected savings.

Agencies with improperly structured and resourced internal audit functions face a greater risk of fraud and wasted taxpayer dollars

While there is no guarantee internal auditors will identify fraud or waste, having an effective internal audit function can go a long way to reduce the risk of such activities occurring. Multiple state agencies have experienced fraud or wasted taxpayer dollars during periods when the internal audit function had notable deficiencies, including the Oregon Department of Energy, the Department of State Lands, the Oregon Youth Authority, and the Oregon Health Authority.

Increased risk of fraud, waste, and abuse

“Not having these protections [internal audit] leaves the state vulnerable to inefficient and ineffective management practices that result in wasted public funds. The lack of the internal audit function can also lead to fraud and abuse of state funds.”

- *Assessment of North Carolina Internal audit functions*

The Oregon Department of Energy has long struggled to maintain audit staff and meet state requirements for internal audit work. Until recently, the department tasked a manager in a non-audit position with additional responsibilities related to internal auditing.²⁴ The agency has not performed a risk assessment or convened a meeting of its audit committee since 2015, and consistently has not met state requirements for audits completed. Yet the agency has faced challenges, such as fraud and waste related to the Business Energy Tax Credits program that could have possibly been mitigated with dedicated audit resources.

At the Oregon Health Authority, significant payment issues were uncovered in a period when the internal audit function was found to be insufficiently independent and only partially conforming to professional standards by an external quality assurance review. These payment issues spanned several years. Separately, the Oregon Audits Division found significant deficiencies in how the agency detected and prevented improper Medicaid payments. These issues led to tens of millions of dollars in questionable spending. Because the Oregon Health Authority shares an internal audit function with the Department of Human Services, both agencies would be affected by the deficiencies identified in the quality assurance review.

The Department of State Lands has not established an internal audit function, despite meeting the criteria set in state law. In 2016, following an inventory of securities and bonds held by the agency, the department found it could not determine if the inventory was complete and correct or whether any fraud occurred, because the agency did not track its inventory over time or changes made to the system. This absence of internal controls would be of concern to an internal auditor who would potentially perform an audit with recommendations for improvement.

In 2009, a superintendent of a youth correctional facility managed by the Oregon Youth Authority was found guilty of theft, misconduct, tampering with records, and tampering with a witness. Department staff testified to the Oregon Legislature the root of the problem came from the agency’s leadership, who shielded managers from criticism and covered up wrongdoing, problems that could have been improved with a more involved and independent internal audit

²⁴ The Oregon Department of Energy hired a full-time internal auditor in June 2018.

function. Today, the audit function at the Oregon Youth Authority is a well-functioning unit that brings value to the organization and leadership in the statewide audit community.

DAS has not been fulfilling state internal auditor oversight and coordination responsibilities for many years

Despite being charged by the Legislature with coordinating internal audit activities, DAS has not fulfilled this responsibility. Agency efforts have diminished over time, missing or unclear guidance has contributed to inconsistency and confusion in application of state laws and policies, and opportunities to support internal audit functions have been missed.

DAS coordination approach is missing key elements and has diminished over time

DAS does not have a strategy for coordinating internal auditing and does not measure the effectiveness of coordination activities. Historically, DAS has not collected information on stakeholders' perceptions of their coordination or support activities, such as CAEs, agency directors or state legislators. Without this information, DAS cannot assess the impact of their coordination efforts. In a survey we conducted of state agency internal audit staff in Oregon, less than half believed that DAS understands and values internal auditing, and less than one-third agreed that DAS promotes internal auditing at state agencies.

Prior to 2013, DAS had dedicated staff to coordinate internal auditing. The coordinator worked with agency internal auditors to create resources related to risk assessments and audit committees and consulted on changes to state law regarding internal auditing. However, this position was eliminated in 2013, which left DAS with only a single internal audit position to complete both audit work within DAS and statewide internal audit coordination as required by state law.

Furthermore, DAS has experienced vacancies in its single internal audit position, resulting in loss of institutional knowledge and coordination activities within DAS ceasing altogether. Most recently, the position was vacant for a year until it was filled at the beginning of this audit.

The current extent of DAS coordination activities includes maintaining price agreements for internal audit contractors, holding licenses for audit management software, producing the annual report on statewide internal audit activities, and providing ad hoc guidance and support. Reductions and vacancies in the DAS internal audit function have limited the effectiveness of even these basic efforts, and the agency has called on internal auditors at other agencies to donate time to complete these tasks.

DAS has not provided clear guidance on application of internal audit laws and rules

State law²⁵ tasks DAS with coordinating agency internal audit functions to promote effectiveness, and instructs DAS to adopt rules setting standards and policies for audit functions within state government.²⁶ The rules must include the adoption of professional auditing standards, and policies and procedures that ensure the integrity of the internal audit process. However, DAS has depended on agencies to comply voluntarily with these rules, as it is unclear whether DAS has the authority or available mechanisms to enforce them.

In addition, specific statutory and rule requirements have been unclear to internal auditors. These include the general applicability of laws and rules, criteria for exemptions to the internal

²⁵ ORS 184.360 Internal audits in state government, policy, reports, rules.

²⁶ ORS 174.111 "State Government" means the executive department, judicial department and the legislative department.

audit requirement, and the minimum level of internal audit resources that meet the requirement.

Some state agencies, such as the Oregon Judicial Department and Oregon State Lottery, have claimed they are not subject to state policy relating to internal auditing but are complying voluntarily, and DAS has not provided clear guidance to correct this assertion.

Statute directs DAS to adopt rules that include, but are not limited to, standards for internal audit operations, and annual reporting requirements in all branches of Oregon state government. The statute goes on to list specific requirements for audit work performed, which apply specifically to executive agencies.

In the rules set by DAS, the audit work requirements are extended to “any elected or appointed officer, board, commission, department, institution, branch, or other unit of the state government” that meets the criteria for the internal audit requirement. As DAS has the statutory ability to set internal audit rules for all of state government and is not limited in the scope of those rules, it is clear that agencies such as the Oregon State Lottery and the Judicial Department are subject to those requirements. DAS recently reported they were reviewing their past interpretation of the state policy.

Another example involves the Public Utility Commission, which requested and was granted an exemption to the internal audit requirement in 2006. To support its request, the commission referenced a state accounting policy rather than a newly passed state law or recently established state rule, both of which indicated the commission was subject to the audit requirement. Twelve years later, DAS and the commission disagree as to whether the commission is currently exempt from the requirement. While the commission has some elements of an internal audit function in place, we found they had deficiencies such as not having a member of its governing commission on its audit committee and no current external review. PUC relies on audit work from MBA interns to meet state requirements, but has not reviewed the work to ensure these audits conform to professional auditing standards.

Oregon Housing and Community Services also received an exemption in 2012, which was recently extended until 2019. As part of the justification for the exemption request, the department cited agency reorganization and shifting areas of strategy. This is an example of a situation when an internal audit function would have provided valuable assurance and advice to agency management. Without an internal audit function, however, the agency missed several red flags related to performance. In 2016, our audit at the agency found insufficient strategic planning, poor data management, inconsistent staffing levels, inadequate policies and procedures, and poor communication from management.²⁷

Some agencies that appear to meet the criteria for the internal audit requirement have never established functions, applied for an exemption, or been included in the DAS annual report. The newly-hired DAS CAE performed an analysis and identified several agencies without an internal auditor that exceeded the state criteria related to annual expenditures and annual cash processed. DAS was unaware of the last time a similar analysis was performed, and has not notified all of these agencies that they are not in compliance with state law.

We performed a similar analysis using a different interpretation of what funds should be counted as cash processed. Like DAS, we also found several agencies should have an internal audit function that were not previously identified in any past DAS reports. These agencies include the Watershed Enhancement Board, the Public Defense Services Commission, Oregon Correctional Enterprise, and the Secretary of State’s Office. None of these agencies has an

²⁷ Oregon Audits Division Report No. 2016-31.

established internal audit function. The Public Defense Services Commission appears to have met the requirement since at least 2003, before the initial passage of the internal audit statute.

The criteria for determining which agencies are required to establish and maintain an internal audit function has not been revised since its implementation in 2006. For example, dollar amounts have not been adjusted for inflation. Over time, more agencies will meet the criteria, meaning DAS's coordination role responsibilities will be increasing in the years ahead.

DAS has not provided clear guidance on how agencies should staff internal audit functions

Poor guidance from DAS has contributed to insufficient internal audit staffing. In 2014, DAS made changes to statewide internal audit policy. One change was to remove the expectation that internal audit functions at agencies be staffed at a minimum of one full-time auditor. This change made it easier for agencies to staff internal audit functions with less than one full-time auditor, or contract for minimal audit services. As noted previously, total internal audit staffing in state agencies is at the lowest level ever recorded.

Some of the largest and highest-spending agencies in the state have small audit functions, yet DAS has never provided guidance on how to determine appropriate internal audit staffing. The now-dissolved Statewide Audit Advisory Committee made this a priority in 2007, but the committee was unable to find an existing model.²⁸

As a result, some agencies have reported meeting the requirement despite applying very few resources to internal auditing. For example, one agency reported meeting the requirement with 0.25 FTE of non-audit staff and another through a project from a Willamette University MBA student. DAS reports did not note that agencies without staff or contract arrangements, or with vacant positions, failed to meet the requirement.

The poor guidance from DAS, in addition to reductions and vacancies in the DAS internal audit staffing over time, has diminished the credibility of DAS in the statewide internal audit community. While DAS is taking positive steps, it will take more time and effort to improve its standing. This additional effort should include providing clearer guidance about the meaning and correct implementation of standards and policies.

Other states have encountered similar issues and developed guidance to ensure internal audit functions are sufficiently staffed. In New York, an internal audit task force convened by statewide executive leaders proposed that internal auditing, by its nature, requires a vibrant exchange of ideas among a team investigating a problem. The task force concluded audit functions staffed by only one auditor are “less than ideal.”



North Carolina has what appears to be the most robust methodology developed specifically for staffing state agency internal audit functions. We replicated this methodology and applied it to Oregon agencies. Under this model, internal audit functions in Oregon are understaffed by 70 to 137 auditors. Few agencies meet the methodology's recommended internal audit staffing level. See Appendix C for results.

Professional auditing standards require that CAEs ensure that internal audit resources are appropriate to achieve the audit plan. CAEs in Oregon must also ensure mandated audit work is completed, and their functions perform administrative tasks necessary for conformance to professional standards. A single auditor or an understaffed function may struggle to complete a risk assessment, annual audit plan, annual risk based audit, annual report to DAS, and an

²⁸ The Statewide Audit Advisory Committee was dissolved in 2013 following the removal of the DAS statewide internal audit coordination position. The Committee served in an advisory capacity to “promote excellence and professional, standards-based internal auditing services in state government.”

governance audit every five years while also performing consulting projects, staffing the audit committee, ensuring necessary reviews, updating internal audit and audit committee charters, and completing other tasks noted in this report.

DAS does not provide or facilitate training and resources for internal auditors

DAS does not currently provide or facilitate training and resources for internal auditors. Professional organizations, other states, and past DAS efforts offer examples that could bring value to internal audit functions and promote effective internal auditing in the state.

The IIA provides templates for audit documents mandated in auditing standards, such as the internal audit charter and audit committee charter. Minnesota developed a number of tools and resources to help internal audit functions maintain their integrity, remain compliant with standards, and be effective. These include control environment self-assessment tools, risk assessment tools, and templates.



Leveraging opportunities for group training among small internal audit functions can reduce overall expenditures on such training while allowing internal audit staff the chance to obtain important CPE.²⁹ In North Carolina, for example, the coordinating entity overseeing internal auditing in the state offers training for internal audit staff.



In addition to audit staff, audit committee members also benefit from training, as it allows them to become familiar with their responsibilities.

Before the reduction of internal audit staff in 2013, DAS provided training that included information on the role and impact of audit committees, state laws and rules related to auditing, professional audit standards, benefits and drawbacks of contracting audit services, and best practices for overseeing the internal audit function. Audit staff at the Oregon Parks and Recreation Department also developed position descriptions for audit committee members, which include helpful descriptions of audit committee purpose, committee member attributes, audit committee meetings, and expectations.

DAS has not adequately reported on the condition and impacts of state internal audit functions

As previously noted, it has been unclear if DAS has the authority or available resources and expertise to enforce state rules related to internal auditing in state agencies. The DAS annual report to the Legislature on statewide internal audit activities is their strongest oversight and enforcement mechanism. Legislators and internal auditors both pointed to the annual report as an opportunity for DAS to show the impact internal auditing has on state agencies and describe the challenges internal auditors face, but recent reports have been unclear, inaccurate, and have not effectively communicated the condition, needs, and impacts of state internal audit functions.

While the current format of the report provides information on most of the requirements of agency internal audit functions, it includes little to no analysis or judgement on the effectiveness and challenges of various audit functions. Legislative stakeholders indicated they wanted to know more about the results and impact of internal audit work, internal audit reporting structures, and rationale agencies use for contract audit work. CAEs believe the process for compiling the annual report is difficult and the final product did not effectively show the impact they generate, describe the challenges they face, or advocate for needed resources or changes in policy.

²⁹ Continuing Professional Education.

By statute, DAS is required to report to the Legislature at the end of every calendar year for internal audit activities that occurred during that year. By state rule, agencies are required to report information to DAS by fiscal year, which runs from July to June. This conflict creates a challenge for DAS, as they would receive information from agencies that does not align with their required reporting period. In order to overcome this challenge, DAS has reported on internal activities in the state by fiscal year in violation of state statute.

The DAS report on internal audit activities is not accurate. To create the report, DAS staff rely on self-reported information submitted by agencies, which they do not always validate. Our review of information agencies provided to DAS for the most recent fiscal year showed inaccuracies, including information about audit committee membership, the percentage of audits completed, and the percentage of audits originating from agency risk assessments. Additionally, the 2017 DAS report to the Legislature included inaccurate information on years of the most recent agency risk assessments, risk-based audits, and governance and risk process management audits.

Further, important information is missing or obscured in the report. For instance, in the 2017 report, three agencies noted they did not have internal audit staff but were “fulfilling audit requirements by other means.” Typically, this means the agency is contracting for audit services, but we found at least one of the three agencies that listed this response did not, in fact, contract for audit services or apply any resources to internal auditing.

The annual report includes misleading information on audit work performed by agencies. Multiple annual reports attributed non-audit and external audit work as internal auditing completed by the agencies. These included risk assessments, consulting engagements, external reviews, program evaluations, studies, and external audits. In 2017, the DAS report indicated Business Oregon complied with the requirement to perform a risk-based audit for the year due to an external audit conducted by the Oregon Audits Division.

DAS annual reports do not always effectively highlight consulting activities performed by internal audit functions, which many CAEs identified as some of their most impactful work in the agency. At times, DAS reports have highlighted consulting activities clearly by reporting them in a dedicated section of the report. Often, however, these activities are reported together with a range of “Value-Added Activities” that have included less important tasks such as committee participation, conference presentations, and non-audit roles filled by the internal auditor. Reporting in this way not only obscures the value internal auditors offer through consulting, but could cause further confusion about the role auditors fill in agencies and how these resources are being utilized.

Finally, the professional certifications held by internal audit staff are reported in aggregate, which obscures individual auditor qualifications. This does not indicate to stakeholders which internal audit functions lack necessary skills and competencies. For example, the 2017 report indicated only 12% of internal auditors in the state held certifications in auditing information systems, but included no information about which agencies need resources for training, additional staff, or contracting to fill this gap.

IIA Code of Ethics: Competency

Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.

- Annual CPE required for active Certified Internal Auditors: 40 hours.
- Annual CPE required for active Certified Governmental Auditing Professionals: 20 hours.

GAO Yellow Book: Competency

The staff assigned to perform the audit must collectively possess adequate professional competency needed to address the objectives and perform the work in accordance with standards.

- CPE required: 80 hours every two years, with at least 20 of those hours in every year.

Coordinating agencies in other states also produce annual reports on statewide internal audit activities. These reports provide potential models for DAS to consider.



Minnesota includes performance metrics for internal audit functions, strategies used to promote internal auditing in the state, and results of agency internal control self-assessments.



North Carolina includes statewide internal audit staffing compared to recommended levels, internal audit budgets and historical budget comparisons, updates on training and professional development of internal auditors, results of all internal audit peer reviews, supplemental staffing methods used, and data analysis activities.



Texas includes information related to internal audit progress on completing annual audit plans, consulting services provided, audit services contracted, and instances of suspected fraud, waste, and abuse.

DAS and agencies struggle to measure the impact of internal auditing

Measuring the effectiveness and impact of internal auditing is challenging. Much of the effect of quality internal auditing comes from prevention of risks and potential future problems, which is not easily measured. Nevertheless, audit functions should consider metrics in context and across typical performance measurement areas: quality, efficiency, process, input, outputs, and outcomes.

Professional auditing organizations recommend internal audit functions consider measuring the following:

- percent of staff with professional certification or advanced degrees;
- percent of staff meeting continuing education requirements;
- results of the most recent external peer review;
- estimated financial impact of audit recommendations;
- percent of audit recommendations agreed to and implemented by management;
- number of audits issued;
- number of consulting engagements performed;
- satisfaction of senior management and the audit committee; and
- operational program and service delivery effectiveness and quality measures.

Several audit functions use at least some performance metrics and provide internal reports to management and audit committees that include information demonstrating their impact and the challenges they face. For example, the audit function at the Department of Revenue uses performance measures such as the number of engagements, time spent on consulting engagements, customer feedback surveys, and recommendations accepted and implemented. The Department of Consumer and Business Services uses performance metrics that include the percentage of risk elements identified in the risk assessment that have documented mitigating controls in place.

The internal audit function in the Oregon Judicial Department prepares an annual report for its audit committee that clearly articulates work completed in the past year, as well as performance. The report includes the number of audits released, details on consulting engagements, status of prior audit recommendations, progress towards the completion of the audit plan, customer and committee satisfaction, and external review results.

Examples of metrics that we heard from other states that could demonstrate internal audit impact include:

- Internal audit budget as a percentage of agency budget;
- Percent of audits identified as high risk;
- Number and percent of recommendations implemented;
- Number and percent of recommendations implemented within a year; and
- Percent of audits completed on time, and at or under budget.

While DAS is not directly responsible for improving internal audit functions in other state agencies, they are ideally positioned to facilitate some improvements given their role as a coordinating body. In order to do so, DAS should ensure it has adequate staff for both their responsibilities as a coordinator and their internal audit needs; develops clear and consistent guidance and support; and improves the annual report to the Legislature.

Key stakeholders believe DAS can provide enhanced coordination activities

Agency directors, audit committee chairs, and internal auditors in the state all see a role for DAS and opportunities for improvement. Some offered ideas on how DAS could renew and build upon its past coordination and support efforts. Some ideas include:

- Improving the annual report on internal audit activities;
- Developing recommended performance metrics for internal audit functions;
- Setting expectations for audit committee composition;
- Providing training to audit committee members;
- Developing templates for standard audit processes;
- Coordinating and providing training for internal audit staff;
- Coordinating workpaper³⁰ review for single-person audit functions;
- Creating a pool of auditors that can be shared among smaller agencies who lack resources to staff their internal audit function;
- Expanding software licenses to include data analytics tools; and
- Revising audit-related state rules.

If DAS is able to provide more valuable support, guidance, and reporting, it could help statewide internal audit functions be more effective in addressing challenges rooted in state policies, agency structures, resources, and compliance with requirements. Improvements in these areas will promote the ability for internal auditors to positively impact state government for the benefit of all Oregonians.

Despite challenges, CAEs add value to their organizations and the state

Despite the challenges faced by internal audit functions in the state, internal auditors are generally well qualified for their positions, they have developed a supportive peer community, and their work is having a positive impact in the state.

Internal audit staff in the state are generally well qualified to perform their roles.

All CAEs in the state have at least five years of internal audit experience, and most have more than 10. A significant majority hold professional certifications and advanced degrees, including audit-specific credentials such as the Certified Internal Auditor, Certified Public Accountant, Certified Government Auditing Professional,

Auditor Experience

An academic study from 2005 determined that companies with greater internal auditor experience correlated with greater stock ratings and higher overall earnings.

³⁰ Audit workpapers are the documents which record all audit evidence.

Some examples of this impact reported by internal auditors are included below.

- The Public Employees Retirement System found a benefit calculation error rate of 13%. After a series of audits, the error rate was reduced to near 0%, where it has remained.
- Another Public Employees Retirement System audit showed that health insurance programs for retirees were performing poorly. After implementing recommendations and shifting leadership, they are now functioning well.
- The Oregon Judicial Department audit function provided helpful consulting on the implementation of the eCourt system.
- An Oregon State Police audit of statewide evidence-handling practices identified opportunities for reducing cost and improving performance.
- Another Oregon State Police internal audit provided greater clarity for officers in how they should respond to potentially threatening situations.
- The Oregon Employment Department comprehensively tracked audit recommendations from both internal and external auditors and agency progress in implementation over time, and reported this information to the audit committee.
- The Oregon Youth Authority internal auditor job-shadows front-line employees in youth correctional facilities to clearly understand work processes and gather perspectives not normally heard or understood by senior leadership. The auditor has the goal of completing a job shadow with every type of front-line employee.
- The internal audit function of the Department of Corrections found the department could save thousands of dollars per month through more timely disconnection of agency-issued cellular phone accounts following employee separation.
- The internal auditor at the Oregon Parks and Recreation Department found over 50 different forms being used to complete the same processes in field offices around the state. The auditor consulted with management to simplify processes and reduce staff administrative time by reducing that number down to only three forms, which are now in use statewide.

Other Pertinent Information

In the course of conducting this audit, we identified additional information that, while not strictly within the scope of the audit, is still significant and merits attention.

There is no generally accepted governance structure for statewide oversight and coordination of internal audit functions

There is no universal approach or generally accepted best practice for internal audit governance and oversight in state government, including the degree to which internal audit functions should be centralized or coordinated. States take several different approaches to attempt to balance the sometimes competing values of transparency, accountability, and confidentiality.

Some states, like Utah, are de-centralized without a coordinating body — meaning state agencies with internal audit functions operate independently. Others, like Michigan, have centralized internal audit functions in a single state agency, which provides internal audit services to all other state agencies. In Oregon, Minnesota, and North Carolina, one agency coordinates and supports audit functions within other agencies. For example, the North Carolina Office of Budget and Management has a coordination role similar to DAS. In that role, they coordinate external reviews, recommend staffing levels, produce annual reports, recognize auditors through achievement awards, and maintain a pool of shared internal auditors for smaller state agencies.

Public internal auditors face challenges in applying professional standards

As states struggle with developing an overall model of internal auditing, CAEs also face challenges in applying professional auditing standards on an agency level. The IIA Red Book standards are primarily intended for internal auditors in the private sector, and GAO Yellow Book standards are generally followed by external auditors in the public sector. While most internal audit functions in Oregon state agencies strive to follow the IIA Red Book standards, applying them in a public setting is often challenging given the differences between operations in the public and private sectors.³¹

This report previously mentioned multiple areas where application of professional standards creates challenges for internal auditors, including the responsibility for audit committees to make personnel decisions as part of a dual-reporting structure. The lack of confidentiality of internal audit work in the public sector is another area where auditors could potentially be placed in the position of needing to balance competing interests of agency management, oversight bodies, and the public.

Public reporting requirements complicate the role of internal auditors

In the private sector, audit findings are considered proprietary and kept confidential. If an internal auditor discovers a problem with the operations of the organization, that problem can be addressed internally, and the company can avoid reputational damage or disclosing sensitive information to competitors. This benefits the internal audit function by promoting trust with senior management and the company board.

If the internal audit function within a company also reported audit results to outside organizations, such as governmental regulatory agencies, executive management may decide

³¹ OAR 125-700 requires state agency internal audit functions to select appropriate professional auditing standards to follow in performing their audit work.

that the risk to the company of disclosure outweighs the benefits they receive from their internal audit function, and the function may experience limitations on access and influence as a result.

This is one way to characterize the current system in Oregon. Internal auditors are required to report activities and results externally to DAS and the state Legislature. Audit information is also available to the public by request. If no work from the auditor can be held in confidence, auditors may not be able to serve as trusted advisors to agency leadership.

If an auditor is not able to establish this position of influence, the internal audit function provides less value to the agency and may be more likely to be marginalized, under-resourced, contracted, or never established at all.

The GAO Yellow Book recognizes this challenge with external reporting requirements, and describes such audit functions as hybrids of internal and external auditing.

Yet, government leaders have a responsibility to promote transparency and be accountable to the public, both directly and through the oversight of public officials. It may not be reasonable to apply the same level of confidentiality private sector auditors have to the public sector.

Other states offer models that may better balance the competing values of confidentiality, transparency, and accountability. Multiple states allow for some level of internal audit work to be confidential. Texas, Illinois, New York, Tennessee, and North Carolina allow for confidential audit workpapers. This allows internal auditors to protect the identity of whistleblowers and encourages agency staff to be forthcoming with potentially sensitive or threatening information.

Given the lack of consensus on the appropriate governance structure for statewide internal auditing, the correct way to balance the two sets of professional standards in the public sector, and the appropriate degree of confidentiality for audit work products, this audit focused on the laws and rules currently in place in Oregon. Yet DAS could work with the state leaders, the internal audit community, and professional audit organizations to consider these difficult topics and chart a path forward in Oregon.

Public internal auditors face unique challenges

“The professionals who audit federal, state, and local governments and other public entities must cope daily with career-threatening political risks from which the private-sector internal auditors are largely immune.”

- *Institute of Internal Auditors*

Recommendations

We recommend DAS take the following actions to more effectively coordinate and promote the internal audit function at state agencies. Some of the recommendations will require additional resources be made available for internal audit. Others can be achieved by redirecting current efforts.

1. Define the minimum amount of resources that constitutes an active internal audit function, whether staffed or contracted, and develop a methodology to determine the recommended staffing for internal auditing.
2. Determine whether the minimum qualifications for internal audit classifications should be amended to expand the pool of applicants.
3. Dedicate sufficient human resources for both statewide internal audit coordination and internal auditing within DAS.
4. Evaluate whether the classification of the statewide internal audit coordination position is appropriate, relative to Chief Audit Executives throughout the state.
5. Propose changes to administrative rules to address concerns identified in this report, including those related to misalignment of reporting periods, audit committee composition, and functional and administrative reporting.
6. Provide guidance to agency internal audit functions on minimum requirements for risk assessment processes, risk-based audits, and external reviews.
7. Develop a strategic plan to coordinate agency internal audit efforts, promote effectiveness, and ensure integrity of internal auditing in the state.
8. Work with the Legislature to strengthen and clarify state laws related to internal auditing and DAS's role as a centralized coordinating body.
9. Develop guidance or criteria to determine when an exemption to the internal audit requirement is appropriate.
10. Inform agencies that meet the current criteria that they are required to have an internal audit function.
11. Develop a formal process to track which agencies meet statutory requirements for establishing an internal audit function.
12. Adjust the current criteria in state rules for the internal audit requirement to clearly identify state agencies that face the highest levels of risk. This should include a review of the types of transactions considered as "cash processed," the levels of expenditure and staffing set more than a decade ago, and a consideration of other risk factors.
13. Make training materials available to new and existing internal audit staff at state agencies, including trainings that would enable staff members to participate in external peer reviews at other agencies.

14. Provide training materials to new and existing audit committee members, including training on how to maintain the independence of the audit function and what work products to expect.
15. Revise the annual report on statewide internal audit activities to ensure it is clear, accurate, and helpful for internal audit stakeholders; includes meaningful information on internal audit performance; describes conformance with professional standards and state requirements; and details the costs and outcomes of internal audit contracting.
16. Convene an internal audit working group including stakeholders such as state CAEs and professional auditing organizations to determine the appropriate level of centralization for internal audit functions in Oregon.

Appendix A: Oregon Agencies Reviewed in this Report

Agency Name	Agency Acronym
Business Development Department (Business Oregon)	BIZ
Department of Administrative Services	DAS
Department of Consumer and Business Services	DCBS
Department of Environmental Quality	DEQ
Department of Human Services	DHS
Department of Corrections	DOC
Department of Justice	DOJ
Department of Revenue	DOR
Department of State Lands	DSL
Higher Education Coordinating Commission	HECC
Oregon Department of Agriculture	ODA
Oregon Department of Education	ODE
Oregon Department of Forestry	ODF
Oregon Department of Fish and Wildlife	ODFW
Oregon Department of Energy	ODOE
Oregon Department of Transportation	ODOT
Oregon Department of Veterans' Affairs	ODVA
Oregon Employment Department	OED
Oregon Health Authority	OHA
Oregon Housing and Community Services	OHCS
Oregon Judicial Department	OJD
Oregon Liquor Control Commission	OLCC
Oregon Military Department	OMD
Oregon Parks and Recreation Department	OPRD
Oregon State Lottery	OSL
Oregon State Police	OSP
Oregon State Treasury	OST
Oregon Youth Authority	OYA
Public Employees Retirement System	PERS
Public Utility Commission	PUC

Appendix B: Agency Audit Document Elements

Figure 5 depicts which agencies provided an audit committee charter required by state law and which elements recommended by IIA Red Book standards to safeguard independence each charter includes. While audit committee charters are not required to include all elements, IIA does consider them to be best practices. The Oregon Department of Transportation follows GAO Yellow Book standards rather than IIA Red Book Standards. However, GAO Yellow Book standards do not address audit committees, so their charter is evaluated against best practices recommended by the IIA.

Figure 6 depicts which agencies provided an internal audit function charter required by state law and which elements recommended by IIA Red Book standards to safeguard independence each charter includes. While internal audit function charters are not required to include all elements, IIA does consider them to be best practices.

Figure 7 depicts which agencies provided an audit plan for either 2017 or 2018, and Figure 8 depicts which agencies provided evidence of a risk assessment required by state law for 2016 through 2018. The elements evaluated in both tables are included in IIA Red Book mandatory guidance, and agencies that follow IIA Red Book standards are expected to comply. The Oregon Department of Transportation may not be required by professional standards to include all of these elements.

During the final review process for the audit, several CAEs indicated their agency has an audit plan or risk assessment report more extensive than their summary document indicates. However, our office was not provided with this report when we requested it during fieldwork and, owing to the late date of this notification, we were unable to confirm this assertion.

Blue boxes indicate an agency's document included that element; blank spaces indicate it did not. Several agencies did not provide specific documents, so the audit team was unable to assess further.

Figure 5: Audit committee charter elements

	Provided an audit committee charter	Charter includes statement on committee authority	Charter describes committee membership	Charter includes conflict of interest policy	Charter describes the committee's role in ensuring audit follow-up	Charter includes statement on appointment, removal, and performance review of CAE	Charter includes statement on committee's role in ensuring compliance with professional auditing standards	Charter includes statement on responsibility of the committee to review internal audit budget and staffing
BIZ								
DAS								
DCBS								
DEQ								
DHS								
DOC								
DOJ								
DOR								
DSL	Did not provide	-	-	-	-	-	-	-
HECC	Did not provide	-	-	-	-	-	-	-
ODA								
ODE								
ODF								
ODFW								
ODOE								
ODOT								-
ODVA								
OED								
OHA								
OHCS	Did not provide	-	-	-	-	-	-	-
OJD								
OLCC								
OMD								
OPRD								
OSL								
OSP								
OST								
OYA								
PERS								
PUC								

Figure 6: Internal audit function charter elements

	Agency provided an internal audit function charter	Charter grants CAE authority to manage audit function without undue influence from management	Charter acknowledges that internal auditors will have no direct operational responsibility over audited activities
BIZ		-	-
DAS			
DCBS			
DEQ			
DHS			
DOC			
DOJ	Did not provide	-	-
DOR			
DSL	Did not provide	-	-
HECC	Did not provide	-	-
ODA			
ODE			
ODF			
ODFW			
ODOE			
ODOT			
ODVA			
OED			
OHA			
OHCS	Did not provide	-	-
OJD			
OLCC			
OMD			
OPRD			
OSL			
OSP			
OST			
OYA			
PERS			
PUC			

Figure 7: Audit plan elements

	Agency provided an audit plan from either 2017 or 2018	Plan includes rationale for selection of proposed engagements	Plan has objectives and scope for planned engagements	Plan has evidence it is based on a risk assessment	Information provided to DAS includes external audits completed by the Oregon Audits Division*
BIZ	Did not provide	-	-	-	
DAS					
DCBS					
DEQ					
DHS	Did not provide	-	-	-	
DOC	Did not provide	-	-	-	
DOJ	Did not provide	-	-	-	
DOR					
DSL	Did not provide	-	-	-	
HECC	Did not provide	-	-	-	
ODA	Did not provide	-	-	-	
ODE					
ODF					
ODFW					
ODOE	Did not provide	-	-	-	
ODOT					
ODVA	Did not provide	-	-	-	
OED					
OHA	Did not provide	-	-	-	
OHCS	Did not provide	-	-	-	
OJD					
OLCC					
OMD					
OPRD**					
OSL					
OSP					
OST					
OYA					
PERS					
PUC	Did not provide				

* Several agencies did not provide an audit plan, but indicated that submissions they made to the DAS annual report fulfilled this requirement.

** During the final review process for the audit, the CAE from this agency indicated they have a more extensive audit plan than their summary document indicates. However, our office was not provided with the full audit plan when we requested it during fieldwork and, owing to the late date of this notification, we were unable to confirm this assertion.

Figure 8: Risk assessment elements

	Agency provided evidence of a risk assessment for 2016-2018	Assessment describes risk events	Assessment includes both likelihood and severity/impact of risk events	Assessment describes controls in place to mitigate risk events	Assessment estimates the effectiveness of current controls
BIZ					
DAS					
DCBS					
DEQ	Did not provide	-	-	-	-
DHS					
DOC*					
DOJ					
DOR					
DSL	Did not provide	-	-	-	-
HECC	Did not provide	-	-	-	-
ODA					
ODE					
ODF					
ODFW					
ODOE	Did not provide	-	-	-	-
ODOT					
ODVA					
OED*					
OHA					
OHCS	Did not provide	-	-	-	-
OJD					
OLCC					
OMD*					
OPRD					
OSL					
OSP*					
OST					
OYA					
PERS					
PUC					

* During the final review process for the audit, CAEs from these agencies indicated they perform a more extensive risk assessment process than their summary document indicates. However, our office was not provided with this report when we requested it during fieldwork and, owing to the late date of this notification, we were unable to confirm this assertion.

Appendix C: North Carolina Staffing Model

Figure 9 is based on the methodology used by the North Carolina Office of Management and Budget to determine the recommended minimum number of internal auditors for a given agency. Each agency is assigned a base recommendation based on appropriation, with a minimum of two auditors for each agency that meets the criteria. Other elements of the methodology include agency FTE, risk ranking, number of locations (decentralization), and pass-through funding. Each of these elements are associated with a risk factor, which increases or decreases the number of internal audit staff recommended.

The risk rating is subjective and based on known and perceived financial, operational and technology risk; criticality of the unit; probability of fraud; and public or political sensitivity. This risk rating is determined by consensus of state audit staff. This audit evaluated Oregon agencies both with and without the subjective risk rating. North Carolina agencies are staffed at 79% of the recommended level. Figure 9 includes both a full recommended staffing level for Oregon agencies, as well as the staffing level at 79% of the recommendation, resulting in a recommended range. Recommended staffing levels are rounded to the nearest whole number.

Contracted internal audit services were not included in the staffing analysis or in the table.

Figure 9: Results of North Carolina staffing methodology

	Internal Audit FTE as of May 2018	Recommended FTE without risk rating	Recommended FTE with risk rating	Difference
BIZ	0	2-3	2-3	2-3
DAS	1	3-4	4-5	2-4
DCBS	1	2	2	1
DEQ	0.25	2	2-3	1.75-2.75
***DHS	N/A	18-22	23-29	N/A
***OHA	N/A	18-22	23-29	N/A
***DHS/OHA	8	22-28	29-37	14-29
DOC	2	5-6	6-7	3-5
DOJ	0	3-4	3-4	3-4
DOR	2	2	2-3	0-1
DSL	0	1	1	1
HECC	0	6-7*	6-7*	6-7*
ODA	0	1	1	1
ODE	1	6-7	7-8	5-7
ODF	1	2	2-3	1-2
ODFW	1	2-3	2-3	1-2
ODOE	0	1-2	1-2	1-2
ODOT	6	7-9	9-11	1-5
ODVA	0	2-3	2-3	2-3
OED	1	6-8	7-8	5-7
OHCS	0	3-4	3-4	3-4
OJD	1	3-4	3-4	2-3
OLCC	0	2-3	2-3	2-3
OMD	0	2	2	2
OPRD	1	2-3	2-3	1-2
OSL	3	3	3-4	0-1
OSP	1	2-3	2-3	1-2
OST	1	1**	1**	0**
OYA	1	2	2	1
PERS	4	11-14*	12-15*	7-11*
PUC	0	1	1	1
TOTAL***	36.25	107-150	121-174	70.75-137.75

*Given the elements included in this methodology, staffing recommendations at PERS and HECC may face a higher risk of being overstated.

**Given the elements included in this methodology, staffing recommendations at OST may face a higher risk of being understated.

*** DHS and OHA share an audit function, and they are included both separately and combined. Totals for each column reflect a range that accounts for these calculations.



Oregon

Kate Brown, Governor

Department of Administrative Services

Office of the Chief Operating Officer

155 Cottage Street NE

Salem, OR 97301

PHONE: 503-378-3104

FAX: 503-373-7643

August 24, 2018

Kip Memmott, Director
Secretary of State, Audits Division
255 Capitol St. NE, Suite 500
Salem, OR 97310

Dear Mr. Memmott,

This letter provides a written response to the Audits Division's final draft audit report titled **Opportunities Exist to Increase the Impact of State Agency Internal Audit Functions**.

Thank you for providing the Department of Administrative Services the audit report regarding the internal audit functions of state government. DAS Executive Management and the DAS Chief Audit Executive (CAE) appreciate the collaborative approach taken by the Audits Division and value its work.

The report strongly validates the continuous improvement efforts taking place to enhance the internal audit functions within state agencies. However, while the report places a lot of the responsibility for improving audit functions within state government on DAS, we believe it is equally incumbent on individual agencies to recognize and value the contributions of their internal auditors. The success of an agency's internal audit program will depend on a combination of improved statewide guidelines and policies, as well as executive sponsorship and support at the agency level.

As noted in the body of this report, there has been a significant reduction in internal audit resources throughout state government. Specifically, total internal audit staff has gone from 53 staff in FY 2007-08 to 32 staff in FY 2016-17. DAS internal audit staff has been reduced from three to one in that same time period. As outlined in the audit report, if Oregon was to use North Carolina's staffing methodology, the Secretary of State calculates Oregon would need to add an additional 70 to 137 staff.

In order to address the recommendations outlined in the report with limited resources, DAS plans to rely heavily on the Chief Audit Executive Council (Council), which is made up of state government internal auditors. DAS executive management and the DAS CAE are already working closely with the Council to develop a stronger and more informational Annual Report on Statewide Internal Audit Activities, develop an FAQ for agency directors and audit committee chairs, and review the Oregon Administrative Rule that governs the internal audit role for possible changes. We have also discussed with the Council the need to develop and sustain productive audit committees through supportive training materials.

Below is our detailed response to each recommendation in the audit. Given the workload associated with 16 recommendations, as well as the long-term work projects related to some of the efforts, DAS has charted a five year effort to address the work associated with the recommendations.

RECOMMENDATION 1 Define the minimum amount of resources that constitutes an active internal audit function, whether staffed or contracted, and develop a methodology to determine the recommended staffing for internal auditing.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Generally Agree, however resource levels are determined by the state Legislature every two years through the biennial budget process	July 2023	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 1

In consultation with DAS management, the DAS CAE, the Council and other agency executives, methodologies will be researched with the aim to provide best practices and information helpful to internal audit resources for Oregon state government. It is important to note that a recommendation for staffing or resources does not necessarily mean that any additional staff or resources will ultimately be made available.

RECOMMENDATION 2 Determine whether the minimum qualifications for internal audit classifications should be amended to expand the pool of applicants.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	December 2023	CHRO – Madilyn Zike 503-378-3020

Narrative for Recommendation 2

DAS management and the DAS CAE will work with the Chief Human Resources Office (CHRO) to review the current MQ's of each of the three IA position levels. DAS management and the CHRO feel it would be best to complete this work after implementing Recommendation #1.

RECOMMENDATION 3 Dedicate sufficient human resources for both statewide internal audit coordination and internal auditing within DAS.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Neither agree nor Disagree	January 2022	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 3

DAS management will review the current staffing level and compare it to the resources needed to perform both statewide oversight and internal auditing within DAS. If it is determined that additional resources are needed, DAS may request the resources during the 2021 legislative session.

RECOMMENDATION 4 Evaluate whether the classification of the statewide internal audit coordination position is appropriate, relative to Chief Audit Executives throughout the state.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	December 2023	CHRO – Madilyn Zike 503-378-3020

Narrative for Recommendation 4

DAS management and the DAS CAE will work with the CHRO to review the current classification level of the DAS CAE as well as the classifications of statewide CAE's. DAS management and the CHRO feel it would be best to complete work after implementing Recommendation #1.

RECOMMENDATION 5 Propose changes to administrative rules to address concerns identified in this report, including those related to misalignment of reporting periods, audit committee composition, and functional and administrative reporting.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	July 2021	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 5

DAS management, DAS CAE, the Council, and other necessary stakeholders will work on a review and possible revision of administrative rules relating to internal audit.

RECOMMENDATION 6 Provide guidance to agency internal audit functions on minimum requirements for risk assessment processes, risk-based audits, and external reviews.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	June 2019	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 6

DAS management, DAS CAE, and the Council will develop and make available to agencies guidance on consistent reporting of the work surrounding the risk assessment process, risk-based audits, and external reviews.

RECOMMENDATION 7		
Develop a strategic plan to coordinate agency internal audit efforts, promote effectiveness, and ensure integrity of internal auditing in the state.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Neither Agree nor Disagree	January 2022	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 7

DAS management will collaborate with the DAS CAE and the council on the best set of tools to provide to state agencies that will assist in coordinating of the internal audit function in state agencies, promoting effectiveness and ensuring the integrity of internal auditing in the state.

RECOMMENDATION 8		
Work with the Legislature to strengthen and clarify state laws related to internal auditing and DAS’s role as a centralized coordinating body.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	July 2022	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 8

DAS management and other applicable bodies will work with the Legislature to review and possibly change state laws relating to internal audit in state government, including the role DAS is to play. Because legislative concepts for 2019 are well under way, the next opportunity for DAS to request any statutory changes will be during the 2021 legislative session.

RECOMMENDATION 9		
Develop guidance or criteria to determine when an exemption to the internal audit requirement is appropriate.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	March 2019	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 9

DAS management, DAS CAE, and the Council will review the current policy on requesting and granting exemptions to rule. The DAS CAE and the Council will then develop procedures that relate directly to granting such exemptions on internal audit functions.

RECOMMENDATION 10		
Inform agencies that meet the current criteria that they are required to have an internal audit function.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	March 2019	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 10

DAS management and the DAS CAE will develop a letter that informs agencies that meet the current requirement and what guidance DAS is able to provide.

RECOMMENDATION 11		
Develop a formal process to track which agencies meet statutory requirements for establishing an internal audit function.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	March 2019	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 11

DAS management and the DAS CAE will develop a formal tool to assist in reviewing and tracking when an agency meets the requirement of having an internal audit function.

RECOMMENDATION 12		
Adjust the current criteria in state rules for the internal audit requirement to clearly identify state agencies that face the highest levels of risk. This should include a review of the types of transactions considered as “cash processed,” the levels of expenditure and staffing set more than a decade ago, and a consideration of other risk factors.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	July 2021	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 12

Along with the work being done from recommendation 1, DAS management, DAS CAE, and the Council will work with other bodies to develop a review of current criteria and adjust if necessary. This may potentially require a revision to the current administrative rules.

RECOMMENDATION 13		
Make training materials available to new and existing internal audit staff at state agencies, including trainings that would enable staff members to participate in external peer reviews at other agencies.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	June 2019	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 13

The DAS CAE, in partnership with the Council and the IIA Salem Chapter, will develop a formal review process of training opportunities. This information will then be made available to all agency internal audit functions.

RECOMMENDATION 14		
Provide training materials to new and existing audit committee members, including training on how to maintain the independence of the audit function and what work products to expect.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	June 2019	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 14

In partnership with the Council, the DAS CAE will review the audit committee training currently available, such as the Audit Committee Handbook and a training presentation. They will be updated as determined necessary and made available to audit committees at state agencies.

RECOMMENDATION 15		
Revise the annual report on statewide internal audit activities to ensure it is clear, accurate, and helpful for internal audit stakeholders; includes meaningful information on internal audit performance; describes conformance with professional standards and state requirements; and details the costs and outcomes of internal audit contracting.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Agree	December 2018	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 15

Working with DAS management and the Council, the DAS CAE revise the annual report format after seeking input from stakeholders on what information should be included in the report.

RECOMMENDATION 16		
Convene an internal audit working group including stakeholders such as state CAEs and professional auditing organizations to determine the appropriate level of centralization for internal audit functions in Oregon.		
Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 6 months)	Name and phone number of specific point of contact for implementation
Neither Agree nor Disagree	TBD	DAS CAE – Lisa Upshaw 503-378-3076

Narrative for Recommendation 16

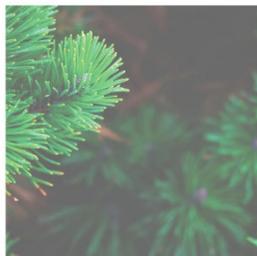
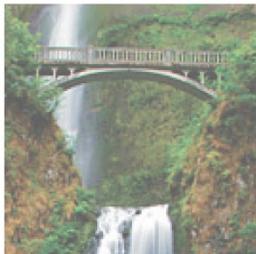
Working with DAS management, the Council and other applicable bodies, a review of this recommendation will be done after work is complete on the preceding 15 recommendations.

Please contact Lisa Upshaw, DAS CAE, at 503-378-3076 with any questions.

Sincerely,



Katy Coba
Chief Operating Officer | DAS Director



Audit Team

Will Garber, CGFM, MPA, Deputy Director

Jamie Ralls, CFE, ACDA, Audit Manager

Rebecca Brinkley, MPA, CFE, Lead Auditor

Eli Ritchie, MPA, Staff Auditor

Krystine McCants, M. Econ, Staff Auditor

About the Secretary of State Audits Division

The Oregon Constitution provides that the Secretary of State shall be, by virtue of his office, Auditor of Public Accounts. The Audits Division performs this duty. The division reports to the elected Secretary of State and is independent of other agencies within the Executive, Legislative, and Judicial branches of Oregon government. The division has constitutional authority to audit all state officers, agencies, boards and commissions as well as administer municipal audit law.

This report is intended to promote the best possible management of public resources.
Copies may be obtained from:

Oregon Audits Division
255 Capitol St NE, Suite 500 | Salem | OR | 97310

(503) 986-2255
sos.oregon.gov/audits