
**Thomas P. DiNapoli
COMPTROLLER**



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**OFFICE OF THE
NEW YORK STATE COMPTROLLER**

**DIVISION OF STATE
GOVERNMENT ACCOUNTABILITY**

**HIGHER EDUCATION
SERVICES CORPORATION**

**QUALITY OF INTERNAL
CONTROL CERTIFICATION**

Report 2008-S-96

AUDIT OBJECTIVE

Our objective was to determine whether the Higher Education Services Corporation (HESC) submitted a quality internal control certification to the Division of Budget on March 31, 2008.

AUDIT RESULTS – SUMMARY

We found that the HESC submitted a quality internal control certification to the Division of Budget (DOB) by April 30, 2008. The certification addressed each of five components of internal control: control environment, risk assessment, monitoring, control activities and information and communication. In addition HESC's certification included a detailed Internal Control Summary as well as examples of activities undertaken to address the recommendations that resulted from the New York State Internal Control Task Force that convened in 2006. We also determined HESC has a structured, ongoing, well-documented internal control review process.

However, we determined HESC has not provided adequate assurance they are addressing the issue of independence with Internal Audit and Internal Control Officer (ICO) responsibilities. HESC's ICO is also the Acting Director of Audit and Quality Assurance which oversees the Internal Audit functions of HESC. Since the Internal Auditor (IA) is responsible for evaluating the effectiveness of an entities system of internal control, it is imperative the individual be independent of the activities that are audited.

Our audit report contains one recommendation to help HESC assure they are maintaining independence in their ICO and Internal Audit responsibilities. HESC officials agreed with our recommendation and

indicate the steps they plan to take to implement it.

This report, dated August, 14, 2008, is available on our website at: <http://www.osc.state.ny.us>.

Add or update your mailing list address by contacting us at: (518) 474-3271 or Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

BACKGROUND

Internal controls are the integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its objectives and mission. While the overall purpose of internal control is to help an organization achieve its mission, internal control also helps an organization to promote orderly, economical, efficient and effective operations, and produce quality products and services consistent with the organization's mission; safeguard resources against loss due to waste, abuse, mismanagement, errors and fraud; promote adherence to laws, regulations, contracts and management directives; develop and maintain reliable financial and management data, and accurately present that data in timely reports.

The Division of Budget's Budget Policy and Reporting Manual (BPRM) Bulletins B-350 and B-1177 require the head of each covered State agency and public authority to certify compliance with the State's Internal Control Act (the Act) by April 30 of each year by submitting a Certification and Internal Control Summary of the internal control activities undertaken during the previous year. The current requirements in the BPRM B-350 internal control certification has been updated

with a list of agencies required to establish and maintain an internal audit function and also requires agencies identify specific actions taken to implement each of the recommendations in the Internal Control Task Force report “*The New York State Internal Control Act Implementation Guide: Strengthening Compliance with the Act and Standards.*” These recommendations include specific guidance for agencies, the Internal Control Task Force, NYS Division of Budget and the NYS Comptroller’s Office. The recommendations were developed to provide agencies with an improved level of assurance that an appropriate set of controls are in place within the agency and are functioning properly. Recommendations directed toward agencies relate to internal control coordination, implementation, education and training as well as internal audit organization, staffing, processes, and continuing education.

Created in 1974, HESC is responsible for improving the postsecondary educational opportunities of eligible students through the centralized processing of student financial aid programs. HESC administers the State’s financial aid and loan programs and coordinates the State’s administrative efforts in student financial aid and loan programs with other levels of government. HESC’s mission is to help people pay for college.

AUDIT FINDINGS AND RECOMMENDATION

Quality of the Internal Control Assessment

Control Environment

Control environment is the attitude toward internal control and control consciousness established and maintained by the management and employees of an organization. It is a product of management’s governance, that is, its philosophy, style and

supportive attitude, as well as the competence, ethical values, integrity and morale of the people of the organization. The control environment is further affected by the organization’s structure and accountability relationships.

Agency management provided us with adequate support for control environment over HESC. Over the past year, each division within HESC worked to develop their own mission statement that states how their work areas contribute to the accomplishment of HESC's overall mission. This process has provided divisions with a sense of purpose and direction.

In compliance with the Internal Control Task Force recommendation that each agency head provide communication to all staff in support of its internal control program, the President of HESC issues annual internal control memos to all staff and quarterly reminders are sent out to staff by the Division of Audit and Quality Assurance (AQA). These reminders stress the importance of internal control in meeting HESC’s mission and outline staff responsibilities under the Internal Control Act.

Management ensures the competence of employees through mandatory employee training, including training on internal controls and cyber security. In addition educating staff on the importance of internal controls is a priority to the AQA unit. The risk assessment staff within this unit train HESC employees in the skills required for risk and control identification as well as implementation of control activities. To uphold their commitment in establishing an effective and efficient risk assessment program, HESC often enlists help from outside consultants in providing guidance and education in enhancing their risk management techniques.

Information and Communication

Communication is the exchange of useful information between and among people and organizations to support decisions and coordinate activities. Information should be communicated to management and other employees who need it in a form and within a time frame that helps them to carry out their responsibilities. Communication with customers, suppliers, regulators and other outside parties is also essential to effective internal control.

Agency management provided us with adequate support for information and communication. HESC management has established effective and timely channels to communicate with staff. Through regular memos from the President and divisional management and administrative manuals, employees are informed of the internal control responsibilities with regard to their job duties. All managers attend regular staff meetings, at least quarterly, to communicate performance expectations and establish clear goals and objectives. In addition, during the annual "State of HESC" program, HESC's President emphasized HESC's mission and values and each division's Vice President described their operation's role in fulfilling HESC's mission.

HESC's internal intranet contains useful information for employees, including agency-wide policies and procedures, training opportunities and help-desk and technical assistance as well as periodic newsletters and employee recognition programs. HESC's internet website offers a wide variety of useful information and resources for students, parents, counselors, college administrators, and lenders. Having electronic information provides a more permanent record and enables managers and others to review the information. In addition, both the internet and

intranet are available in both Spanish and English to recognize the diversity of the students and other internal and external customers.

HESC's commitment to its employees is continually emphasized. Employees provide management with feedback regarding their work opinions and attitudes through regular division staff meetings and through exit interviews. In addition an agency-wide employee survey to solicit employee input and insights is administered every two to three years. Management uses the results to assess HESC's work environment and identify opportunities for improvement. As a result of these surveys, several new initiatives have been developed at HESC. These include having each division develop their own mission statement, creating a new employee orientation program, and creating an employee newsletter.

In addition, the new functional risk assessment process administered through AQA incorporates staff at various levels and across units to ensure and encourage participation and coordination across staff lines and functional areas.

Risk Assessment

Risk should be assessed and managed through an organization-wide effort to identify, evaluate and monitor those events that threaten the accomplishment of the organization's mission. For each risk that is identified, management should decide whether to accept the risk, reduce the risk to an acceptable level, or avoid the risk.

Agency management provided us with adequate support for risk assessment as it relates to HESC. HESC's Risk Management and Corporate Governance Unit (CGU) oversee and facilitate the risk management

activities at HESC. Their process includes assessing the risk involved in a specific function instead of by unit and forming workgroups. Assessing risk by function is one of the Internal Control Task Force recommendations and better ensures that HESC identifies all the operational and control objectives, risks, and controls throughout the organization since many units are interrelated. HESC has identified functions pertaining to HESC's mission and nine of these functions had risk assessments completed during the past year. These assessments included functional reviews of HESC's internal programs and processes such as the processing of Tuition Assistance Program applications and ensuring compliance with federal reporting requirements as well as reviews of HESC services provided to the public including the Call Center and the agency's website.

HESC's risk assessment process involves staff at all levels who are involved with the function and includes identifying business objectives, risks, controls, control activities, a walk-through test of the control activities, and if necessary preparing a corrective action plan. Risk assessments are reviewed by an independent Risk Management Officer (RMO) who reviews assessments and brings the findings to executive management. The RMO also acts as an independent mediator and provides an independent evaluation in cases where there is a disagreement between CGU and the division over established or proposed control activities. CGU plans to review completed risk assessments annually and complete assessments of other HESC functions each year.

Control Activities

Control activities are tools - both manual and automated - that help identify, prevent or reduce the risks that can impede

accomplishment of the organization's objectives. Management should establish control activities that are effective and efficient. When designing and implementing control activities, management should try to get the maximum benefit at the lowest possible cost.

Agency management provided us with adequate support for control activities over HESC. Within different levels of HESC beginning with the executive level, policies are issued and Internal Controls guidance is provided. HESC has an overall agency administrative manual that outlines the internal control guidelines, policies and procedures. The manual outlines the legal requirements on staff responsibilities, internal control guidelines and schedules of events and activities. HESC's comprehensive set of policies and procedures aid personnel in achieving their unit's responsibilities.

The CGU provides oversight in assessing risk in all of the functional areas within HESC. By establishing and coordinating a formal review process of each of these areas, the CGU evaluates if intended business objectives and outcomes within a unit are achieved and if current controls are effective or need to be revised. In addition, the Internal Audit division reviews unit policies and procedures as part of their regular audit activities.

HESC has established other control activities. These include requiring new staff to sign confidentiality agreements and attend security awareness training, securing emails for secure information and utilizing a staff separation checklist to ensure systems and data are controlled when staff discontinues their employment with HESC.

Monitoring

Monitoring is the review of an organization's activities and transactions to assess the quality

of performance over time and to determine whether controls are effective. Management should focus monitoring efforts on internal control and achievement of the organization's mission. Management should ensure that it takes the proper actions to address the results of monitoring.

Agency management provided us with adequate support of HESC monitoring. Employees from various levels are involved in the monitoring process by identifying objectives within their workgroups and determining whether controls are adequate or need to be modified to mitigate the risk of achieving the objective. Management is involved in this process as well and evaluates the results of the workgroups results and recommendations.

HESC is monitored both internally and externally. Internally, employees at all levels are encouraged to be involved during the risk assessment process. They participate in workgroups that evaluate individual unit's business objectives and determine if the necessary controls and control activities for that unit are in place. The workgroups are facilitated and receive guidance from an independent entity, the CGU. Information of the evaluations (risk assessments) completed by the CGU is then reported to executive management who in turn evaluates the results, corrective actions suggested and recommendations.

In addition, HESC has an internal audit function the AQA unit. The Director of AQA meets with executive management bi-weekly and provides quarterly performance reports on AQA and CGU activities.

Externally, HESC is the subject of annual audits by the New York State Banking Department and a "Big Four" accounting firm. In addition the United States

Department of Education and the Office of the New York State Comptroller perform periodic audits of HESC. Monitoring efforts by staff, management, executives and external auditors helps ensure that work is being done properly and in support of agency goals.

Independence

Agency heads are required to appoint an Internal Control Officer who assists the agency head and other management by evaluating and improving the effectiveness of the internal control system. The Internal Control Officer is responsible for implementing and reviewing the organization's internal control efforts. In addition according to the State Comptroller's *Standards for Internal Control in New York State Government*, the Internal Control Officer (ICO) is responsible for assisting in establishing specific procedures and requirements. However, the effectiveness of these procedures and requirements must be audited by someone who was not involved in the process of putting them into place. The Internal Auditor (IA) is responsible for evaluating the effectiveness of the system of internal control and must be independent of the activities that are audited. For this reason, the IA cannot perform the role of ICO.

According to the B350 internal control certification requirements, HESC is listed as one of the agencies required to have an internal audit function. HESC does have an internal audit function. However, HESC does not adequately ensure the independence of the ICO and IA responsibilities. Currently HESC's ICO is also the Acting Director of AQA (Director) which oversees HESC's internal audit functions.

HESC's ICO states his independence is not compromised in his dual roles. His involvement and responsibilities in reviewing

the internal controls and risk assessments completed by the CGU are limited and he ensures the risk assessment and all the necessary steps were completed. In addition the CGU is not responsible for audits and places responsibility for the development and maintenance of adequate internal controls with each manager.

However, part of the Director's role as IA includes reviewing established procedures and making recommendations as part of the audit process. In comparison, the Director's role as ICO includes establishing procedures that he may subsequently be reviewing in his role as IA.

Recommendation

1. Separate the Internal Control Officer position from the Internal Auditor function.

AUDIT SCOPE AND METHODOLOGY

We conducted our performance audit in accordance with generally accepted government auditing standards. We audited the quality of HESC's 2007-08 B-350 Internal Control Certification. To do our audit we interviewed agency officials to learn about their control activities and reviewed all documentation of internal controls provided by HESC to support their certification.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards,

commissions and public authorities, some of who have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

AUTHORITY

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

REPORTING REQUIREMENTS

Draft copies of this report were provided to HESC officials for their review and comment. Their comments were considered in preparing this report and are included as Appendix A.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the President of the Higher Education Services Corporation shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendation contained herein, and if the recommendation was not implemented, the reasons therefor.

CONTRIBUTORS TO THE REPORT

Major contributors to this report include David R. Hancox, Walter Irving, Melissa Little, Claudia Christodoulou and Andrea Dagastine.

APPENDIX A - AUDITEE RESPONSE



David A. Paterson
Governor

NEW YORK STATE HIGHER EDUCATION SERVICES CORPORATION

Office of the President

August 7, 2008

Mr. David R. Hancox
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Dear Mr. Hancox:

This letter is in response to the draft audit report for Higher Education Services Corporation (HESC) on the Quality of Internal Control Certification – Report 2008-S-96. Management at HESC has made raising the level of awareness and compliance with the Internal Control Act of 1987 an agency priority.

I am pleased with the results of your audit. HESC agrees with the recommendation to separate the Internal Control Officer from the Internal Audit function. Our corrective action for this recommendation is to appoint the Vice President and Chief Financial Officer as HESC's Internal Control Officer. The Risk Management and Corporate Governance Unit will move to the Division of Corporate Finance and report to the Director of Loan Program Finance who reports to the new Internal Control Officer.

If you require any further information, please contact Matt Downey, Acting Director of Audit & Quality Assurance at 473-2287.

Cordially,

A handwritten signature in black ink, appearing to read "James C. Ross".

James C. Ross

MJD/nlh

cc: Tom Lukacs, Division of the Budget