Chapter 20 - Internal Control and Auditing

20.40　　　Internal Auditing Policies

20.10
About Internal Control and Auditing Policies

20.10.10 July 1, 2008	**The purpose of this chapter**

This chapter provides agency heads, managers, internal control officers, internal auditors, and other agency staff with a background in and approach to establishing and maintaining an effective system of internal control and internal audit so as to reasonably assure that they are meeting their respective objectives.

20.10.20 July 1, 2008	**Authority for these policies**

The Budget and Accounting Act is found in Chapter 43.88 RCW. Section 43.88.160 (4) requires that the director of the Office of Financial Management (OFM), as an agent of the governor:

"Develop and maintain a system of internal controls and internal audits comprising methods and procedures to be adopted by each agency that will safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies for accounting and financial controls. The system developed by the director shall include criteria for determining the scope and comprehensiveness of internal controls required by the classes of agencies, depending on the level of resources at risk. Each agency head or authorized designee shall be assigned the responsibility and authority for establishing and maintaining internal audits following the standards of internal auditing of the Institute of Internal Auditors..."

20.10.30 July 1, 2008	**Applicability**

This chapter is applicable to and binding on all agencies of the state of Washington, unless otherwise exempted by statute or rule. The Budget and Accounting Act (RCW 43.88.020) defines the term "Agency" to mean and include "...every state office, officer, each institution, whether educational, correctional, or other, and every department, division, board and commission, except as otherwise provided...."

20.15
Internal Control Basics

20.15.10 July 1, 2008	## Background

In the United States there is common guidance on the structure of internal control systems. This is due in part to guidance issued by the American Institute of Certified Public Accountants (AICPA) and the federal Office of Management and Budget (OMB). It is also due to a 1992 report on internal control, *Internal Control – Integrated Framework (Framework),* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). An addendum was published in 1994, and the *Framework* has remained unchanged since then.

The *Framework* is the national internal control standard, and Chapter 20 has been and continues to be based on *Framework* guidance. In 2006, COSO published additional guidance on how to apply the *Framework* and in 2007 and 2008, published *Guidance on Monitoring*. In addition to the aforementioned COSO updates, new standards were recently adopted by the AICPA and OMB that strengthen assessment and reporting requirements for internal controls. Chapter 20 incorporates concepts from the updated COSO guidance and the new AICPA and OMB standards.

20.15.20 July 1, 2008	## Internal control definition

Internal control is a process – effected by those charged with governance, management, and other personnel – designed to provide reasonable assurance about the achievement of the entity's objectives. For purposes of Chapter 20, the state's objectives per RCW 43.88.160 fall into separate but related categories:

- Safeguard its assets.

- Check the accuracy and reliability of its accounting data.

- Promote operational efficiency.

- Encourage adherence to policies for accounting and financial controls.

This definition of internal control reflects the following fundamental concepts:

- Internal control is a process. It is not one event, but a series of ongoing actions and activities that occur throughout each agency's operations and should be an integral part of each agency rather than an add-on system within an agency.

- People are what make internal control work. While the responsibility for good internal control ultimately rests with management, all agency personnel play important roles.

- No matter how well designed and operated, internal control can provide only reasonable (not absolute) assurance that all agency objectives will be met.

20.15.30
July 1, 2008

Who is responsible for internal control?

Each agency, regardless of size, is required to adopt methods to periodically assess risk and to develop, implement, and review its system of internal controls. The methods should be tailored to the specific needs of the agency.

20.15.30.a   The **agency head or authorized designee** is ultimately responsible for identifying risks and establishing, maintaining, and reviewing the agency's system of internal control. If the agency head delegates this responsibility, the designated person should have sufficient authority to carry out these responsibilities. Normally, this person is a senior agency manager who does not serve in the internal audit function.

20.15.30.b   The **internal control officer** (ICO) is responsible for coordinating the agency-wide effort of evaluating internal controls, reporting on reviews, and improving control activities, using the guidance in this chapter. This person provides assurance to the agency head that the required risk assessments and the necessary evaluative processes have been done. In some agencies the ICO may perform these duties on a full-time basis. In other agencies the ICO duties may be assigned to staff who also perform other duties as long as the other duties are not incompatible with the ICO duties. Refer to Subsections 20.15.40.b and 20.15.50.

20.15.30.c   **Agency management** at all levels is responsible for internal control under their span of control. Management should make it clear that **agency staff** have explicit or implicit control activity duties including: delivery of services to the public; producing information for the management control system; maintaining financial information; and inspecting or maintaining physical assets. In addition, agency management should provide channels outside normal reporting lines so agency staff can report problems in operations, noncompliance with codes of conduct, violations of policy, and illegal acts.

Management is also responsible to convey the importance of internal controls to all personnel both by what they say and what they do. If management is willing to override controls, then the message that controls are not important will be conveyed to employees.

20.15.30.d   **Each agency employee** is responsible to be aware of and attentive to risk management and internal control issues, to consider limitations and key risk areas, to document decisions and to provide support information. To be most effective, employees need to understand the agency's mission, objectives, responsibilities, and their own role in managing risk. Each employee is also responsible to report to management noncompliance with codes of conduct, violations of policies, and illegal acts.

20.15.30.e   The **internal auditor or other professionals** (internal or external to the agency) may provide technical assistance in developing appropriate procedures to conduct risk assessments and internal reviews of control activities.

20.15.30.f   Depending on an agency's governance structure, an **audit committee** could help the agency review, monitor, and/or direct the agency's activities related to maintaining effective internal control. An agency audit committee could also improve financial practices and reporting and enhance both the internal and external audit functions.

20.15.40 July 1, 2008	**Internal control framework components**

There are five interrelated components of an internal control framework: control environment, risk assessment, control activities, information and communication, and monitoring. These components make up the minimum level of internal control an agency needs to have in place and are the basis against which internal control is evaluated.

To implement the framework, management develops the detailed policies, procedures, and practices to fit their agency's operations, and ensures that they are built into and are an integral part of operations. If an agency considers the framework components in its planning efforts and builds them into its daily processes, the agency will be poised to achieve the maximum benefit for the lowest cost.

20.15.40.a **Control environment**

The control environment of an agency sets the tone of the organization and influences the effectiveness of internal controls within the agency. The control environment is an intangible factor. Yet, it is the foundation for all other components of internal control, providing discipline and structure and encompassing both technical competence and ethical commitment.

Management is very influential in determining the control environment and influencing the control consciousness of agency staff. Internal controls are likely to function well if management believes that those controls are important and communicates that view to employees at all levels. Conversely, internal controls are likely to be ineffective if management does not believe the controls are important or if management communicates a negative view of controls to employees.

Management influences the control environment through their integrity and ethical values, commitment to competence, philosophy and operating style, design of the organizational structure, assignment of authority and responsibilities, and human resource policies and practices.

Management also influences the control environment through communication of the agency's values and behavioral standards to employees. This can be done by setting a good example, showing a positive attitude toward accounting and internal control, displaying and following a formal code of conduct, communicating other agency policies and procedures, taking swift and appropriate disciplinary action in response to policy departure, and maintaining clear and updated job descriptions.

20.15.40.b   **Risk assessment**

Within the context of the state's operating environment, management sets goals and objectives at the unit and agency level that align with the agency's mission and state law. Objectives must exist before management can identify potential events affecting their achievement.

Risk assessment is the process of: identifying risks to achieving agency objectives; analyzing potential events, considering their likelihood of occurring and impact on achieving agency objectives; and deciding how to respond to the risks.

The first step is risk identification, which is the ongoing process of collecting, analyzing and adjusting information about what could happen in agency operations that would adversely affect the ability to achieve agency objectives.

To fully identify risks, both internal and external events that can affect the achievement of an agency's objectives need to be considered. Risk identification methods may include qualitative and quantitative ranking activities, forecasting, strategic planning, and consideration of findings from audits and other assessments.

Management should be aware of potential high-risk areas and should look for high risk where:

- There is a susceptibility to or history of waste, fraud, or errors.

- Changes have occurred in the organizational structure, systems, or personnel.

- Controls have not been reviewed for a substantial period of time.

The second step is analyzing the key risks for their possible effect, considering likelihood and impact. **Likelihood** is the possibility that a specific event will occur. **Impact** is the result or effect of an event.

The third step is deciding how to respond to each risk. The most common risk responses are avoiding, reducing, transferring (sharing), and accepting risk. A complete risk response should consider what actions to take and who is responsible. Refer to Section 20.20 for more information on risk assessment.

20.15.40.c   **Control activities**

Control activities help ensure risk responses are effectively carried out and include policies and procedures, manual and automated tools, approvals, authorizations, verifications, reconciliations, security over assets, and segregation of duties. These activities occur across an agency, at all levels and in all functions, and are designed to help prevent or reduce the risk that agency objectives will not be achieved.

Managers set up control activities to provide *reasonable assurance* that the agency and business unit objectives are met. An example of a control activity is something as simple as listing tasks assigned to staff members and then periodically checking the list to verify that assignments are completed on time. Refer to Section 20.25 for further discussion of control activities.

20.15.40.d   **Information and communication**

An agency's control structure must provide for the identification, capture and exchange of information both within the agency and with external parties. Information communicated should be timely and accurate.

Risk communication creates a dialog about the existence, nature, severity, or acceptability of risks. The identification of new risks or changes in risk is dependent on communication.

Communication can be formal through reports, training, written policy manuals, accounting and financial reporting manuals, websites, memoranda, etc. Information is also communicated informally through email, speech, and actions of management and other agency personnel.

Effective **internal communication** happens when information can travel in all directions within an agency – up, down, and across. Clear internal communication conveys the agency's code of ethics, internal control philosophy and approach, and delegation of authority. Communication effectively conveys the importance and relevance of internal control and the roles each person plays to support it, including the means of reporting exceptions to an appropriate higher level within the agency.

Open **external communication** channels allow stakeholders, including citizens, clients, and suppliers, to understand the agency's service standards and provide valuable input on performance and service quality and effectiveness. This exchange enables an agency to address evolving needs, demands, and preferences. Management should appropriately convert such input into continuous improvements in operations, reporting, and compliance.

20.15.40.e   **Monitoring**

Things change and, by monitoring the risks and the effectiveness of control measures on a regular basis, an agency can react dynamically to changing conditions.

Monitoring evaluates the effectiveness of an agency's internal controls and is designed to ensure that internal controls continue to operate effectively. Monitoring is effective when it leads to the identification and correction of control weaknesses *before* they **materially** affect the achievement of the agency's objectives.

An agency's internal control is most effective when there is proper monitoring, results are prioritized and communicated, and weaknesses are corrected and followed up on as necessary.

There are two types of monitoring: ongoing and periodic. Ongoing monitoring occurs in the course of operations. It includes tasks such as supervisory reviews of reconciliations, reports, and processes. Periodic monitoring includes tasks such as periodic internal audit sampling and annual reviews of high-risk business processes. Internal control deficiencies uncovered by monitoring should be reported to higher levels of management.

20.15.50	**Annual requirements for agencies**

July 1, 2008

20.15.50.a   **Annual assurance**

A risk assessment and internal control review process provides management with reasonable assurance that controls are operating as expected. In addition, the process should be used to determine if internal control modifications are needed by considering events that have occurred, processes or procedures that have changed, new projects or programs that are being planned or implemented, and other changes within the agency that may have additional risks. If the review uncovers internal control weaknesses or if prior weaknesses still exist, they should be documented and addressed.

Periodically, an agency should conduct a comprehensive review of the internal control structure to determine if it is adequately addressing agency risks. This can be done agency-wide at one time or by sections of the agency over a period of time.

Agencies must maintain adequate written documentation of activities conducted in connection with risk assessments, review of internal control activities and follow-up actions. This documentation includes any checklists and methods used to complete these activities. Refer to Subsection 20.25.50 for required documentation. For sample checklists and procedures, refer to the OFM Administrative and Accounting Resources website at: http://www.ofm.wa.gov/resources/default.asp.

Agencies have the flexibility to assign appropriate staff to complete the risk assessments and review of internal control activities required by this policy. The internal control officer is the person appointed by the agency head who is assigned responsibility for coordinating and scheduling the agency-wide effort of evaluating and reporting on reviews and improving control activities. The internal control officer also provides assurance to the agency head that the agency has performed the required risk assessments and the necessary evaluative processes. This communication may be ongoing and informal, but **at least once per year**, this assurance must **be made in writing** to the agency head.

The internal control officer is responsible for ensuring that the required documentation is maintained and available for review by agency management, the State Auditor's Office (SAO), and OFM.

20.15.50.b   **Annual reporting**

Annually, each agency head and chief financial officer is required to sign and submit a Financial Disclosure Certification and, if applicable, a Federal Assistance Certification, to OFM's Accounting Division. By signing the certification(s), they certify that:

- They are responsible for establishing and maintaining effective internal controls over financial reporting.

- Their agency's system of internal controls complies with the requirements of Chapter 20.

- If applicable, they have established and maintained effective internal control over compliance for federal programs.

A summary description of any material internal control weakness(es) and a brief corrective action plan must be attached to the certification. Refer to Subsections 90.40.95 and 95.20.90.

20.20
Risk Assessment

20.20.10   What is risk assessment?
July 1, 2008

Risk assessment is an ongoing process that includes identifying risks to achieving agency objectives, analyzing the risks, and deciding how to respond to the risks.

In risk assessment, management considers the mix of potential events relevant to the agency and its activities in the context of the agency's public visibility, size, operational complexity, regulatory restraints, and other factors. Because of these variables, the same activity could have very different levels of risk for two different agencies.

20.20.20   How does an agency identify risk?
July 1, 2008

Risk identification is the first step in risk assessment because risk cannot be measured, prioritized, and managed until it has been identified. Every agency faces a variety of risks, both expected and unexpected, from external and internal sources that must be identified.

External risks arise from activities outside the agency. These external risks may not be directly controllable by the agency or they may constrain the way in which the agency is permitted to take or address risk. Technological developments, changing public expectations, legislative directives, natural catastrophes and economic changes all have the potential for creating external risks in an agency.

Internal risks arise from activities inside the agency. Examples of internal risks include disruption of the central computer system or telephone system and turnover in a key managerial position.

The process of identifying risks should consider the following characteristics and attributes: type of risk, source of risk, areas the risk impacts, and level of ability to control the risk.

Risk identification can often be integrated into the planning activities that occur at various levels within the agency. Some risks may be apparent at the agency level, whereas others may be a factor only within a certain function or process. Risks at all levels should be identified and aggregated across the agency. The significant ones will become apparent during the risk analysis process.

Risks can also be identified through ongoing activities. The budget process, audits, and the strategic planning process provide opportunities for managers to conduct quantitative and qualitative reviews and to identify risks. More informal opportunities include senior management planning meetings, meetings with auditors, and everyday interaction with staff.

More important than the specific method used to identify risks is management's careful consideration of factors unique to the agency, including the following:

- An agency's past experience
- Staffing levels and quality
- Statutory framework
- The significance and complexity of activities in relation to the agency's mission

Tools related to risk identification and assessment are available online at: http://des.wa.gov/services/Risk/AboutRM/Pages/default.aspx.

20.20.30
July 1, 2008

How does an agency analyze and measure risk?

Once risks have been identified, they need to be analyzed. This analysis includes estimating the impact of a risk, measuring the likelihood it will occur, and considering how to respond to the risk.

20.20.30.a   **Analysis of the control environment**

Analyzing risk begins with analyzing the control environment. The control environment is the foundation for all other components of internal control. Refer to Section 20.15.40.a for a discussion of the control environment.

20.20.30.b   **Analysis of inherent risk**

Analyzing risk also includes analyzing the inherent risk. High inherent risk is not necessarily a reflection of management performance or lack of control; rather, high inherent risk points to areas that, due to the nature of their operations, require additional attention. For example, from a safeguarding of assets perspective, activities involving the handling of cash are inherently more risky than activities involving the handling of sand and gravel. However, from a financial reporting perspective, the measuring of cash is inherently less risky than measuring sand and gravel.

20.20.30.c   **Other factors that influence risk**

Other factors may influence risk measurement. These factors can be grouped into broad categories such as:

- Financial
- Operational
- Human capital
- Legal
- Technology
- Security
- Political
- Environmental
- Ethics
- Compliance.

The degree to which these factors influence a specific agency or function will vary depending on the agency's objectives, the nature of its operations and its control environment.

20.20.30.d   **Measuring risk**

A visual matrix can be useful in measuring risk. For each event, determine the likelihood that it will occur and the impact on the agency if it does occur.

Likelihood = the possibility that a given event will occur.
Impact = the result or effect of an event.

	Low Impact	Medium Impact	High Impact
High Likelihood	2	3	3
Medium Likelihood	1	2	3
Low Likelihood	1	1	2

A general guideline for handling the different levels of risk is:

> **3** = High Risk – Mitigate or reduce the risks
> **2** = Medium Risk – Manage the risks
> **1** = Low Risk – Accept the risks

The specific method used to measure risk is not as important as ensuring that management gives careful consideration to factors unique to their agency and that the risk assessment process is well documented.

20.20.40   How does an agency respond to risk?
July 1, 2008

Risk response refers to the actions taken to deal with an identified risk. Possible responses fall into four categories: avoidance, reduction, transferring (sharing), and acceptance.

Avoidance: Risk avoidance involves eliminating the risk-producing activity entirely (or never beginning it). Although avoidance is highly effective, it is often impractical or undesirable, either because the agency is legally required to engage in the activity or because the activity is so beneficial to the public that it cannot be discontinued.

Reduction: Risk reduction strategies reduce the frequency or severity of the losses resulting from a risk, usually by changing operations. For example, routine mechanical maintenance could decrease the likelihood of a major computer hardware failure, while routine backups could decrease the impact of technology equipment failure on the agency's ability to provide services.

Transferring (sharing): Risk transfer strategies turn over or share the responsibility of performing a risky activity to another party. Examples of risk transfer are transferring the liability for losses to an insurance carrier, or outsourcing an activity to a contractor with the stipulation that the contractor assume the risk.

Acceptance: After all reasonable and cost-effective risk responses have been taken, an agency is left with risk acceptance.

When deciding how to respond to each risk, management should consider the following:

- The availability and effectiveness of control activities on likelihood and impact (significance).

- The availability of resources to implement control activities.

- The cost of the control activity in relation to its benefit.

Limitations on resources will define the way and level to which risks can be managed. Therefore, risk responses must be prioritized based on level of risk and the cost, availability, and effectiveness of control activities.

When considering the cost versus benefit and recognizing interrelationships among risks, management may pool agency responses to address similar risks across an agency's units or programs. Examples include mandating ethics training for all agency employees and centralizing functions, such as contract management and receipting.

20.25
Control Activities

20.25.10	**What are control activities?**
July 1, 2008	

Control activities are the policies, procedures, techniques, and mechanisms that help ensure that management's response to reduce risks identified during the risk assessment process is carried out. In other words, control activities are **actions taken** to minimize risk. The need for a control activity is established in the risk assessment process. When the assessment identifies a significant risk to the achievement of an agency's objective, a corresponding control activity or activities is determined and implemented.

Control activities can be preventive or detective:

Preventive activities are designed to deter the occurrence of an undesirable event. The development of these controls involves predicting potential problems before they occur and implementing procedures to avoid them.

Detective activities are designed to identify undesirable events that do occur and alert management about what has happened. This enables management to take corrective action promptly.

Internal control activities can be incorporated into the following:

- Policies
- Procedures
- Sequences or combinations of procedures
- Assignments of duties, responsibilities, and authorities
- Physical arrangements or processes
- Combinations of the above.

20.25.20
July 1, 2008

How should control activities be incorporated into an agency's internal control plan?

Control activities occur at all levels and functions of the agency. Management should establish control activities that are effective and efficient. When designing and implementing control activities, management should aim to get the maximum benefit at the lowest possible cost. Consideration should be given to the following:

- The cost of the control activity should not exceed the cost that would be incurred by the agency if the undesirable event occurred.

- Management should build control activities into business processes and systems as the processes and systems are being designed.

- Adding control activities after the development of a process or system is generally more costly.

- The allocation of resources among control activities should be based on the likelihood and impact of the risk. Refer to Subsection 20.15.40.b.

- For any given risk, there may be multiple appropriate control activities that can be put into place, either individually or in combination with other control activities.

- Excessive use of controls could impede productivity.

20.25.30
July 1, 2008

Commonly used control activities

20.25.30.a

The following are descriptions of some commonly used control activities. This is not an exhaustive listing of the alternatives available to management.

Authorization – Control activities in this category are designed to provide reasonable assurance that all transactions are within the limits set by policy or that exceptions to policy have been granted by the appropriate officials.

Review and approval – Control activities in this category are designed to provide reasonable assurance that transactions have been reviewed for accuracy and completeness by appropriate personnel.

Verification – Control activities in this category include a variety of computer and manual controls designed to provide reasonable assurance that all accounting information has been correctly captured.

Reconciliation – Control activities in this category are designed to provide reasonable assurance of the accuracy of financial records through the periodic comparison of source documents to data recorded in accounting information systems.

Physical security over assets – Control activities in this category are designed to provide reasonable assurance that assets are safeguarded and protected from loss or damage due to accident, natural disaster, negligence or intentional acts of fraud, theft or abuse.

Segregation of duties – Control activities in this category reduce the risk of error and fraud by requiring that more than one person is involved in completing a particular fiscal process.

Education, training and coaching – Control activities in this category reduce the risk of error and inefficiency in operations by ensuring that personnel have the proper education and training to perform their duties effectively. Education and training programs should be periodically reviewed and updated to conform to any changes in the agency environment or fiscal processing procedures.

Performance planning and evaluation – Control activities in this category establish key performance indicators for the agency that may be used to identify unexpected results or unusual trends in data which could indicate situations that require further investigation and/or corrective actions. Evaluations may be done at multiple levels within the agency, as appropriate: the agency as a whole; major initiatives; specific functions; or specific activities.

Performance reviews may focus on compliance, financial or operational issues. For example, financial reviews should be made of actual performance versus budgets, forecasts and performance in prior periods.

20.25.30.b   Although control activity procedures are not intended to increase staffing levels, acceptable procedures are to be established and followed which may require changes in existing workloads and/or additional staff position(s).

However, a periodic thorough internal review of control activities may identify policies and procedures that are no longer required. It is recognized that some small to medium size operations may not be able to institute internal control procedures on the same level as larger, more complex agencies. In those cases where staffing may prohibit or restrict the appropriate segregation of duties, management must either have more active oversight of operations or utilize personnel from other units to the extent possible as compensating controls.

20.25.40 July 1, 2008	## What are some limitations of control activities?

Control activities, no matter how well designed and executed, can provide only *reasonable assurance* regarding achievement of objectives. The likelihood of achievement is affected by limitations inherent in all control systems. These limitations include the following:

Judgment – The effectiveness of controls will be limited by the fact that decisions must be made with human judgment in the time available, based on information at hand and under the pressures to conduct business.

Breakdowns – Even if control activities are well designed, they can break down. Personnel may misunderstand instructions or simply make mistakes. Errors may also stem from new technology and the complexity of computerized information systems.

Management override – Even in an effectively controlled agency, high-level personnel may be able to override prescribed policies or procedures for personal gain or advantage. This should not be confused with management intervention, which represents management actions to depart from prescribed policies or procedures for legitimate purposes.

Collusion – Collusion between two or more individuals can result in control failures. Individuals acting collectively often can alter financial data or other management information in a manner that cannot be identified by the control system.

Costs versus benefit – In determining whether a particular control activity should be established, the cost of establishing the control must be considered along with the risk of failure and the potential impact. Excessive control is costly and counterproductive. Too little control presents undue risk. Agencies should make a conscious effort to strike an appropriate balance.

Resource limitations – Every agency must prioritize control activities because resources are not available to put every control activity into practice.

20.25.50	**What internal control documentation is required?**

July 1, 2008

20.25.50.a   Documentation involves preserving evidence that substantiates a decision, event, transaction or system. Documentation should be complete, accurate and clearly written. It should be recorded timely and in a format that can be used efficiently.

At a minimum, documentation should be retained of the following:

- Key policies, procedures and processes.
- The annual assurance required in Subsection 20.15.50.a.

20.25.50.b   Agencies should strive to develop documentation of its processes that includes:

- The control objective as related to a desired goal or condition.
- The flow of information and documents through the process or function.
- The control activities in place over the function.

20.25.50.c   Documentation should be considered in making decisions about the internal controls in place over a specific process. The documentation should be sufficient to allow the agency to:

- Conclude as to the overall soundness of the internal controls.
- Be aware of the existence of internal control weaknesses, if any.
- Formulate the agency's plan of action for addressing internal control weaknesses and improving the internal controls where necessary.

20.40
Internal Auditing Policies

20.40.10
May 1, 1999

Why an internal audit function?

An internal audit function aids management by improving the quality of the control environment (refer to Subsection 20.15.40.a). These internal auditing policies should provide agency directors, internal control officers, internal auditors, and other agency staff with a background and approach toward the establishment, as appropriate, of an effective internal audit function.

20.40.20
May 1, 1999

What is internal auditing?

Internal auditing is an independent appraisal activity established within an agency for the review of operations as a service to management. The objective of internal auditing is to assist agency staff in the effective discharge of their responsibilities.

Internal auditors examine and evaluate the planning, organizing, and directing processes to determine whether reasonable assurance exists that the agency will achieve its goals and objectives. Such evaluations, in the aggregate, provide information to appraise the agency's overall control system and the quality in implementing assigned responsibilities. All systems, processes, operations, functions, and activities within an agency are subject to evaluations by internal auditors.

20.40.30
May 1, 1999

What are the differences between internal and external auditing?

Internal and external audits are different in the following respects:

20.40.30.a   Internal auditors are employees or contractors providing internal auditing services in a specific governmental unit.

20.40.30.b   External auditors are independent of the governmental unit. External
                 auditors must be independent both in fact and in appearance.
                 External auditors include:

- State Auditor.

- Government auditors who are members of a government other than
  the state of Washington.

- Independent public auditors who provide auditing services on a fee
  basis.

- Auditors of legislative organizations such as the Joint Legislative
  Audit and Review Committee.

20.40.30.c   External audits do not alleviate the need for an internal audit function, or
                 vice-versa. Internal and external audit functions are complementary.
                 Agencies are not to rely solely on audits performed by outside parties to
                 measure the appropriateness and degree of internal activities. Audits by
                 external agencies, such as the Joint Legislative Audit and Review
                 Committee and the Office of the State Auditor, are not intended to replace
                 an ongoing management review of operations and may in fact be limited
                 by law to the scope of the examination they may perform. This limit on the
                 scope may preclude a comprehensive review of an agency's internal
                 procedures.

20.40.40   What are the basic requirements of internal auditing?
May 1, 1999

20.40.40.a   Agency heads or authorized designees are assigned the responsibility and
                 authority for establishing and maintaining an internal audit program. An
                 agency's decision to employ an internal audit program should be made
                 based on the results of a risk assessment and the priority of the need for an
                 internal program is compared to the agency's other programmatic needs.

                 Internal audit programs implemented by agencies should follow auditing
                 standards as appropriate for the agency or program (i.e. Generally
                 Accepted Government Audit Standards or Institute of Internal Auditor
                 Standards).

20.40.40.b   Internal auditing is to:

1. Review operations or programs to ascertain whether results are consistent with established goals and objectives and whether the operations or programs are managed according to plan.

2. Review the management control system designed to ensure compliance with those policies, plans, procedures, laws, regulations, and contracts that could have a significant impact on operations. Also report whether the management control system is working as designed.

3. Review the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.

4. Review the means of safeguarding assets and, as appropriate, verify the existence of such assets.

5. Appraise the economy and efficiency with which resources are employed.

6. Isolate problem areas and provide a means for corrective action before the problem affects operational efficiency.

7. Promote open communications and establish a positive relationship among the internal auditor, external auditor, agency staff, management, and audit committee and authority/board/committee/commission members as applicable.

20.40.40.c   The internal audit function is an integral part of the agency and derives its authority from senior management. It serves to promote objective, comprehensive review coverage and to assure the consideration of audit recommendations.

To accomplish this, the internal audit function should be responsible to an individual in the agency with sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of audit reports, and appropriate action on audit recommendations. Internal auditors should also be independent of the activities they audit by having no direct or indirect authority or responsibility for the programs or operations they audit. Generally, reports and associated audit findings, recommendations, and analysis are directed to the agency head, or chief executive officer.

20.40.40.d   Internal audits may be performed during or after a fiscal period. In either case, an audit is not part of any control activity, however it serves as an important component of the management control system.

The activities of an internal audit, whether performed during or after a fiscal period, may include:

- Consultation and education sessions to familiarize agency staff with control activity responsibilities,

- Assisting agency staff in preparing for new processes or requirements,

- A review of agency activities to serve as a basis for recommending improvements as necessary to aid in the accomplishment of agency identified goals and objectives.