

**INTERNAL AUDITING
IN KENTUCKY STATE GOVERNMENT**

SEPTEMBER 2001 – PERFORMANCE AUDIT



**EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS**

The Auditor Of Public Accounts Ensures That Public Resources Are Protected, Accurately Valued, Properly Accounted For, And Effectively Employed To Raise The Quality Of Life Of Kentuckians.



EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

September 28, 2001

To the People of Kentucky and the Honorable Paul E. Patton, Governor

Re: Assessment of Internal Auditing in Kentucky State Government

Ladies and Gentlemen:

We present our assessment on internal auditing in Kentucky state government. We are distributing this report in accordance with the mandates of Kentucky Revised Statute 43.090. In addition, we are distributing copies to members of germane committees of the General Assembly and other interested parties.

Our Division of Performance Audit evaluates the effectiveness and efficiency of government programs. The Division also performs risk assessments and benchmarks government operations. We will be happy to discuss with you at any time this audit or the services offered by our office. If you have any questions, please call Gerald W. Hoppmann, Director of our Division of Performance Audit, or me.

We appreciate the courtesies and cooperation extended to our staff during the assessment.

Respectfully submitted,

Edward B. Hatchett, Jr.
Auditor of Public Accounts

Executive Summary

Audit Objective

Determine the extent of internal auditing in Kentucky state government.

Internal Auditing Has Not Been Institutionalized in Executive Branch Cabinets

A majority of the Commonwealth's Executive Branch Cabinets have not instituted a formal internal auditing function. The following five of the 14 Executive Cabinets have formalized internal audits, with only 15 employees fully dedicated to performing internal audits:

- Education, Arts, & Humanities
- Finance & Administration
- Public Protection & Regulation
- Tourism
- Transportation

The other cabinets either do not perform internal auditing at all, or they do not have staff dedicated full-time to internal auditing. With over \$13 billion in appropriations to Executive Branch Cabinets for FY 2001, institutionalizing internal auditing could pay handsome dividends by identifying costs savings and improving program efficiencies.

No Statute Requires Internal Auditing Across State Government

There is no statutory criteria requiring internal auditing across state government. Explicit statutory provision is made for internal auditing in only one executive cabinet: Finance & Administration. KRS 42.065 establishes the Administrative Policy and Audit Division within the Cabinet.

Internal Auditing Is Not Consistent Across State Government

The five cabinets performing formal internal audits approach it differently. Four cabinets observe the *Standards for Professional Practice of Internal Auditing*, while one cabinet uses *Government Auditing Standards* promulgated by the Comptroller of the United States. Three of the five cabinets observe additional varying standards as supplements. Only one cabinet requires training for its internal auditors as required by federal standards.

The cabinets also plan and perform audits differently. Three cabinets use standardized audit programs, while two cabinets develop audit steps or programs on an audit-by-audit basis. Total annual costs for conducting internal audits range from \$68,629 to \$526,887 for these cabinets.

Only Two Cabinets Recognize Internal Audit Personnel Classifications

In 1984, the Personnel Cabinet created classifications for Internal Auditor I and II. Two cabinets engaged in internal auditing use these classifications. As a result, internal auditors may not be required to bring the same education or experience to their work from cabinet to cabinet.

Recommendations

1. The General Assembly should consider enacting legislation to require internal auditing in all Executive Branch Cabinets. The federal *Inspector General Act of 1978*, statutes in Illinois and Virginia, and model legislation proposed by the Institute of Internal Auditors may be helpful in this deliberation. Proposed legislation should address the following areas:
 - Internal auditor independence
 - Reporting of findings and recommendations
 - Internal auditor access to records
 - Internal auditor training requirements
 - Standards for performing internal audits
 - Qualifications for internal auditors
2. Secretaries of the Executive Branch Cabinets should consider the reallocation of existing resources in order to establish an effective internal audit function.

Table of Contents

TRANSMITTAL LETTER

EXECUTIVE SUMMARY	i
-------------------------	---

Chapter 1

INTRODUCTION	1
--------------------	---

Audit Purpose and Objective	6
-----------------------------------	---

FINDINGS

Chapter 2

Internal Auditing Has Not Been Institutionalized in Executive Branch Cabinets	8
---	---

Five Cabinets in the Commonwealth Engage in Formal Internal Auditing	9
--	---

Employees Engaging in Internal Auditing Are Often Not Classified as Internal Auditors.....	13
--	----

RECOMMENDATIONS.....	14
----------------------	----

Appendices

I. Scope and Methodology	15
--------------------------------	----

II. Illinois Fiscal Control and Internal Auditing Act of 1967	18
---	----

III. Sections 2.2-1600 and 2.2-1601 of the Virginia Code.....	22
---	----

IV. Institute of Internal Audit Model Legislation	23
---	----

V. Excerpts From the <i>Inspector General Act of 1978</i>	30
---	----

VI. Auditor of Public Accounts Information	41
--	----

Tables

Table 1 Internal Auditing Activities in Other States.....	4
---	---

Table 2 Cabinets Not Using Internal Auditors.....	8
---	---

Table 3 Internal Auditing in Five Cabinets.....	10
---	----

Table 4 Auditing Standards Observed by Five Cabinets	11
--	----

Table 5 Annual Internal Auditing Costs for Various Cabinets	12
---	----

Table 6 Classifications Used by the Cabinets Engaging in Internal Auditing	13
--	----

Internal Auditing in Government

Internal auditing provides management with an independent appraisal of an organization's operations and controls, offering detailed information, analyses, and recommendations on the following objectives:

- Establishing whether goals and other performance criteria are being achieved
- Assessing internal and management controls
- Ascertaining whether resources are used efficiently
- Determining whether policies and procedures are followed
- Calculating the reliability and validity of performance information
- Evaluating whether adequate deterrents to fraud and waste exist

Internal auditing is a preventive as well as detective control for an organization because an internal auditor's continued presence may deter fraud or abuse. In addition, the expectation that an audit will be performed to detect wrongdoing or inefficient use of resources can be a powerful performance incentive for employees. A survey conducted by the National Association of State Auditors, Comptrollers, and Treasurers (NASACT), revealed that there are only six states that do not have an internal auditing function.

Internal auditing has its origins in the private sector where management's primary concern is profit. In government, when some form of performance criterion is noted, it is usually related to cost per unit of service, or an outcome such as a reduction in the crime rate.

There are countless opportunities for internal auditing to provide the information and analyses leading to a more effective, efficient government. Whether employment applications are being processed quickly by a personnel cabinet, whether an advertising campaign to increase child immunizations is working in a health services cabinet, or whether a tax abatement program optimizes job creation in an economic development cabinet are all valuable internal audit objectives. In addition, internal auditing of performance information contained in cabinet budget submissions and strategic plans may yield helpful assessments of accuracy and reliability.

Internal Auditing Generates Cost Savings

Internal auditing can generate more in savings than it costs. For example, A *Progress Report to the President* submitted by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency for FY 2000, concluded that the work of more than 11,000 employees of Inspectors General resulted in potential savings of \$9.5 billion and recovery actions of almost \$5.5 billion. For every dollar spent at the federal level for Inspectors General, the federal government either potentially saved or recovered approximately \$12.

Similar comparisons apply to external audit agencies like the General Accounting Office (GAO) and the Kentucky Auditor of Public Accounts. The Comptroller General reported that the GAO identified \$23 billion in savings for FY 2000, which was a \$61 return on every dollar invested in GAO. Also, the Auditor of Public Accounts Division of Performance Audit has issued findings and recommendations related to savings, missed opportunities, and mismanaged funds of over \$241 million through FY 2001. This represents a return on taxpayer investment of \$72 for every dollar invested in performance audits.

**The Value of Performing Both
Internal and External Auditing**

The internal and external auditing functions are distinct, each contributes independently to better government, and each merits the allocation of adequate resources. External auditing, as in the form of an annual financial audit, is a post-audit function, which provides a snapshot of an agency's effectiveness, efficiency, or financial condition during a just-concluded audit period. The internal auditor, unlike the external auditor, is a continual and integral presence within the agency. The findings of external audits of government agencies inform the public, while internal audit reports may contain proprietary agency information and guide even preliminary decisions of managers.

The practice of performing external and internal audits is commonplace at both the federal and state government levels. For example, the United States General Accounting Office is a large external audit function with 2,272 evaluators and auditors. In contrast, the federal Inspectors General framework encompasses over 11,000 employees. At the state level, many states have external audit functions comparable to the Auditor of Public Accounts, as well as cadres of internal auditors.

An internal auditor may examine subjects that are not "material" to an external auditor's work. External auditors are generally constrained by scarce resources and a vast audit universe. For example, during the course of auditing a multi-million dollar agency, scarce time and resources will likely dictate that an external financial auditor develop an audit step to examine only transactions over \$20,000 occurring in a previous fiscal year. However, an internal auditor's perspective is more confined, allowing analyses of transactions under \$20,000 occurring during a current fiscal year.

Internal auditors are also better positioned to assess performance information contained in budget submissions and strategic or other planning documents. Internal auditors can help develop as well as check the validity and reliability of the information generated by internal systems. External auditing, however, usually compares the agency performance information to acknowledged external benchmarks. External auditors are prevented by their professional standards on independence from playing a role in the auditee's development of such performance data.

Nor can it be legitimately argued that internal and external audits are duplicative. External auditors may rely on internal audit work if it meets acceptable professional standards. When that reliance is possible, the time and expenses of the external auditing are correspondingly reduced. Furthermore, internal auditors often rely upon the findings and recommendations of external audits for context and guidance in focusing internal audit work.

**Performance Based
Budgeting Pilot
Program**

During the 2000 Regular Session of the General Assembly, funding for executive branch strategic planning and performance based budgeting pilot programs was included in the biennial budget. The initiative requires the Office of State Budget Director to design and implement state performance based budgeting pilot programs. Four programs within the Transportation, Natural Resources & Environmental Protection, and Justice Cabinets, as well as the Governor's Office for Technology, were chosen and are required to submit a performance based budget request for FB 2002-04.

The initiative also requires Executive Branch agencies to submit strategic plans

with their budget requests that include goals, objectives, and performance indicators. It should be noted that the *2000-2002 Budget Instructions* require that agencies submit “program and performance and outcome measures and any other information which explains the program’s purpose and justification for expenditures,” and that the information “should be considered by the Agency as the most important part of the budget request.”

In light of the current requirements for Executive Branch agencies to develop and submit performance information as part of the budget process, and the possibility that performance based budgeting may become a requirement for all agencies, the use of internal auditors to verify the reliability and validity of performance information should become a vital component of the budget process. Such a component ensures that accurate and complete data is being submitted to the Legislature.

Federal Inspectors General are also moving in this direction. According to *A Progress Report to the President*, one of the top management challenges for federal Inspectors General relates to the Government, Performance, and Results Act (GPRA), which requires federal agencies to develop strategic plans that include a mission, goals, and objectives. Offices of Inspector General are currently including the assessment of GPRA performance measures as a standard part of every audit program.

Legislation on Internal Auditing

Legislation providing the framework for an internal auditing function assures consistency and sets standards. State governments, like the federal government, have passed legislation authorizing and requiring internal auditing functions. See appendices II through V for examples of this legislation. The NASACT survey revealed that 13 states that have internal audit functions also have enabling legislation.

Illinois Internal Auditing Legislation

Illinois passed the Fiscal Control and Internal Auditing Act of 1967. This act requires that state agencies designated by the Governor establish and observe a full-time program of internal auditing. Illinois’ policy is that every agency’s chief executive officer is responsible for effectively and efficiently managing the agency and establishing and maintaining an effective system of internal control. This policy applies to all state agencies, including the agencies not required to have an internal auditing program.

In 1988, after more than 20 years since the passage of the legislation, Illinois’ Office of the Auditor General released a report on internal auditing. The report contained the following conclusions that should be considered by other states when structuring an internal audit program:

- Reporting and coordinating structures are deemed inadequate.
- Agency managers misunderstand and do not properly use the internal audit function.
- Uniform professional audit standards have not been adopted.
- Chief internal auditor qualifications and staff training are inadequate.
- The number of full-time internal auditors is insufficient.

Virginia Internal Auditing Legislation

Virginia has also enacted legislation that established the Department of the State Internal Auditor. Section 2.2-1601 of the Virginia Code stipulates ten duties for this department. The following are paraphrased selected duties:

- Establish state policies and procedures that will ensure an effective internal audit program in all state agencies.
- Assist in the professional development of agency internal auditors by developing and conducting training programs.
- Develop a plan for accommodating the internal audit needs of agencies that do not have full-time internal auditors.
- Prepare a biennial report on the status of agency internal audit programs generally, and on agency adherence to other legislative requirements on internal auditing.

Virginia's Department of the State Internal Auditor reported that there are approximately 180 internal auditors working within the executive branch. Internal auditing positions are established at the discretion of each agency. At times, Virginia's Auditor of Public Accounts will recommend that an agency employ an internal auditor, but there are no legal requirements. When an agency decides to employ an internal auditor, the Department of the State Internal Auditor is available to help it develop job descriptions, qualifications, etc. However, agencies must first obtain approval and funding for these positions from the Legislature.

The following table contains information collected on surrounding states regarding their internal auditing programs:

Table 1
Internal Auditing Activities in Other States

State	Has Internal Auditors	Centralized/Decentralized	State has Legislation	*Type of Report
Illinois	Yes	Decentralized	Yes	Financial, Compliance
Indiana	Yes	Decentralized	No	Financial, Compliance, Performance
Missouri	Yes	Decentralized	No	Compliance, Performance
Ohio	Yes	Decentralized	No	Compliance, Performance
Tennessee	Yes	Decentralized	No	Financial, Compliance, Performance
Virginia	Yes	Decentralized	Yes	Financial, Performance

Source: Auditor of Public Accounts, from telephone interviews with state officials.

* **Financial** audits typically assess whether an entity's financial statements are presented fairly according to established or stated criteria. **Compliance** audits assess an entity's conformity and adherence to prescribed policies, procedures, laws, regulations, or contracts. **Performance** audits are an independent assessment of an organization or program to determine its effectiveness and efficiency.

**Federal Internal Auditing
Legislation**

The *Inspector General Act of 1978* established internal auditing at the federal level. Congress enacted this legislation after receiving evidence that fraud and waste among federal agencies had become a significant problem. Congress decided to address the problem by creating Offices of Inspector General within executive agencies. This act has been amended several times to increase the number of agencies with statutory Inspectors General. Currently, there are 58 Offices of Inspector General.

The *Inspector General Act of 1978*, as amended, posits the mission of an Inspector General to be to:

- Conduct independent and objective audits, investigations, and inspections
- Prevent and detect fraud and abuse
- Promote economy, effectiveness, and efficiency
- Review pending legislation and regulations
- Keep the agency head and Congress fully and currently informed

Inspectors General are independent and may not be prevented from conducting an audit or investigation. They are authorized to have direct access to all records and information of the agency, issue subpoenas for information and documents outside the agency (with few exceptions), administer oaths for taking testimony, conduct investigations, and issue such reports as the Inspector General considers important (with some national security and law enforcement exceptions). Inspectors General may receive and investigate complaints from employees of agencies concerning possible violations of statutes and regulations, but may not disclose the identity of such employees without their consent.

**Institute of Internal Auditors’
Model Legislation**

The Institute of Internal Auditors has model legislation to assist states in promulgating their own internal auditing legislation. In brief, the model recommends that internal auditing legislation require the following:

- Internal auditors should follow the *Standards for the Professional Practice of Internal Auditing*, as published by the Institute of Internal Auditors.
- State agencies with annual spending levels over a specified amount must establish an internal audit function.
- Annual reviews should be performed of each state agency’s internal auditing function, reporting on variances from general practices.

**Internal Auditor Versus
External Auditor**

The role of the internal auditor is very different from that of an external auditor. While the internal auditor’s sole responsibility is to management, the external auditor’s responsibility is to users outside the organization, such as legislative bodies and the general public. Some state agencies have auditing functions that examine external entities receiving funding from the agency or entities that the agency is responsible for regulating.

At least four agencies in the Commonwealth of Kentucky provide external auditing services. These agencies include the Auditor of Public Accounts, the Inspector General in the Cabinet for Health Services, the Inspector General in the Natural Resources and Environmental Protection Cabinet, and the Program Review and Investigations Committee of the Legislative Research Commission. All four entities are seen as independent of the agencies, programs, vendors, and

individuals they audit. Brief descriptions of these four agencies follow.

Auditor of Public Accounts

The Auditor of Public Accounts provides an independent audit of the accounts, financial transactions, and performance of all spending agencies of the state through an elected constitutional officer, who is entirely independent of the state administration whose affairs he/she is called upon to audit. Chapter 43 of the Kentucky Revised Statutes (KRS) guides the efforts of the Auditor of Public Accounts. For example, the language in KRS 43.050(2) authorizes the Auditor of Public Accounts to conduct annual audits of state, local, or other agencies receiving state funds, as well as other audits and investigations related to effectiveness, efficiency, and fraud detection. The Auditor of Public Accounts conducts financial, performance, information technology, and investigative audits.

**Cabinet for Health Services’
Office of Inspector General**

The duties of the Inspector General within the Cabinet for Health Services (CHS) set forth in KRS 194A.030(6). These duties include being responsible for conducting audits and investigations in order to detect the perpetration of fraud or abuse on any program by any client or by any vendor of services with whom the cabinet has contracted. This statute also gives the Inspector General the authority to conduct special investigations requested by the secretary, commissioners, or office heads of the cabinet into matters related to the cabinet or its programs. However, according to a staff assistant with the Office of Program Support, there are no plans to have internal audit teams within the cabinet. The Office of the Inspector General consists of 5 divisions – Division of Audits, Division of Community Health Services, Division of Licensed Child Care, Division of Long Term Care, and Division of Special Investigations.

**Natural Resources &
Environmental Protection
Cabinet’s Office of the
Inspector General**

The Inspector General within the Natural Resources & Environmental Protection Cabinet (NREPC) was established by the 2000 General Assembly. The Secretary of the NREPC is authorized to appoint an Executive Director to head the office. KRS 224.10-025(3) specifies the duties of the Office for investigating alleged violations of environmental laws. It also states that the Office provides support for the NREPC’s participation in investigations involving the cabinet, other Kentucky state agencies, and agencies of other states and the federal government.

**LRC’s Program Review and
Investigations Committee**

The Program Review and Investigations Committee is a 16-member bipartisan committee authorized by KRS Chapter 6. Established in 1978 as a permanent standing committee of the General Assembly, the Program Review and Investigations Committee’s duties are authorized by KRS 6.910. These duties include, but are not limited to, conducting performance reviews of operations of state agencies to ascertain the appropriate expenditure of funds and the effectiveness of the programs. In addition, the Committee’s staff may study the operations, practices, and duties of state agencies, as they relate to efficiency in the utilization of space, personnel, equipment, and facilities. Finally, the staff may conduct special studies and reports upon request by the General Assembly.

**Audit Purpose and
Objective**

This performance audit on internal auditing in Kentucky state government was conducted to provide information and make recommendations on internal auditing within the Commonwealth. It is an assessment of internal auditing activities within the state, and does not constitute an audit of any Cabinet.

Specifically, we identify Executive Branch Cabinets that are engaged in internal auditing and provide additional information. In addition, we identify cabinets that

do not engage in internal auditing and explore the reasons this type of auditing is not occurring. Finally, we provide additional information on what other states are doing about internal auditing.

See the Scope and Methodology section in Appendix I for additional information on the audit process.

Chapter 2

Status of Internal Auditing Within Kentucky's Executive Branch Cabinets

Internal Auditing Has Not Been Institutionalized in Executive Branch Cabinets

There are nine Executive Branch Cabinets with either no formal internal audit function or no employees fully dedicated to internal auditing. Since the Commonwealth has no statute requiring internal auditing across state government, these cabinets lack a proven framework for identifying cost savings or inefficiencies within their departments and programs. These nine cabinets expend almost \$7 billion annually and employ thousands of employees.

The following table provides a listing of these cabinets, their budgeted appropriations, and the number of personnel employed:

Table 2
Cabinets Not Using Internal Auditors

Executive Branch Cabinets	2001 Budgeted Appropriations	Number of Employees	
		Full Time	Part Time
Economic Development	\$ 28,095,800	130	27
Families and Children	915,071,100	5,795	29
Health Services	3,974,947,700	3,564	49
Justice	616,395,300	6,882	27
Labor	510,031,000	461	14
Natural Resources & Environmental Protection	198,149,900	1,545	9
Personnel	40,404,200	200	3
*Revenue	99,021,000	1,001	4
Workforce Development	531,785,800	2,075	365
Totals	\$6,913,901,800	21,653	527

Source: Auditor of Public Accounts, from budget information provided by the 2000-2002 Final Budget of the Commonwealth and personnel figures as of 9/24/01 from the Personnel Cabinet.

* Although the Revenue Cabinet's organizational chart shows an internal audit function, the employees within that function engaged in internal auditing are classified as Executive Staff Advisor and Resource Management Analyst III. Both employees also have significant duties not related to internal auditing.

Cabinet officials generally stated that the main reason their cabinets do not employ internal auditors is because of budgetary constraints. Also, one cabinet official stated that the Auditor of Public Accounts was the entity that provides this type of oversight, so internal auditing was not needed.

Chapter 2

Status of Internal Auditing Within Kentucky's Executive Branch Cabinets

These statements appear to ignore both the benefits of internal auditing and the possibility of reallocating existing resources to establish the function. The potential for cost savings revealed through internal auditing would most likely outweigh its associated costs. In addition, external audit agencies like the Auditor of Public Accounts typically conduct financial and performance audits once each year. In addition, the Auditor of Public Accounts observes *Government Auditing Standards (Yellow Book)* promulgated by the Comptroller General of the United States for financial and performance audits. Internal auditors, on the other hand, may conduct various types of audits and examinations on a continual basis and may use differing professional standards.

Internal Audit Activities

The nine cabinets appear to engage in limited, sporadic activities that could be deemed internal auditing. For example, the Revenue Cabinet has two employees that focus part-time on internal audit-like activities. They are responsible for data security, use of confidential tax information by authorized agencies, and special projects related to Management Administrative Reporting System (MARS) and EMPOWER Kentucky initiatives. According to the Revenue Cabinet's Executive Staff Advisor, there are plans in the near future, however, to perform more financial, performance, and compliance audits. In addition, some cabinets have offices established to monitor specific activities. An example of this is the Program Servicing Division that monitors statutory compliance and contractual mandates within the Economic Development Cabinet.

Five Cabinets in the Commonwealth Engage in Formal Internal Auditing

Only five of the Commonwealth's 14 executive cabinets (36%) have employees fully dedicated to performing internal audits. With the exception of the Finance & Administration Cabinet, no statutory or regulatory requirements provide for such audits. Internal auditing procedures vary among these cabinets. As a result, the Commonwealth is not realizing the benefits and cost savings that are normally associated with an established framework of internal auditing. In addition, a majority of the Commonwealth's cabinets and related departments do not appear to have the inclination or means to routinely evaluate effectiveness and efficiency of their internal programs and activities.

The table on the following page provides additional information on internal auditing in the Commonwealth:

Chapter 2
Status of Internal Auditing Within Kentucky’s Executive Branch Cabinets

Table 3
Internal Auditing in Five Cabinets

Executive Branch Cabinets	Year Internal Auditing Started	Authority to Conduct Internal Auditing	Focus of Internal Audit Work	Total Reports Released	Staff Size
*Education, Arts, & Humanities	2000	Internal Decision	Effectiveness Efficiency Compliance	4	1
Finance & Administration	1984	KRS 42.065	Compliance	***28	5
Public Protection & Regulation	2000	Internal Decision	Financial and Compliance	5	1
Tourism	1985	Internal Decision	Compliance	**260	1
Transportation	1975	Federal Regulation	Compliance	700	7
Total	N/A	N/A	N/A	997	15

Source: Auditor of Public Accounts, from information provided by various Commonwealth cabinets.

* Includes the internal auditor for the Department of Education.

** Includes the internal auditor for the Department of Parks.

*** Approximate total based on average of two audits per year for 14 years, including 2001. Audits were not conducted between 1997-2000.

****Records available only to 1995.

This table illustrates differences in the way the five cabinets use their internal auditors. We also found differences in the planning of audit work. For example, auditors for the Finance & Administration, Tourism, Transportation, and Public Protection & Regulation cabinets use standard audit programs for the majority of their work. The internal auditor for the Public Protection & Regulation Cabinet develops her standardized plan with the assistance of a computerized software program designed to check compliance with certain audit areas. The internal auditor with the Education, Arts, & Humanities Cabinet develops audit programs or audit steps on a project-by-project basis.

Only One Cabinet Is Explicitly Authorized to Perform Internal Audits

Only the Finance & Administration Cabinet is explicitly authorized by statute to engage in internal auditing. KRS 42.065 establishes the Administrative Policy and Audit Division within the Finance & Administration Cabinet. It empowers the Division to undertake internal audits of some of the Secretary’s duties and responsibilities and grants internal auditors access to all books, reports, papers, and accounts. In contrast, the internal auditors in the other four cabinets lack the imprimatur of statutory mandate, raising the possibility that cooperation will be withheld or inquiry will be resisted.

Enacting government-wide state legislation is also important to ensure consistency in the mechanics of internal auditing, as well as to enhance the credibility of internal auditors. The 13 states that have internal audit enabling legislation benefit accordingly.

Also, the *Inspector General Act of 1978* was enacted to create “independent and objective units” to provide oversight of federal agencies. Legislative language should also establish the mechanics of audit independence, reporting, access to documents, and standards. The *Inspector General Act of 1978* has specific sections governing independence, subpoena power, access to records,

Chapter 2
Status of Internal Auditing Within Kentucky’s Executive Branch Cabinets

administration of oaths, and use of *Government Auditing Standards* promulgated by the Comptroller General of the United States.

Cabinets Use Various Standards

Executive cabinets that engage in internal auditing observe various auditing standards. All five cabinets use some type of industry standard when planning and executing their audits. Following these standards will increase the chances of producing usable and credible work products.

The following table provides additional information on the standards observed by cabinets engaging in internal auditing:

Table 4
Auditing Standards Observed by Five Cabinets

Cabinet	Standards Followed		
	Government Auditing Standards	Standards for the Professional Practice of Internal Auditing	*Other
Education, Arts, & Humanities			
Finance & Administration		✓	✓
Public Protection & Regulation		✓	
Tourism			✓
Transportation	✓	✓	✓

Source: Auditor of Public Accounts, from information provided by various Commonwealth cabinets.

* This category includes standards from the Governmental Accounting Standards Board, United States Department of Health and Human Services, American Institute of Certified Public Accountants, and Sawyer’s Internal Auditing.

According to a Senior Manager for Technical Services for the Institute of Internal Auditors, formal standards are an important component of internal auditing. Without them, audit entities may be ineffective at training and ensuring that auditors know how to plan and perform audits. For example, the Tourism Cabinet consults a textbook, *Sawyer’s Internal Auditing*, as its primary guide for standards. This excellent resource should not be a substitute for established, documented internal auditing standard and a discrete internal audit training curriculum.

In order to ensure auditing consistency as well as ease of training, states establishing internal audit functions should require one set of standards for all agencies. The Institute of Internal Auditors holds that the *Standards for the Professional Practice of Internal Auditing* are appropriate for any governmental agency because they focus on efficiency and effectiveness. Although this is the Institute’s preference, it also acknowledges that states and the federal Inspectors General using *Government Auditing Standards* have very successful audit functions.

Internal Auditing Costs Vary

The costs for internal auditing among the five cabinets vary. Total annual costs for performing internal audits range from \$68,629 to \$526,887 for these cabinets. The majority of total costs consists of salaries, with the remaining costs attributable to operating expenses.

Chapter 2
Status of Internal Auditing Within Kentucky’s Executive Branch Cabinets

The following table provides additional information on the costs associated with internal auditing for various cabinets:

Table 5
Annual Internal Auditing Costs for Various Cabinets

Cabinet	Salaries & Benefits	Operating Costs	Total	Number of Employees
Education, Arts, & Humanities	\$ 81,250	\$ 3,750	\$ 85,000	1
Finance & Administration	164,000	34,857	198,857	5
Public Protection & Regulation	65,129	3,500	68,629	1
Tourism	82,938	11,696	94,634	1
Transportation	441,189	85,698	526,887	7
<i>Total</i>	\$834,506	\$139,501	\$974,007	15

Source: Auditor of Public Accounts, from information provided by various Commonwealth cabinets.

There appears to be no standard of appropriateness for costs associated with an internal auditing function. However, the cost figures set out above make it apparent that adequate resources are not being allocated to internal auditing in the Commonwealth. Total appropriations for Executive Branch Cabinets for FY 2000 and FY 2001 were \$12,098,337,100 and \$13,134,868,200 respectively. The current budgetary allocation for internal auditing functions with fully dedicated personnel, accounts for only seven one-thousandths of one percent (.007 %) of the annual appropriation for all cabinets in FY 2001.

Only One Cabinet Requires Training for Its Internal Auditors

Only the Transportation Cabinet requires continuing professional education for its internal auditors. The Transportation Cabinet’s internal auditors follow *Government Auditing Standards*, which requires 80 hours of training (24 of which relate to the government environment and to government auditing) during a two-year period. However, the internal auditors in the remaining four cabinets are subjected to no requirements for completing specific amounts of training.

Other cabinets following the *Standards for Professional Practice of Internal Auditing* are not required to meet specific training requirements. These standards are comparatively vague, only requiring internal auditors to “maintain their technical competence through continuing education.” It is essentially left up to the individual auditors and their organizations to ensure that audit staff receives adequate training. However, according to an Institute for Internal Auditing manager, the Institute is in the process of defining specific training requirements as part of its standards. Consistent and adequate training is an essential tool to ensure that internal auditors are credible, efficient, and effective in their duties and responsibilities.

It should be noted that the internal auditors for the Public Protection & Regulation and Finance and Administration cabinets receive some audit-related training. Examples range from a correspondence course on internal auditing to training on financial and database systems.

Chapter 2
Status of Internal Auditing Within Kentucky’s Executive Branch Cabinets

Internal Auditors Maintain Their Independence

According to feedback from the internal auditors working for the five cabinets that engage in internal auditing, all felt that they are operating independently within their cabinets. In other words, inappropriate forces are not influencing the choice of audit subjects or the findings and recommendations of the audits. It should be noted, however, that one internal auditor did feel that some assignments might be based on personal, as opposed to professional, reasons.

Internal auditors also stated that they feel comfortable with their working environments and believe what they do is important and appreciated by others in their cabinets.

Employees Engaging In Internal Auditing Are Often Not Classified as Internal Auditors

Only two cabinets engaged in internal auditing use the classifications established by the Personnel Cabinet for internal auditors. The Finance and Administration Cabinet has three employees classified as an Internal Auditor II and the Public Protection and Regulation Cabinet has one employee classified as an Internal Auditor II.

The Internal Auditor I and II positions were created by the Personnel Cabinet in 1984. The remaining cabinets engaged in internal auditing do not use these classifications. As a result, the majority of personnel involved in internal auditing do not have to meet consistent requirements.

The following table provides additional information related to classifications used by personnel engaged in internal auditing:

Table 6
Classifications Used by the Cabinets Engaging in Internal Auditing

	Internal Auditor II	Division Director II	Auditor II	Audit Team Leader	Audit Reviewer/Specialist	Audit Team Leader	Audit Manager
Public Protection and Regulation	✓						
Finance and Administration	✓	✓					✓
Transportation			✓	✓	✓	✓	✓
Department of Parks					✓		
Department of Education *							

Source: Auditor of Public Accounts, from information provided by the Personnel Cabinet.

* Internal Auditor holds a non-merit position.

According to the Personnel Cabinet, the Finance and Administration Cabinet requested the class titles of Internal Auditor I and Internal Auditor II in 1984. The minimum requirements for both Internal Auditor I and II positions is a bachelor’s degree with 20 hours in accounting or a Certified Public Accountant certification and 4 years of professional accounting or auditing experience.

Personnel Cabinet officials are not sure why these classifications have fallen into disuse. However, they provided some possible reasons. One is that there may be

difficulty in recruiting auditors with the required experience. Both the Internal Auditor I and Internal Auditor II positions require four years of professional accounting or auditing experience. This requirement would prevent an agency from hiring a recent college graduate with little or no experience. The remaining classifications currently used by those doing internal auditing require one to five years of experience (either in professional accounting/ auditing or management/ administration). Personnel officials also suggested that the Internal Auditor classification fell into disuse because persons working within an agency might be intimidated by this title and could be reluctant to provide information.

Another possible reason for the use of other classifications for individuals performing internal auditing duties may relate to pay. For example, the pay scale for the Internal Auditor classifications is lower, and the position has limited promotional opportunities. The Internal Auditor I position is a grade 14 with a salary range of \$30,384.96 – 50,126.88 and the Internal Auditor II position is a grade 15 with a salary range of \$33,425.04 – 55,140.24. The other classifications used by these cabinets range in grade from 13 to 19 with the pay varying based on education and professional experience.

By allowing cabinets to hire internal auditors within classifications other than Internal Auditor I and II, the Commonwealth may not be hiring individuals with the experience necessary to perform internal auditing work, especially if that individual is the only internal auditor for the cabinet or department.

Recommendations

1. The General Assembly should consider enacting legislation to require internal auditing in all Executive Branch Cabinets. The *Inspector General Act of 1978*, the Illinois and Virginia legislation, and the model legislation from the Institute of Internal Auditors could provide a basis for this deliberation. Potential legislation should address the following areas:
 - Internal auditor independence
 - Reporting of findings
 - Internal auditor access to records
 - Internal auditor training requirements
 - Standards for performing internal audits
 - Qualifications for internal auditors
2. Secretaries of the Cabinets of the Executive Branch should consider the reallocation of existing resources in order to establish an effective internal audit function.

Scope

We conducted our audit in accordance with *Government Auditing Standards* promulgated by the Comptroller General of the United States. The audit's purpose was to address the following objective:

Determine the extent of internal auditing in Kentucky State Government.

The following *Government Auditing Standards* were not significant to the audit's objective:

- Compliance with laws and regulations
- Understanding of management controls
- Assessing the reliability of computer-based data

In addition, because the audit's objective did not focus specifically on any one Cabinet within the Commonwealth and we made no agency recommendations, there was no need to incorporate a written response from Cabinet officials.

Methodology

We surveyed personnel from all 14 cabinets to determine the extent of their internal auditing activities. We received a 100% response rate. We then interviewed the following cabinets who indicated on their surveys that they engaged in internal auditing:

- Education, Arts, & Humanities
- Finance & Administration
- Public Protection & Regulation
- Revenue
- Tourism
- Transportation

We also conducted telephone interviews with officials from the following cabinets who indicated on their surveys that they did not engage in internal auditing:

- Economic Development
- Families & Children
- Health Services
- Justice
- Labor
- Natural Resources & Environmental Protection
- Personnel
- Workforce Development

We also solicited anonymous feedback from employees engaged in internal auditing activities related to independence and objectivity.

Because the Kentucky Revenue Cabinet has employees who are not fully dedicated to internal auditing activities, we included them in the group of cabinets that do not formally engage in internal auditing. In addition, we did not include the Cabinet for Health Service's Office of the Inspector General or the Natural Resources & Environmental Protection Cabinet's Inspector General in the group of cabinets that conducted internal auditing. Because the personnel from these

offices conduct audits related to detecting fraud or abuse of programs by clients and contractors and do not consider themselves internal auditors, we did not include them in our cabinets that conduct internal audits.

We also asked the Personnel Cabinet to provide us with the classifications that could be used by cabinets to employ internal auditors. They identified the following classifications:

- Internal Auditor I
- Internal Auditor II
- Audit Manager
- Audit Reviewer/Specialist
- Audit Supervisor
- Audit Team Leader
- Auditor I
- Auditor II
- Auditor for Special Investigations I
- Auditor for Special Investigations II

As a result of our interviews with Cabinet officials, we determined that personnel engaged in internal auditing were using the following classifications:

- Internal Auditor II
- Division Director II
- Audit Manager
- Audit Reviewer/Specialist
- Audit Team Leader
- Auditor II
- KBE/KDE Internal Auditor (non merit position)

We reviewed applicable state and federal statutes, regulations, Attorney General's Opinions, and sections of the Constitution to document information related to internal auditing.

We reviewed documents, legislation, and reports from various agencies and associations to determine the extent of internal auditing in other states and at the federal level. These documents included the following:

- National Association of State Auditors, Comptrollers, and Treasurers.
- Professional President's Council on Integrity and Efficiency.
- The Executive Council on Integrity and Efficiency.
- Council on State Governments.
- National Conference on State Legislatures.
- United State General Accounting Office.
- Institute for Internal Auditors.

Benchmarking With Other States

To develop an understanding of the internal auditing function of other states, we interviewed officials from the following states:

- Illinois.
- Tennessee.
- Missouri.
- Ohio.
- Indiana.
- Virginia.

Illinois Fiscal Control and Internal Auditing Act of 1967

ARTICLE 1. GENERAL PROVISIONS.

(30 ILCS 10/1001)

Sec. 1001. Short title. This Act may be cited as the Fiscal Control and Internal Auditing Act.

(Source: P.A. 86-936.)

(30 ILCS 10/1002)

Sec. 1002. Public policy. It is the policy of this State that the chief executive officer of every State agency is responsible for effectively and efficiently managing the agency and establishing and maintaining an effective system of internal control.

(Source: P.A. 86-936.)

(30 ILCS 10/1003)

Sec. 1003. Definitions.

(a) "Designated State agencies" include the offices of the Secretary of State, the State Comptroller, the State Treasurer, and the Attorney General, the State Board of Education, the State colleges and universities, the Illinois Toll Highway Authority, the Illinois Housing Development Authority, and other State agencies designated by the Governor under Section 2001.

(b) "State agency" means that term as defined in the Illinois State Auditing Act, as now or hereafter amended, except the judicial branch which shall be covered by subsection (c) of Section 2001 and Section 3004 of this Act.

(c) "Chief executive officer" includes, respectively, the Secretary of State, the State Comptroller, the State Treasurer, the Attorney General, the State Superintendent of Education, such chief executive officers as are designated by the governing board of each State college and university, the executive director of the Illinois Toll Highway Authority, and the executive director of the Illinois Housing Development Authority, as well as the chief executive officer of each other State agency.

(Source: P.A. 86-936.)

ARTICLE 2. INTERNAL AUDITING.

(30 ILCS 10/2001)

Sec. 2001. Program of internal auditing.

(a) Each designated State agency shall establish a full-time program of internal auditing. The Governor shall designate State agencies under this Act not later than April 1 of each odd numbered year. The designations shall be filed with the Index Division of the Office of the Secretary of State as a public record. The Legislative Audit Commission may make formal recommendations to the Governor that the Governor designate other State agencies under this Act.

(b) The chief executive officer of a State agency is not relieved from the responsibility for maintaining an effective internal control system merely because that State agency is not designated and required to have a full-time program of internal auditing under this Act. Agencies which do not have full-time internal audit programs may have internal audits performed by the Department of Central Management Services.

(c) The Supreme Court will establish by its rulemaking authority or by administrative order a full-time program of internal auditing of State-funded activities of the judicial branch, which is consistent with the intent of this Article.

(Source: P.A. 86-936.)

(30 ILCS 10/2002)

Sec. 2002. Qualifications of chief internal auditor.

(a) The chief executive officer of each designated State agency shall appoint a chief internal auditor with a bachelor's degree, who is either:

Illinois Fiscal Control and Internal Auditing Act of 1967

-
- (1) a certified internal auditor by examination or a certified public accountant and who has at least 4 years of progressively responsible professional auditing experience; or
 - (2) an auditor with at least 5 years of progressively responsible professional auditing experience.

(b) The chief internal auditor shall report directly to the chief executive officer and shall have direct communications with the chief executive officer and the governing board, if applicable, in the exercise of auditing activities. All chief internal auditors and all full-time members of an internal audit staff shall be free of all operational duties.

(Source: P.A. 86-936.)

(30 ILCS 10/2003)

Sec. 2003. Internal auditing program requirements.

(a) The chief executive officer of each designated State agency shall ensure that the internal auditing program includes:

- (1) A two-year plan, identifying audits scheduled for the pending fiscal year, approved by the chief executive officer before the beginning of the fiscal year. By September 30 of each year the chief internal auditor shall submit to the chief executive officer a written report detailing how the audit plan for that year was carried out, the significant findings, and the extent to which recommended changes were implemented.
- (2) Audits of major systems of internal accounting and administrative control conducted on a periodic basis so that all major systems are reviewed at least once every 2 years. The audits must include testing of:
 - (A) the obligation, expenditure, receipt, and use of public funds of the State and of funds held in trust to determine whether those activities are in accordance with applicable laws and regulations; and
 - (B) grants received or made by the designated State agency to determine that the grants are monitored, administered, and accounted for in accordance with applicable laws and regulations.
- (3) Reviews of the design of major new electronic data processing systems and major modifications of those systems before their installation to ensure the systems provide for adequate audit trails and accountability.
- (4) Special audits of operations, procedures, programs, electronic data processing systems, and activities as directed by the chief executive officer or by the governing board, if applicable.

(b) Each chief internal auditor shall have, in addition to all other powers or duties authorized by law, required by professional ethics or standards, or assigned consistent with this Act, the powers necessary to carry out the duties required by this Act.

(Source: P.A. 86-936.)

(30 ILCS 10/2004)

Sec. 2004. Consultations by internal auditor. Each chief internal auditor may consult with the Auditor General, the Department of Central Management Services, the Economic and Fiscal Commission, the appropriations committees of the General Assembly, the Bureau of the Budget, or the Internal Audit Advisory Board on matters affecting the duties or responsibilities of the chief internal auditor under this Act.

(Source: P.A. 86-936.)

(30 ILCS 10/2005)

Sec. 2005. Internal Audit Advisory Board.

(a) An 11 member Internal Audit Advisory Board is created.

(b) The composition of the Board shall be as follows:

- (1) the chief internal auditor of the Department of Central Management Services;
- (2) the chief internal auditor of the Office of the State Comptroller;
- (3) the chief internal auditor of the Office of the Secretary of State;
- (4) the chief internal auditor of the Office of the State Treasurer;
- (5) the chief internal auditor of the Office of the Attorney General; and
- (6) 6 chief internal auditors appointed by the Governor.

At least one of the members appointed by the Governor must be an employee of a State college or university or university governing board.

Illinois Fiscal Control and Internal Auditing Act of 1967

(c) The initial appointments by the Governor of the 6 chief internal auditors who shall be members of the Board shall be made before the next February 1 after the date this Act takes effect and shall be as follows: 2 appointments for three-year terms, 2 appointments for two-year terms, and 2 appointments for one-year terms. After the initial terms each member appointed by the Governor shall serve a three-year term.

(d) A vacancy shall exist whenever a member ceases to be employed in the position which qualified the member for appointment. Vacancies shall be filled in the same manner as the original appointment. Persons appointed to fill a vacancy shall serve the balance of the unexpired term.

(e) The Board shall select a chairman from its members, who shall serve for a one-year term as chairman. Board members shall receive no additional compensation for their services, but shall be reimbursed by their employing agency for expenses necessarily incurred in the performance of their duties as Board members.

(f) The Board shall be responsible for:

- (1) promulgating a uniform set of professional standards and a code of ethics (based on the standards and ethics of the Institute of Internal Auditors, the General Accounting Office, and other professional standards as applicable) to which all State internal auditors must adhere;
- (2) serving as a clearinghouse for the correlation of internal audit training needs and training designed to meet those needs; and
- (3) coordinating peer review activities among the State's internal audit units.

(Source: P.A. 86-936.)

ARTICLE 3. FISCAL CONTROLS.

(30 ILCS 10/3001)

Sec. 3001. Internal controls required. All State agencies shall establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that:

- (1) resources are utilized efficiently, effectively, and in compliance with applicable law;
- (2) obligations and costs are in compliance with applicable law;
- (3) funds, property, and other assets and resources are safeguarded against waste, loss, unauthorized use, and misappropriation;
- (4) revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources; and
- (5) funds held outside the State Treasury are managed, used, and obtained in strict accordance with the terms of their enabling authorities and that no unauthorized funds exist.

(Source: P.A. 86-936.)

(30 ILCS 10/3002)

Sec. 3002. Certification guidelines for chief executive officers.

(a) By the next March 1 after the date this Act takes effect, the Comptroller, in consultation with the Director of Central Management Services, shall establish guidelines for:

- (1) the evaluation by State agencies of their systems of internal fiscal and administrative controls to determine whether the systems comply with the requirements of Section 3001; and
- (2) the certification by chief executive officers required by Section 3003.

(b) The guidelines must be approved by the Legislative Audit Commission and may be modified, as needed, with the Commission's approval.

(Source: P.A. 86-936.)

(30 ILCS 10/3003)

Sec. 3003. Certification by chief executive officers.

(a) By May 1 of each year, each chief executive officer of all State agencies shall, on the basis of an evaluation conducted in accordance with guidelines established under Section 3002, prepare and transmit to the Auditor General a certification that:

(1) the systems of internal fiscal and administrative controls of the State agency fully comply with the requirements of this Act; or

(2) the systems of internal fiscal and administrative controls of the State agency do not fully comply with the requirements of this Act.

(b) If the systems do not fully comply with the requirements of this Act, the certification shall include a report describing any material weaknesses in the systems of internal fiscal and administrative controls and the plans and schedule for correcting the weaknesses, or a statement of the reasons why the weaknesses cannot be corrected.

(Source: P.A. 86-936.)

(30 ILCS 10/3004)

Sec. 3004. The Supreme Court will establish by its rulemaking authority or by administrative order procedures to annually assess the adequacy of internal controls for State-funded activities of the judicial branch, using procedures consistent with the intent of this Article.

(Source: P.A. 86-936.)

§ 2.2-1600. (Effective October 1, 2001) Department created; appointment of State Internal Auditor; staff support.

There is created a Department of the State Internal Auditor (the "Department"). The Department shall be an agency under the direction of the Secretary of Finance. The State Internal Auditor shall be selected by and report directly to the Secretary of Finance. The State Internal Auditor shall be either a certified public accountant or a certified internal auditor. The State Internal Auditor, in order to provide continuity to the state's internal audit program, shall be a classified position subject to the provisions of the Virginia Personnel Act (§ 2.2-2900 et seq.).

The Secretary of Finance shall assign responsibility for the Department's administrative support services to one or more state agencies within responsibility of his Secretariat.

The Department shall provide for the development and maintenance of internal audit programs in state agencies in order to ensure that the Commonwealth's assets are subject to appropriate internal management controls. Appropriate internal management controls assist in safeguarding assets, ensuring accurate accounting and reporting of financial transactions, and in providing effective and efficient management.

(1985, c. 72, §§ 2.1-234.29, 2.1-234.30, 2.1-234.33; 2001, c. 844.)

§ 2.2-1601. (Effective October 1, 2001) Duties of the Department.

A. The Department shall have the following duties to:

1. Establish state policies, standards, and procedures that will ensure an effective internal audit program in all state agencies;
2. Provide technical information to state agencies concerning trends and new techniques in internal auditing;
3. Develop evaluative tools and other modern methods to assist agency internal auditors in performing audits;
4. Assist state agencies in developing and implementing automated data processing internal audit programs in the Commonwealth;
5. Provide general technical and audit assistance to agency internal auditors and to the Auditor of Public Accounts and the Governor on request;
6. Assist agency heads and collegial bodies in establishing and operating internal audit organizations;
7. Assist in the professional development of agency internal auditors by developing and conducting training programs;
8. Examine the adequacy of agency internal audit programs through periodic assessments of such programs and provide the Governor, Governor's Secretaries, the State Comptroller, the Director of the Department of Planning and Budget, and agency heads with the results of such assessments;
9. Develop, in conjunction with the State Comptroller, the Auditor of Public Accounts, the Joint Legislative Audit and Review Commission, and other appropriate state officials, a plan for accommodating the internal audit needs of agencies that do not require full-time internal auditors; and
10. Prepare a biennial report for the Governor, Governor's Secretaries, Auditor of Public Accounts, and appropriate agency heads on the status of agency internal audit programs generally, and on agency adherence to other legislative requirements on internal auditing.

B. The provisions of subsection A shall not infringe upon responsibilities assigned to the Comptroller, the Auditor of Public Accounts, or the Joint Legislative Audit and Review Commission by other provisions of the Code of Virginia.

(1985, c. 72, § 2.1-234.32; 1990, c. 467; 2001, c. 844.)

MODEL INTERNAL AUDIT LEGISLATION FOR STATE GOVERNMENTS

Citation of the Act

This Act shall be known and may be cited as the (name of State) Internal Audit Act.

Purpose

The purpose of the Act is to establish a full-time program of internal auditing to assist in improving agency operations. The agency internal audit director shall furnish independent analyses, appraisals, and recommendations concerning the adequacy of each state agency's systems of internal control, and the efficiency and effectiveness of agency management in carrying out assigned responsibilities in accordance with applicable laws, rules, and regulations. The internal auditing program shall evaluate and advise the organization in the establishment of controls necessary to accomplish agency goals and objectives at reasonable costs. The agency internal audit director shall be alert to the possibility of abuse or illegal acts, errors and omissions, and conflicts of interest.

Definitions

- (a) "State agency" means each executive or judicial branch agency, board, or commission created pursuant to law, and also includes each state university.
- (b) "Agency head" means the Governor, a Cabinet officer, an elected official, an agency secretary, an executive director, or a governing board or commission.
- (c) "Agency internal audit director" means the person appointed by the agency head to direct the internal audit function for the state agency. Where consistent with responsibilities described in this Act, the term agency internal audit director may also be referred to as inspector general, audit director, chief auditor, or similar internal audit administrator descriptions.
- (d) "Audit committee" means a standing committee external to organization management that collectively has the expertise to provide effective oversight and advice over the acquisition and provision of internal audit services.

Note: These are example definitions. Each state should define these terms to comply with law and the organizational structure in the affected state.

Applicability of the Act

Any Agency meeting one or more of the following criteria shall establish an ongoing program of internal auditing:

- (a) The agency has an operating budget exceeding (Ex. \$10-\$50) million annually.
- (b) The agency has a staff of more than (Ex. 100-500) employees.

- (c) The agency receives and processes collections in excess of (Ex.\$5-25) million annually.
- (d) The agency administers programs that the agency head considers high risk and essential to the safety, health, and welfare of the state, and which can therefore justify an ongoing program of internal auditing.

Note: Each state should set its own threshold for establishing a required internal audit function.

Appointment of Agency Internal Audit Director, Staffing, and Location of Audit Organization

Each state agency shall employ an agency internal audit director who shall be appointed by the agency head. The agency head shall ensure that the Director is allowed to employ a sufficient number of professional and support staff to implement an effective program of internal auditing. Compensation, training, job tenure, and advancement of internal auditing staff shall be based upon merit. The internal audit organization shall have organizational status outside the agency's staff or line management functions or units subject to audit, and shall be free of operational and management responsibilities that would impair the ability to make independent audits of any aspects of the agency's operations.

Note: As an alternative, a state may prefer to structure an internal audit function under one central internal audit organization. The central internal audit organization could also provide internal auditing services to smaller agency organizations that have a need for internal auditing services, but are not large enough to support a full-time audit staff. A centralized internal audit function may be more efficient and may be more consistent in providing broad audit coverage for the state as a whole. However, such structure may not promote a detailed understanding of each agency program or be responsive to the needs of each agency head or the agency. The benefits of a central internal audit organization for the state as a whole versus an internal audit function for each agency should be carefully considered. Additional state internal audit organizational structures are possible. For example, some states may want to establish a central internal audit organization to meet the oversight needs of the Governor, and may also want to allow individual agencies to employ an agency internal audit director. Care should be taken to ensure that the structure of the internal audit function provides adequate audit coverage and is responsive to the needs of the organization.

Professional Qualifications

The agency internal audit director shall possess the following qualifications:

- (a) A bachelor's degree from an accredited college or university and (Ex. 5 to 8) years of progressively responsible professional auditing experience as an internal auditor or independent postauditor, electronic data processing auditor, or any combination thereof. The auditing experience shall at a minimum consist of audits of units of government or private business enterprises, operating for profit or not for profit; or
- (b) A master's degree from an accredited college or university and (Ex. 4-7) years of progressively responsible professional auditing experience as an internal auditor or independent postauditor, electronic data processing auditor, or any combination therefore; or

(c) A certificate as a certified internal auditor issued by The Institute of Internal Auditors and (Ex. 4-7) years of progressively responsible professional auditing experience as an internal auditor or independent postauditor, electronic data processing auditor, or any combination thereof.

Note: In the absence of a certified internal auditor certificate, consideration should be given to substituting one or more of the following:

1. A certificate as a certified public accountant,
 2. A certificate as a certified information systems auditor, or
 3. A certificate as a certified management accountant.
-

Duties of the Agency Internal Audit Director

The agency internal audit director shall:

(a) Report directly to the agency head or deputy agency head through the audit committee.

Note: A state may prefer that the Director report only to the agency head. Government Auditing Standards allow the Director to also report to the deputy agency head; however, a state may require a higher level of reporting.

(b) Conduct financial, compliance, electronic data processing, and performance audits of agency programs, activities, and functions and prepare audit reports of findings.

(c) Review and evaluate internal controls over agency programs, accounting systems, administrative systems, electronic data processing systems, and all other major systems necessary to ensure accountability of the state agency.

(d) Develop long-term and annual audit plans to be based on the findings of periodic documented risk assessments. The plan shall show the individual audits to be conducted during each year, and the related resources to be devoted to each of the respective audits. The audit plan shall ensure that internal controls are reviewed on a periodic basis. The plan shall be submitted to the agency head for approval and the audit committee for comment. A copy of the approved plan shall be available upon request to the state and/or legislative auditor or other appropriate external auditor to assist in planning and coordination of any external financial, compliance, electronic data processing, or performance audit.

(e) The scope and assignment of the audits shall be determined by the agency internal audit director; however, the head of the agency may at any time request the agency internal audit director to perform an audit of a special program, activity, function, or organizational unit.

Applicable Professional Standards

(a) Audits shall be conducted in accordance with the Standards for the Professional Practice of Internal Auditing published by The Institute of Internal Auditors, Inc., and, when required by law, regulation, agreement, contract, or policy, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. All audit reports issued by internal audit staff shall include a statement that the audit was conducted pursuant to the appropriate standards.

Working Papers

(a) Audit working papers and reports shall be public records to the extent that they do not include information which has been made confidential pursuant to law.

(b) When the agency internal audit director or a member of his/her staff receives from an individual a complaint or information protected by whistleblower or other legislation, the name or identity of the individual shall not be disclosed without the written consent of the individual, or unless required by law or judicial processes.

(c) The director and the internal audit staff shall have access to all personnel and any records, data, and other information of the state agency deemed necessary to carry out assigned duties. The agency internal audit director shall maintain the confidentiality of any public records that are made confidential by law, and shall be subject to the same penalties as the custodian of those public records for violating confidentiality statutes.

Note: Some states may prefer that working papers not be a public record, or at least not be a public record until the audit report is released. Each state should consider the needs of the internal audit function and its public records law requirements.

Reporting

(a) At the conclusion of each audit, the agency internal audit director shall submit preliminary findings and recommendations to the person responsible for supervision of the program, activity, function, or organizational unit being audited who shall respond in writing to any findings of the agency internal audit director within (Ex. 15-45) working days after receipt of the findings. Such response and, if necessary, the agency internal audit director's response may be included in the final audit report.

(b) The agency internal audit director shall submit the final report to the head of the agency and the audit committee. The report shall be provided upon request to any applicable legislative, executive, or judicial branch oversight body, appropriate state and/or legislative auditor, or other external auditor. The report shall be distributed to the extent authorized by law.

Follow-Up on Issued Reports

- (a) No later than (Ex. 4-12) months after a financial, compliance, electronic data processing, or performance audit is issued, the agency internal audit director shall follow-up on reported findings to determine that corrective action was taken and is achieving the desired results. The agency internal audit director shall inform the agency head and audit committee of the status of corrective actions taken by the agency manager responsible for supervision of the program activity, function, or organizational unit audited.
- (b) If a follow-up report is issued, the agency internal audit director shall submit the report to the head of the agency and the audit committee. The follow-up report shall be provided upon request to any legislative, executive, or judicial branch oversight body, appropriate state and/or legislative auditor, or other external auditor.

Action on Findings

- (a) The state and/or legislative auditor or other external auditor, in connection with planning independent postaudits of the same agency, shall give appropriate consideration to internal audit reports and the resolution of findings therein.
- (b) Appropriate legislative committees may inquire into the reasons or justifications for failure of the agency to correct the deficiencies reported in internal audits.

Professional Development

- (a) The agency head shall make available to the internal audit director adequate resources to ensure the professional development and continuing professional education of internal audit staff.
- (b) The internal audit director shall cooperate with the state and/or legislative auditor or other external auditor in the exchange of technical assistance and access to current information concerning audit techniques, policies, and procedures.

Quality Control

- (a) Each agency internal audit organization should have an external quality control review at least once every 3 years to determine compliance of issued reports with current Standards for the Professional Practice of Internal Auditing and/or, if appropriate, Government Auditing Standards. The review shall be performed by qualified persons who are independent of the organization and who do not have a real or apparent conflict of interest. The report issued on the external quality control review shall be a public record to the extent authorized by law.

Audit Committee

(a) An audit committee shall be established to monitor the activities of the agency internal and external audit activities. The internal audit director shall report to the agency head through the audit committee, and shall have freedom of access to the agency head to be responsive to specific request, direction, and needs.

Note: In some states it may not be feasible to have an audit committee for every agency. Alternatives would be to have: (1) one audit committee to serve all state agencies; (2) one audit committee to serve agencies whose head is appointed by the Governor, one audit committee to serve the agency of each elected officer (Treasurer, Attorney General, etc.), and one audit committee to serve agencies whose head is appointed by the Governor and Cabinet; or (3) some other audit committee arrangement based upon each state's unique organizational structure.

(b) The audit committee shall:

- (1) Be composed of individuals who are external to the organization's management structure, and who have the program and/or management expertise to perform the review function effectively.
- (2) Carry out oversight responsibilities relating to financial, compliance, electronic data processing, performance, and other reporting practices.
- (3) Concur in the appointment or removal of the director of internal auditing.
- (4) Review the annual internal audit plan and budget, internal and external audit reports, follow-up reports, and quality assurance reviews.
- (5) Periodically meet with the agency internal audit director to discuss pertinent matters, including whether there are any restrictions on the scope of audits.
- (6) Not be compensated for services provided. However, they shall be reimbursed for travel expenses in accordance with authorizing law.

State Interagency Internal Audit Forum

(a) A State Interagency Internal Audit Forum shall be established and composed of agency internal audit directors. The purpose of the Forum will be to promote the exchange of communication, to identify professional development needs and/or conduct or coordinate training programs, to share audit techniques and approaches, and to address ways to improve agency operations and systems of internal control. The Forum will elect officers from its membership and shall meet periodically throughout the year.

Annual Report

(a) Within (Ex. 60-180) days after the end of each fiscal year, the agency internal audit director shall issue an annual report which separately lists audit reports issued, and other activities completed or in progress as of the end of the fiscal year. The annual report shall describe accomplishments of the internal audit activities. Copies of the report shall be provided to the Governor, the agency head, and the audit committee. The annual report shall be provided upon request to any legislative, executive, or judicial branch oversight body, and to the appropriate state and/or legislative auditor, or other external auditor.

For more information contact:

The Institute of Internal Auditors
249 Maitland Avenue
Altamonte Springs, FL 32701-4201
Phone 407/830-7600
FAX no. 407/831-5171

Sec. 2. Purpose and establishment of Offices of Inspector General; departments and agencies involved.

In order to create independent and objective units –

(1) to conduct and supervise audits and investigations relating to the programs and operations of the establishments listed in section 11(2);

(2) to provide leadership and coordination and recommend policies for activities designed (A) to promote economy, efficiency, and effectiveness in the administration of, and (B) to prevent and detect fraud and abuse in, such programs and operations; and

(3) to provide a means for keeping the head of the establishment and the Congress fully and currently informed about problems and deficiencies relating to the administration of such programs and operations and the necessity for and progress of corrective action; there is established -

(A) in each of such establishments an office of Inspector General, subject to subparagraph (B); and

(B) in the establishment of the Department of the Treasury -

(i) an Office of Inspector General of the Department of the Treasury; and

(ii) an Office of Treasury Inspector General for Tax Administration.

Credit(s): (Pub. L. 95-452, Sec. 2, Oct. 12, 1978, 92 Stat. 1101; Pub. L. 96-88, title V, Sec. 508(n)(1), Oct. 17, 1979, 93 Stat. 694; Pub. L. 97-113, title VII, Sec. 705(a)(1), Dec. 29, 1981, 95 Stat. 1544; Pub. L. 97-252, title XI, Sec. 1117(a)(1), Sept. 8, 1982, 96 Stat. 750; Pub. L. 99-93, title I, Sec. 150(a)(1), Aug. 16, 1985, 99 Stat. 427; Pub. L. 99-399, title IV, Sec. 412(a)(1), Aug. 27, 1986, 100 Stat. 867; Pub. L. 100-504, title I, Sec. 102(a), (b), Oct. 18, 1988, 102 Stat. 2515; Pub. L. 100-527, Sec. 13(h)(1), Oct. 25, 1988, 102 Stat. 2643; Pub. L. 105-206, title I, Sec. 1103(a), July 22, 1998, 112 Stat. 705.)

Sec. 3. Appointment of Inspector General; supervision; removal; political activities; appointment of Assistant Inspector General for Auditing and Assistant Inspector General for Investigations.

(a) There shall be at the head of each Office an Inspector General who shall be appointed by the President, by and with the advice and consent of the Senate, without regard to political affiliation and solely on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigations. Each Inspector General shall report to and be under the general supervision of the head of the establishment involved or, to the extent such authority is delegated, the officer next in rank below such head, but shall not report to, or be subject to supervision by, any other officer of such establishment. Neither the head of the establishment nor the officer next in rank below such head shall prevent or prohibit the Inspector General from initiating, carrying out, or completing any audit or investigation, or from issuing any subpoena during the course of any audit or investigation.

(b) An Inspector General may be removed from office by the President. The President shall communicate the reasons for any such removal to both Houses of Congress.

(c) For the purposes of section 7324 of title 5, United States Code, no Inspector General shall be considered to be an employee who determines policies to be pursued by the United States in the nationwide administration of Federal laws.

(d) Each Inspector General shall, in accordance with applicable laws and regulations governing the civil service -

(1) appoint an Assistant Inspector General for Auditing who shall have the responsibility for supervising the performance of auditing activities relating to programs and operations of the establishment, and

(2) appoint an Assistant Inspector General for Investigations who shall have the responsibility for supervising the performance of investigative activities relating to such programs and operations.

Credit(s) (Pub. L. 95-452, Sec. 3, Oct. 12, 1978, 92 Stat. 1101.)

Sec. 4. Duties and responsibilities; report of criminal violations to Attorney General

(a) It shall be the duty and responsibility of each Inspector General, with respect to the establishment within which his Office is established -

(1) to provide policy direction for and to conduct, supervise, and coordinate audits and investigations relating to the programs and operations of such establishment;

(2) to review existing and proposed legislation and regulations relating to programs and operations of such establishment and to make recommendations in the semiannual reports required by section 5(a) concerning the impact of such legislation or regulations on the economy and efficiency in the administration of programs and operations administered or financed by such establishment or the prevention and detection of fraud and abuse in such programs and operations;

(3) to recommend policies for, and to conduct, supervise, or coordinate other activities carried out or financed by such establishment for the purpose of promoting economy and efficiency in the administration of, or preventing and detecting fraud and abuse in, its programs and operations;

(4) to recommend policies for, and to conduct, supervise, or coordinate relationships between such establishment and other Federal agencies, State and local governmental agencies, and nongovernmental entities with respect to (A) all matters relating to the promotion of economy and efficiency in the administration of, or the prevention and detection of fraud and abuse in, programs and operations administered or financed by such establishment, or (B) the identification and prosecution of participants in such fraud or abuse; and

(5) to keep the head of such establishment and the Congress fully and currently informed, by means of the reports required by section 5 and otherwise, concerning fraud and other serious problems, abuses, and deficiencies relating to the administration of programs and operations administered or financed by such establishment, to recommend corrective action concerning such problems, abuses, and deficiencies, and to report on the progress made in implementing such corrective action.

(b) (1) In carrying out the responsibilities specified in subsection (a)(1), each Inspector General shall -

(A) comply with standards established by the Comptroller General of the United States for audits of Federal establishments, organizations, programs, activities, and functions;

(B) establish guidelines for determining when it shall be appropriate to use non-Federal auditors; and

(C) take appropriate steps to assure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General as described in paragraph (1).

(2) For purposes of determining compliance with paragraph (1)(A) with respect to whether internal quality controls are in place and operating and whether established audit standards, policies, and procedures are being followed by Offices of Inspector General of establishments defined under section 11(2), Offices of Inspector General of designated Federal entities defined under section 8F(a)(2), and any audit office established within a Federal entity defined under section 8F(a)(1), reviews shall be performed exclusively by an audit entity in the Federal Government, including the General Accounting Office or the Office of Inspector General of each establishment defined under section 11(2), or the Office of Inspector General of each designated Federal entity defined under section 8F(a)(2).

(c) In carrying out the duties and responsibilities established under this Act, each Inspector General shall give particular regard to the activities of the Comptroller General of the United States with a view toward avoiding duplication and insuring effective coordination and cooperation.

(d) In carrying out the duties and responsibilities established under this Act, each Inspector General shall report expeditiously to the Attorney General whenever the Inspector General has reasonable grounds to believe there has been a violation of Federal criminal law.

Credit(s) (Pub. L. 95-452, Sec. 4, Oct. 12, 1978, 92 Stat. 1102; Pub. L. 100-504, title I, Sec. 109, Oct. 18, 1988, 102 Stat. 2529; Pub. L. 103-82, title II, Sec. 202(g)(5)(A), Sept. 21, 1993, 107 Stat. 890.)

Sec. 5. Semiannual reports; transmittal to Congress; availability to public; immediate report on serious or flagrant problems; disclosure of information; definitions.

(a) Each Inspector General shall, not later than April 30 and October 31 of each year, prepare semiannual reports summarizing the activities of the Office during the immediately preceding six-month periods ending March 31 and September 30. Such reports shall include, but need not be limited to -

(1) a description of significant problems, abuses, and deficiencies relating to the administration of programs and operations of such establishment disclosed by such activities during the reporting period;

(2) a description of the recommendations for corrective action made by the Office during the reporting period with respect to significant problems, abuses, or deficiencies identified pursuant to paragraph (1);

(3) an identification of each significant recommendation described in previous semiannual reports on which corrective action has not been completed;

(4) a summary of matters referred to prospective authorities and the prosecutions and convictions which have resulted;

(5) a summary of each report made to the head of the establishment under section 6(b)(2) during the reporting period;

(6) a listing, subdivided according to subject matter, of each audit report issued by the Office during the reporting period and for each audit report, where applicable, the total dollar value of questioned costs (including a separate category for the dollar value of unsupported costs) and the dollar value of recommendations that funds be put to better use;

(7) a summary of each particularly significant report;

(8) statistical tables showing the total number of audit reports and the total dollar value of questioned costs (including a separate category for the dollar value of unsupported costs), for audit reports -

(A) for which no management decision had been made by the commencement of the reporting period;

(B) which were issued during the reporting period;

(C) for which a management decision was made during the reporting period, including -

(i) the dollar value of disallowed costs; and

(ii) the dollar value of costs not disallowed; and

(D) for which no management decision has been made by the end of the reporting period;

(9) statistical tables showing the total number of audit reports and the dollar value of recommendations that funds be put to better use by management, for audit reports -

(A) for which no management decision had been made by the commencement of the reporting period;

(B) which were issued during the reporting period;

(C) for which a management decision was made during the reporting period, including -

(i) the dollar value of recommendations that were agreed to by management; and

(ii) the dollar value of recommendations that were not agreed to by management; and

(D) for which no management decision has been made by the end of the reporting period;

(10) a summary of each audit report issued before the commencement of the reporting period for which no management decision has been made by the end of the reporting period (including the date and title of each such report), an explanation of the reasons such management decision has not been made, and a statement concerning the desired timetable for achieving a management decision on each such report;

(11) a description and explanation of the reasons for any significant revised management decision made during the reporting period;

(12) information concerning any significant management decision with which the Inspector General is in disagreement; and

(13) the information described under section 05(b) of the Federal Financial Management Improvement Act of 1996.

(b) Semiannual reports of each Inspector General shall be furnished to the head of the establishment involved not later than April 30 and October 31 of each year and shall be transmitted by such head to the appropriate committees or subcommittees of the Congress within thirty days after receipt of the report, together with a report by the head of the establishment containing -

(1) any comments such head determines appropriate;

-
- (2) statistical tables showing the total number of audit reports and the dollar value of disallowed costs, for audit reports -
- (A) for which final action had not been taken by the commencement of the reporting period;
 - (B) on which management decisions were made during the reporting period;
 - (C) for which final action was taken during the reporting period, including -
 - (i) the dollar value of disallowed costs that were recovered by management through collection, offset, property in lieu of cash, or otherwise; and
 - (ii) the dollar value of disallowed costs that were written off by management; and
 - (D) for which no final action has been taken by the end of the reporting period;
- (3) statistical tables showing the total number of audit reports and the dollar value of recommendations that funds be put to better use by management agreed to in a management decision, for audit reports -
- (A) for which final action had not been taken by the commencement of the reporting period;
 - (B) on which management decisions were made during the reporting period;
 - (C) for which final action was taken during the reporting period, including -
 - (i) the dollar value of recommendations that were actually completed; and
 - (ii) the dollar value of recommendations that management has subsequently concluded should not or could not be implemented or completed; and
 - (D) for which no final action has been taken by the end of the reporting period; and
- (4) a statement with respect to audit reports on which management decisions have been made but final action has not been taken, other than audit reports on which a management decision was made within the preceding year, containing -
- (A) a list of such audit reports and the date each such report was issued;
 - (B) the dollar value of disallowed costs for each report;
 - (C) the dollar value of recommendations that funds be put to better use agreed to by management for each report; and
 - (D) an explanation of the reasons final action has not been taken with respect to each such audit report, except that such statement may exclude such audit reports that are under formal administrative or judicial appeal or upon which management of an establishment has agreed to pursue a legislative solution, but shall identify the number of reports in each category so excluded.
- (c) Within sixty days of the transmission of the semiannual reports of each Inspector General to the Congress, the head of each establishment shall make copies of such report available to the public upon request and at a reasonable cost. Within 60 days after the transmission of the semiannual reports of each establishment head to the Congress, the head of each establishment shall make copies of such report available to the public upon request and at a reasonable cost.
- (d) Each Inspector General shall report immediately to the head of the establishment involved whenever the Inspector General becomes aware of particularly serious or flagrant problems, abuses, or deficiencies relating to the administration of programs and operations of such establishment. The head of the establishment shall transmit any such report to the appropriate committees or subcommittees of Congress within seven calendar days, together with a report by the head of the establishment containing any comments such head deems appropriate.
- (e) (1) Nothing in this section shall be construed to authorize the public disclosure of information which is -
- (A) specifically prohibited from disclosure by any other provision of law;
 - (B) specifically required by Executive order to be protected from disclosure in the interest of national defense or national security or in the conduct of foreign affairs; or
 - (C) a part of an ongoing criminal investigation.
- (2) Notwithstanding paragraph (1)(C), any report under this section may be disclosed to the public in a form which includes information with respect to a part of an ongoing criminal investigation if such information has been included in a public record.
- (3) Except to the extent and in the manner provided under section 6103(f) of the Internal Revenue Code of 1986 (26 U.S.C. 6103(f)), nothing in this section or in any other provision of this Act shall be construed to authorize or permit the withholding of information from the Congress, or from any committee or subcommittee thereof.
- (f) As used in this section -
- (1) the term "questioned cost" means a cost that is questioned by the Office because of -

(A) an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds;

(B) a finding that, at the time of the audit, such cost is not supported by adequate documentation; or

(C) a finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable;

(2) the term "unsupported cost" means a cost that is questioned by the Office because the Office found that, at the time of the audit, such cost is not supported by adequate documentation;

(3) the term "disallowed cost" means a questioned cost that management, in a management decision, has sustained or agreed should not be charged to the Government;

(4) the term "recommendation that funds be put to better use" means a recommendation by the Office that funds could be used more efficiently if management of an establishment took actions to implement and complete the recommendation, including -

(A) reductions in outlays;

(B) deobligation of funds from programs or operations;

(C) withdrawal of interest subsidy costs on loans or loan guarantees, insurance, or bonds;

(D) costs not incurred by implementing recommended improvements related to the operations of the establishment, a contractor or grantee;

(E) avoidance of unnecessary expenditures noted in preaward reviews of contract or grant agreements; or

(F) any other savings which are specifically identified;

(5) the term "management decision" means the evaluation by the management of an establishment of the findings and recommendations included in an audit report and the issuance of a final decision by management concerning its response to such findings and recommendations, including actions concluded to be necessary; and

(6) the term "final action" means -

(A) the completion of all actions that the management of an establishment has concluded, in its management decision, are necessary with respect to the findings and recommendations included in an audit report; and

(B) in the event that the management of an establishment concludes no action is necessary, final action occurs when a management decision has been made.

Credit(s) (Pub. L. 95-452, Sec. 5, Oct. 12, 1978, 92 Stat. 1103; Pub. L. 97-252, title XI, Sec. 1117(c), Sept. 8, 1982, 96 Stat. 752; Pub. L. 100-504, title I, Sec. 102(g), 106, Oct. 18, 1988, 102 Stat. 2521, 2525; Pub. L. 104-208, div. A, title I, Sec. 101(f) (title VIII, Sec. 805(c)), Sept. 30, 1996, 110 Stat. 3009-314, 3009-393.)

Sec. 6. Authority of Inspector General; information and assistance from Federal agencies; unreasonable refusal; office space and equipment

(a) In addition to the authority otherwise provided by this Act, each Inspector General, in carrying out the provisions of this Act, is authorized -

(1) to have access to all records, reports, audits, reviews, documents, papers, recommendations, or other material available to the applicable establishment which relate to programs and operations with respect to which that Inspector General has responsibilities under this Act;

(2) to make such investigations and reports relating to the administration of the programs and operations of the applicable establishment as are, in the judgment of the Inspector General, necessary or desirable;

(3) to request such information or assistance as may be necessary for carrying out the duties and responsibilities provided by this Act from any Federal, State, or local governmental agency or unit thereof;

(4) to require by subpoena the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence necessary in the performance of the functions assigned by this Act, which subpoena, in the case of contumacy or refusal to obey, shall be enforceable by order of any appropriate United States district court: Provided, That procedures other than subpoenas shall be used by the Inspector General to obtain documents and information from Federal agencies;

(5) to administer to or take from any person an oath, affirmation, or affidavit, whenever necessary in the performance of the functions assigned by this Act, which oath, affirmation, or affidavit when administered or taken by or before an employee of an Office of Inspector General designated by the Inspector General shall have the same force and effect as if administered or taken by or before an officer having a seal;

-
- (6) to have direct and prompt access to the head of the establishment involved when necessary for any purpose pertaining to the performance of functions and responsibilities under this Act;
- (7) to select, appoint, and employ such officers and employees as may be necessary for carrying out the functions, powers, and duties of the Office subject to the provisions of title 5, United States Code, governing appointments in the competitive service, and the provisions of chapter 51 and subchapter III of chapter 53 of such title relating to classification and General Schedule pay rates;
- (8) to obtain services as authorized by section 3109 of title 5, United States Code, at daily rates not to exceed the equivalent rate prescribed for grade GS-18 of the General Schedule by section 5332 of title 5, United States Code; and
- (9) to the extent and in such amounts as may be provided in advance by appropriations Acts, to enter into contracts and other arrangements for audits, studies, analyses, and other services with public agencies and with private persons, and to make such payments as may be necessary to carry out the provisions of this Act.
- (b)(1) Upon request of an Inspector General for information or assistance under subsection (a)(3), the head of any Federal agency involved shall, insofar as is practicable and not in contravention of any existing statutory restriction or regulation of the Federal agency from which the information is requested, furnish to such Inspector General, or to an authorized designee, such information or assistance. (2) Whenever information or assistance requested under subsection (a)(1) or (a)(3) is, in the judgment of an Inspector General, unreasonably refused or not provided, the Inspector General shall report the circumstances to the head of the establishment involved without delay.
- (c) Each head of an establishment shall provide the Office within such establishment with appropriate and adequate office space at central and field office locations of such establishment, together with such equipment, office supplies, and communications facilities and services as may be necessary for the operation of such offices, and shall provide necessary maintenance services for such offices and the equipment and facilities located therein.
- (d) For purposes of the provisions of title 5, United States Code, governing the Senior Executive Service, any reference in such provisions to the "appointing authority" for a member of the Senior Executive Service or for a Senior Executive Service position shall, if such member or position is or would be within the Office of an Inspector General, be deemed to be a reference to such Inspector General.

Credit(s) (Pub. L. 95-452, Sec. 6, Oct. 12, 1978, 92 Stat. 1104; Pub. L. 100-504, title I, Sec. 107, 110(a), Oct. 18, 1988, 102 Stat. 2528, 2529.)

Sec. 8G. Requirements for Federal entities and designated Federal entities

- (a) Notwithstanding section 11 of this Act, as used in this section -
- (1) the term "Federal entity" means any Government corporation (within the meaning of section 103(1) of title 5, United States Code), any Government controlled corporation (within the meaning of section 103(2) of such title), or any other entity in the Executive branch of the Government, or any independent regulatory agency, but does not include -
- (A) an establishment (as defined under section 11(2) of this Act) or part of an establishment;
 - (B) a designated Federal entity (as defined under paragraph (2) of this subsection) or part of a designated Federal entity;
 - (C) the Executive Office of the President;
 - (D) the Central Intelligence Agency;
 - (E) the General Accounting Office; or
 - (E) any entity in the judicial or legislative branches of the Government, including the Administrative Office of the United States Courts and the Architect of the Capitol and any activities under the direction of the Architect of the Capitol;
- (2) the term "designated Federal entity" means Amtrak, the Appalachian Regional Commission, the Board of Governors of the Federal Reserve System, the Board for International Broadcasting, the Commodity Futures Trading Commission, the Consumer Product Safety Commission, the Corporation for Public Broadcasting, the Denali Commission, the Equal Employment Opportunity Commission, the Farm Credit Administration, the Federal Communications Commission, the Federal Election Commission, the Federal Housing Finance Board, the Federal Labor Relations Authority, the Federal Maritime Commission, the Federal Trade Commission, the

Legal Services Corporation, the National Archives and Records Administration, the National Credit Union Administration, the National Endowment for the Arts, the National Endowment for the Humanities, the National Labor Relations Board, the National Science Foundation, the Panama Canal Commission, the Peace Corps, the Pension Benefit Guaranty Corporation, the Securities and Exchange Commission, the Smithsonian Institution, the United States International Trade Commission, and the United States Postal Service;

(3) the term "head of the Federal entity" means any person or persons designated by statute as the head of a Federal entity, and if no such designation exists, the chief policymaking officer or board of a Federal entity as identified in the list published pursuant to subsection (h)(1) of this section;

(4) the term "head of the designated Federal entity" means any person or persons designated by statute as the head of a designated Federal entity and if no such designation exists, the chief policymaking officer or board of a designated Federal entity as identified in the list published pursuant to subsection (h)(1) of this section, except that -

(A) with respect to the National Science Foundation, such term means the National Science Board; and

(B) with respect to the United States Postal Service, such term means the Governors (within the meaning of section 102(3) of title 39, United States Code);

(5) the term "Office of Inspector General" means an Office of Inspector General of a designated Federal entity; and

(6) the term "Inspector General" means an Inspector General of a designated Federal entity.

(b) No later than 180 days after the date of the enactment of this section (Oct. 18, 1988), there shall be established and maintained in each designated Federal entity an Office of Inspector General. The head of the designated Federal entity shall transfer to such office the offices, units, or other components, and the functions, powers, or duties thereof, that such head determines are properly related to the functions of the Office of Inspector General and would, if so transferred, further the purposes of this section. There shall not be transferred to such office any program operating responsibilities.

(c) Except as provided under subsection (f) of this section, the Inspector General shall be appointed by the head of the designated Federal entity in accordance with the applicable laws and regulations governing appointments within the designated Federal entity.

(d) Each Inspector General shall report to and be under the general supervision of the head of the designated Federal entity, but shall not report to, or be subject to supervision by, any other officer or employee of such designated Federal entity. The head of the designated Federal entity shall not prevent or prohibit the Inspector General from initiating, carrying out, or completing any audit or investigation, or from issuing any subpoena during the course of any audit or investigation.

(e) If an Inspector General is removed from office or is transferred to another position or location within a designated Federal entity, the head of the designated Federal entity shall promptly communicate in writing the reasons for any such removal or transfer to both Houses of the Congress.

(f) (1) For purposes of carrying out subsection (c) with respect to the United States Postal Service, the appointment provisions of section 202(e) of title 39, United States Code, shall be applied.

(2) In carrying out the duties and responsibilities specified in this Act, the Inspector General of the United States Postal Service (hereinafter in this subsection referred to as the "Inspector General") shall have oversight responsibility for all activities of the Postal Inspection Service, including any internal investigation performed by the Postal Inspection Service. The Chief Postal Inspector shall promptly report the significant activities being carried out by the Postal Inspection Service to such Inspector General.

(3)(A)(i) Notwithstanding subsection (d), the Inspector General shall be under the authority, direction, and control of the Governors with respect to audits or investigations, or the issuance of subpoenas, which require access to sensitive information concerning. So in original. Two pars. (3) have been enacted.

(I) ongoing civil or criminal investigations or proceedings;

(II) undercover operations;

(III) the identity of confidential sources, including protected witnesses;

(IV) intelligence or counterintelligence matters; or

(V) other matters the disclosure of which would constitute a serious threat to national security.

(ii) With respect to the information described under clause (i), the Governors may prohibit the Inspector General from carrying out or completing any audit or investigation, or from issuing any subpoena, after

such Inspector General has decided to initiate, carry out, or complete such audit or investigation or to issue such subpoena, if the Governors determine that such prohibition is necessary to prevent the disclosure of any information described under clause (i) or to prevent the significant impairment to the national interests of the United States.

(iii) If the Governors exercise any power under clause (i) or (ii), the Governors shall notify the Inspector General in writing stating the reasons for such exercise. Within 30 days after receipt of any such notice, the Inspector General shall transmit a copy of such notice to the Committee on Governmental Affairs of the Senate and the Committee on Government Reform and Oversight of the House of Representatives, and to other appropriate committees or subcommittees of the Congress.

(B) In carrying out the duties and responsibilities specified in this Act, the Inspector General

(i) may initiate, conduct and supervise such audits and investigations in the United States Postal Service as the Inspector General considers appropriate; and

(ii) shall give particular regard to the activities of the Postal Inspection Service with a view toward avoiding duplication and insuring effective coordination and cooperation.

(C) Any report required to be transmitted by the Governors to the appropriate committees or subcommittees of the Congress under section 5(d) shall also be transmitted, within the seven-day period specified under such section, to the Committee on Governmental Affairs of the Senate and the Committee on Government Reform and Oversight of the House of Representatives.

(3) Nothing in this Act shall restrict, eliminate, or otherwise adversely affect any of the rights, privileges, or benefits of either employees of the United States Postal Service, or labor organizations representing employees of the United States Postal Service, under chapter 12 of title 39, United States Code, the National Labor Relations Act, any handbook or manual affecting employee labor relations with the United States Postal Service, or any collective bargaining agreement.

(4) As used in this subsection, the term "Governors" has the meaning given such term by section 102(3) of title 39, United States Code.

(g) (1) Sections 4, 5, 6 (other than subsections (a)(7) and (a)(8) thereof), and 7 of this Act shall apply to each Inspector General and Office of Inspector General of a designated Federal entity and such sections shall be applied to each designated Federal entity and head of the designated Federal entity (as defined under subsection (a)) by substituting -

(A) "designated Federal entity" for "establishment"; and

(B) "head of the designated Federal entity" for "head of the establishment".

(2) In addition to the other authorities specified in this Act, an Inspector General is authorized to select, appoint, and employ such officers and employees as may be necessary for carrying out the functions, powers, and duties of the Office of Inspector General and to obtain the temporary or intermittent services of experts or consultants or an organization thereof, subject to the applicable laws and regulations that govern such selections, appointments, and employment, and the obtaining of such services, within the designated Federal entity.

(3) Notwithstanding the last sentence of subsection (d) of this section, the provisions of subsection (a) of section 8C (other than the provisions of subparagraphs (A), (B), (C), and (E) of subsection (a)(1)) shall apply to the Inspector General of the Board of Governors of the Federal Reserve System and the Chairman of the Board of Governors of the Federal Reserve System in the same manner as such provisions apply to the Inspector General of the Department of the Treasury and the Secretary of the Treasury, respectively.

(h) (1) No later than April 30, 1989, and annually thereafter, the Director of the Office of Management and Budget, after consultation with the Comptroller General of the United States, shall publish in the Federal Register a list of the Federal entities and designated Federal entities and the head of each such entity (as defined under subsection (a) of this section).

(2) Beginning on October 31, 1989, and on October 31 of each succeeding calendar year, the head of each Federal entity (as defined under subsection (a) of this section) shall prepare and transmit to the Director of the Office of Management and Budget and to each House of the Congress a report which

(A) states whether there has been established in the Federal entity an office that meets the requirements of this section;

(B) specifies the actions taken by the Federal entity otherwise to ensure that audits are conducted of its programs and operations in accordance with the standards for audit of governmental organizations, programs, activities, and functions issued by the Comptroller General of the United States, and includes a list of each audit

report completed by a Federal or non-Federal auditor during the reporting period and a summary of any particularly significant findings; and

(C) summarizes any matters relating to the personnel, programs, and operations of the Federal entity referred to prospective authorities, including a summary description of any preliminary investigation conducted by or at the request of the Federal entity concerning these matters, and the prosecutions and convictions which have resulted.

Credit(s) (Pub. L. 95-452, Sec. 8G, formerly Sec. 8E, as added Pub. L. 100-504, title I, Sec. 104(a), Oct. 18, 1988, 102 Stat. 2522; amended Pub. L. 101-73, title VII, Sec. 702(c), Aug. 9, 1989, 103 Stat. 415; renumbered Sec. 8F and amended Pub. L. 103-82, title II, Sec. 202(g)(1), (2)(A), Sept. 21, 1993, 107 Stat. 889, 890; renumbered Sec. 8G and amended Pub. L. 103-204, Sec. 23(a)(3), (4), Dec. 17, 1993, 107 Stat. 2408; Pub. L. 104-88, title III, Sec. 319, Dec. 29, 1995, 109 Stat. 949; Pub. L. 104-208, div. A, title I, Sec. 101(f) (title VI, Sec. 662(b)(1), (2)), Sept. 30, 1996, 110 Stat. 3009-314, 3009-379; Pub. L. 105-134, title IV, Sec. 409(a)(1), Dec. 2, 1997, 111 Stat. 2586; Pub. L. 105-277, div. C, title III, Sec. 306(h), as added Pub. L. 106-31, title I, Sec. 105(a)(5), May 21, 1999, 113 Stat. 63; Pub. L. 106-422, Sec. 1(b)(1), Nov. 1, 2000, 114 Stat. 1872.)

Sec. 9. Transfer of Functions

(a) There shall be transferred -

(1) to the Office of Inspector General -

(A) of the Department of Agriculture, the offices of that department referred to as the "Office of Investigation" and the "Office of Audit";

(B) of the Department of Commerce, the offices of that department referred to as the "Office of Audits" and the "Investigations and Inspections Staff" and that portion of the office referred to as the "Office of Investigations and Security" which has responsibility for investigation of alleged criminal violations and program abuse;

(C) of the Department of Defense, the offices of that department referred to as the "Defense Audit Service" and the "Office of Inspector General, Defense Logistics Agency", and that portion of the office of that department referred to as the "Defense Investigative Service" which has responsibility for the investigation of alleged criminal violations;

(D) of the Department of Education, all functions of the Inspector General of Health, Education, and Welfare or of the Office of Inspector General of Health, Education, and Welfare relating to functions transferred by section 301 of the Department of Education Organization Act (20 U.S.C. 3441);

(E) of the Department of Energy, the Office of Inspector General (as established by section 208 of the Department of Energy Organization Act);

(F) of the Department of Health and Human Services, the Office of Inspector General (as established by title II of Public Law 94-505);

(G) of the Department of Housing and Urban Development, the office of that department referred to as the "Office of Inspector General";

(H) of the Department of the Interior, the office of that department referred to as the "Office of Audit and Investigation";

(I) of the Department of Justice, the offices of that Department referred to as (i) the "Audit Staff, Justice Management Division", (ii) the "Policy and Procedures Branch, Office of the Comptroller, Immigration and Naturalization Service", the "Office of Professional Responsibility, Immigration and Naturalization Service", and the "Office of Program Inspections, Immigration and Naturalization Service", (iii) the "Office of Internal Inspection, United States Marshals Service", (iv) the "Financial Audit Section, Office of Financial Management, Bureau of Prisons" and the "Office of Inspections, Bureau of Prisons", and (v) from the Drug Enforcement Administration, that portion of the "Office of Inspections" which is engaged in internal audit activities, and that portion of the "Office of Planning and Evaluation" which is engaged in program review activities;

(J) of the Department of Labor, the office of that department referred to as the "Office of Special Investigations";

(K) of the Department of Transportation, the offices of that department referred to as the "Office of Investigations and Security" and the "Office of Audit" of the Department, the "Offices of Investigations and

Security, Federal Aviation Administration", and "External Audit Divisions, Federal Aviation Administration", the "Investigations Division and the External Audit Division of the Office of Program Review and Investigation, Federal Highway Administration", and the "Office of Program Audits, Urban Mass Transportation Administration";

(L) (i) of the Department of the Treasury, the office of that department referred to as the "Office of Inspector General", and, notwithstanding any other provision of law, that portion of each of the offices of that department referred to as the "Office of Internal Affairs, Bureau of Alcohol, Tobacco, and Firearms", the "Office of Internal Affairs, United States Customs Service", and the "Office of Inspections, United States Secret Service" which is engaged in internal audit activities; and

(ii) of the Treasury Inspector General for Tax Administration, effective 180 days after the date of the enactment of the Internal Revenue Service Restructuring and

Reform Act of 1998 (July 22, 1998), the Office of Chief Inspector of the Internal Revenue Service;

(M) of the Environmental Protection Agency, the offices of that agency referred to as the "Office of Audit" and the "Security and Inspection Division";

(N) of the Federal Emergency Management Agency, the office of that agency referred to as the "Office of Inspector General";

(O) of the General Services Administration, the offices of that agency referred to as the "Office of Audits" and the "Office of Investigations";

(P) of the National Aeronautics and Space Administration, the offices of that agency referred to as the "Management Audit Office" and the "Office of Inspections and Security";

(Q) of the Nuclear Regulatory Commission, the office of that commission referred to as the "Office of Inspector and Auditor";

(R) of the Office of Personnel Management, the offices of that agency referred to as the "Office of Inspector General", the "Insurance Audits Division, Retirement and Insurance Group", and the "Analysis and Evaluation Division, Administration Group";

(S) of the Railroad Retirement Board, the Office of Inspector General (as established by section 23 of the Railroad Retirement Act of 1974);

(T) of the Small Business Administration, the office of that agency referred to as the "Office of Audits and Investigations";

(U) of the Veterans' Administration, the offices of that agency referred to as the "Office of Audits" and the "Office of Investigations". So in original. The word "and" at end of subpar. (U) probably should appear at end of subpar. (V).

(V) of the Corporation for National and Community Service, the Office of Inspector General of ACTION;

(W) of the Social Security Administration, the functions of the Inspector General of the Department of Health and Human Services which are transferred to the Social Security Administration by the Social Security Independence and Program Improvements Act of 1994 (other than functions performed pursuant to section 105(a)(2) of such Act), except that such transfers shall be made in accordance with the provisions of such Act and shall not be subject to subsections (b) through (d) of this section; and

(2) such other offices or agencies, or functions, powers, or duties thereof, as the head of the establishment involved may determine are properly related to the functions of the Office and would, if so transferred, further the purposes of this Act, except that there shall not be transferred to an Inspector General under paragraph (2) program operating responsibilities.

(b) The personnel, assets, liabilities, contracts, property, records, and unexpended balances of appropriations, authorizations, allocations, and other funds employed, held, used, arising from, available or to be made available, of any office or agency the functions, powers, and duties of which are transferred under subsection (a) are hereby transferred to the applicable Office of Inspector General.

(c) Personnel transferred pursuant to subsection (b) shall be transferred in accordance with applicable laws and regulations relating to the transfer of functions except that the classification and compensation of such personnel shall not be reduced for one year after such transfer.

(d) In any case where all the functions, powers, and duties of any office or agency are transferred pursuant to this subsection, such office or agency shall lapse. Any person who, on the effective date of this Act (Oct. 1, 1978), held a position compensated in accordance with the General Schedule, and who, without a break in service, is appointed in an

Office of Inspector General to a position having duties comparable to those performed immediately preceding such appointment shall continue to be compensated in the new position at not less than the rate provided for the previous position, for the duration of service in the new position.

Credit(s) (Pub. L. 95-452, Sec. 9, Oct. 12, 1978, 92 Stat. 1107; Pub. L. 96-88, title V, Sec. 508(n)(2), Oct. 17, 1979, 93 Stat. 694; Pub. L. 97-252, title XI, Sec. 1117(a)(2), (3), Sept. 8, 1982, 96 Stat. 750; Pub. L. 100-504, title I, Sec. 102(d), Oct. 18, 1988, 102 Stat. 2516; Pub. L. 103-82, title II, Sec. 202(g)(3)(A), Sept. 21, 1993, 107 Stat. 890; Pub. L. 103-296, title I, Sec. 108(l)(1), Aug. 15, 1994, 108 Stat. 1488; Pub. L. 105-206, title I, Sec. 1103(c)(1), July 22, 1998, 112 Stat. 708.)

Contributors to This Report

Edward B. Hatchett, Jr., Auditor of Public Accounts

Gerald W. Hoppmann, MPA, Director, Division of Performance Audit

Jettie Sparks, CPA, Performance Audit Manager

Julie Lewis, MPA, Performance Auditor-in-Charge

Brooke Sinclair, Performance Auditor

Deborah Crocker, JD, MPA, Performance Auditor

Kevin M. Devlin, JD, MPA, Performance Auditor

James M. Ryan, MPA, Performance Auditor

Obtaining Audit Reports

Copies of this report or other previously issued reports can be obtained for a nominal fee by faxing the APA office at 502-564-2912. Alternatively, you may

order by mail: Report Request
 Auditor of Public Accounts
 144 Capitol Annex
 Frankfort, Kentucky 40601

visit : 8 AM to 4:30 PM weekdays

email: Hatchett@kyauditor.net

browse our web site: <http://www.kyauditor.net>

Services Offered by Our Office

The staff of the APA office performs a host of services for governmental entities across the commonwealth. Our primary concern is the protection of taxpayer funds and furtherance of good government by elected officials and their staffs. Our services include:

Performance Audits: The Division of Performance Audit conducts performance audits, performance measurement reviews, benchmarking studies, and risk assessments of government entities and programs at the state and local level in order to identify opportunities for increased efficiency and effectiveness.

Financial Audits: The Division of Financial Audit conducts financial statement and other financial-related engagements for both state and local government entities. Annually the division releases its opinion on the Commonwealth of Kentucky's financial statements and use of federal funds.

Investigations: Our fraud hotline, 1-800-KY-ALERT (592-5378), and referrals from various agencies and citizens produce numerous cases of suspected fraud and misuse of public funds. Staff conducts investigations in order to determine whether referral of a case to prosecutorial offices is warranted.

Training and Consultation: We annually conduct training sessions and offer consultation for government officials across the commonwealth. These events are designed to assist officials in the accounting and compliance aspects of their positions.

General Questions

General questions should be directed to Harold McKinney, Intergovernmental Liaison, at (502) 564-5841 or the address above.