



Solutions

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Division of State Services

Internal Controls - Your Life Could Depend on Them

All too often, managers are not particularly interested in understanding internal control concepts. We find many managers cannot even define what constitutes good internal control. But you only need to talk with the executives ensnared in the recent corporate scandals to appreciate the need for an appropriate system of internal control to keep you out of prison. They now know all too well that organizational culture is directly tied to management's attitude, philosophy and operating style.

Or talk with NASA managers. The Columbia Accident Investigation Board determined physical and organizational causes played an equal role in the Columbia accident - the NASA organizational culture had as much to do with the accident as the foam that struck the Orbiter on ascent. The Board concluded NASA's present Space Shuttle is not inherently unsafe. However, the Board also found NASA's

management does not have a strong safety culture and concluded the agency's management system is unsafe to manage the shuttle system beyond the short term.

CONTROL CONSCIOUSNESS

Internal control needs to be built into business processes to assure core activities are achieved efficiently, effectively and economically. Good controls can help preserve human life and can help identify staff stealing. Recently, we identified an employee making personal charges on her State procurement card. These charges were simple to identify because the vendors were nationally recognized cruise lines. Yet agency management did not find the problems - the State Comptroller's auditors did. In addition to improper credit card charges, the auditors subsequently uncovered other improper activity. The auditors attributed the cause to management's attitude and philosophy. Management had a hands-off approach

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After the Payroll System Upgrade: What's Next?

As 2003 draws to a close, it is a good time to reflect on the events of the past 12 months - to recognize and celebrate our successes and commit to improving in areas that are still



Robin Rabii
Director of State Payroll Services

“unfinished business.” From a payroll system perspective, 2003 provided a good opportunity to do both.

First, the successful payroll system

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The FOCAS Project

Defining the Central Accounting System's Purpose, Functions, and Utility

The October issue of *Solutions* began a discussion on the guiding principles that were used to define the new Central Accounting System (CAS). This discussion continues with an examination of three of the guiding principles: the core purpose, core business functions and utility of the system.

Core Purpose

The true value of an accounting system lies in its ability to maintain data that will inform its users. Based on this premise, this guiding principle defines the major theme for the CAS: effective decision-making will improve New York State's management, operations, compliance and accountability. The new CAS will provide the information that will enable and facilitate effective decision-making. This capability will benefit both operating agency and internal OSC users.

Core Business Functions

Core business functions were established to fulfill the mandate specified in the core purpose. The business functions serve to generate needed information, provide for efficiency of operations, and create significant value to satisfy OSC and operating agency business processing, reporting and decision-making needs. Execution of the core processes is central to meeting the Comptroller's constitutional mandates.

Examples of improvements that will be realized through the new CAS include volume buying and payment discounts through the provision of a central vendor file, automated

identification of liens and offsets prior to issuance of a payment, enhanced reporting of Federal 1099 information, and increased investment returns based on improved monitoring of payment clearance patterns.

Utility of CAS Data

There is a clear recognition of the fact that the data that resides in the Central Accounting System must provide maximum utility to the system's users. The CAS will be designed to provide a useful "backbone system" and will include a menu of customizable accounting, information and reporting features to allow organizations to create "My Organization's CAS." Users will be able to see the information that matters most to them.

This article is the second in our continuing series of *Solutions* articles outlining the guiding principles that OSC used to guide the development of the new Central Accounting System. If you have any questions or comments, please e-mail the FOCAS Team at FOCAS@osc.state.ny.us.



FOCAS Project Core Business Functions

- Appropriation and Segregation Control and Accounting
- Contract and Purchase Order Management
- Payment Processing
- Federal Grant and Payment Management
- Lien Offset Processing
- Revenue Accounting
- Cash and Investment Management
- Debt Management
- General Ledger Reporting
- Financial Reporting
- Access to Available Data
- Audit

After the Payroll System Upgrade: What's Next?

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upgrade was a major achievement. The upgrade project, which began in the fall of 2001, called upon the entire payroll community to contribute in a variety of ways and culminated with a successful go-live on August 4, 2003. We can all look back with pride and satisfaction on our collective success.

At the same time, the post go-live period presented us with a number of challenges that required continued collaboration to address performance issues that impacted system availability, reliability and speed. In the four months since the upgrade, OSC has implemented

a number of technical and application improvements that have had measurable impacts on performance, functionality and user satisfaction. In addition, certain agencies have implemented changes to their own systems and connections to improve access and performance. We are encouraged by these successes and are committed to addressing the remaining challenges that lie ahead.

In addition to a continued focus on PayServ performance and reliability, we

are also working on a number of key post-upgrade initiatives – the most prominent of which is the “Automated Interface Development Project.” The primary objective of this multi-phase effort is to eliminate the re-keying of data into the payroll system through the creation of an automated approach. Over the longer term, this effort envisions

“Like 2003, the year ahead promises to be exciting and full of opportunity. We look forward to continuing our collaboration with agency users as we pursue additional improvements to PayServ and other key projects that will benefit the statewide payroll community.”

*Robin Rabii
Director of State Payroll Services*

the development of a standard interface that replaces the data capture process and provides interested agencies with the opportunity to reduce or eliminate on-line data entry into PayServ.

At the end of January 2004, the Automated Interface Project will be nearing the end of its first phase, Business Rule Discovery and Requirements Gathering. At the end of Phase 1, a decision will be made regarding the feasibility of proceeding with the design and development of an



automated solution. This decision will be reached in consultation with the affected agencies and with the Project's Steering and Advisory Committees.

Discussions are also continuing concerning the plan for implementation of employee self-service. This effort, which was originally included in the scope of the upgrade project, was deferred until the post go-live period. OSC's strategic commitment to employee

self-service is still intact; at the present time, the costs and benefits of implementing this new functionality are under consideration.

“Like 2003, the year ahead promises to be exciting and full of opportunity. We look forward to continuing our collaboration with agency users as we pursue additional improvements to PayServ and other key projects that will benefit the statewide payroll community,” Robin Rabii, Director of State Payroll Services, promised.



For more information, please visit us at www.osc.state.ny.us.

State Audit Bureau Introduces New Report Format For Technology Audits

The State Audit Bureau performs audits of New York State and City agencies, as well as public authorities. Recently, the Bureau completed many audits that address information technology and IT related matters, such as data centers, network security controls, general and application controls, and disaster recovery plans. Public Officers Law §87 (the Freedom of Information section) (2)(i) states that an agency may deny access to records or portions thereof that: if disclosed, would jeopardize an agency's capacity to guarantee the security of its information technology assets, such assets encompassing both electronic information systems and infrastructure. Consistent with this provision, the State Audit Bureau has instituted a new reporting format whereby the audit team will determine if the information technology data obtained during the audit and being

reported on in the audit report is sensitive and/or confidential. If the data is deemed as sensitive and/or confidential, the material will not be included in our issued final report, which is a public document.

However, we will continue to issue a draft audit report to the auditee detailing the issues we identified during our audit and recommendations we made to address those issues, and the auditee will provide a detailed response to that document. These detailed documents will be kept confidential within OSC's audit work papers. The documents will not be released to the public, but will be the basis for the subsequent follow-up review. In those instances where the entire report is considered to be sensitive and/or confidential, the audit team will prepare a condensed version of our typical audit report. This condensed final report, with the auditee's brief response, will be issued as a public audit

report. If only a section or sections of the draft report contains sensitive and/or confidential information technology material, it will be removed from the final report and generic report language will be prepared and inserted into the audit report by the audit team, indicating that the sensitive and/or confidential information is not being included.

Thus far, one final report has been issued and several others are being processed under this new format. This type of reporting ensures that the State Comptroller's Office does not in any way jeopardize the State's information technology assets by releasing information that could lead to possible damage of those assets. Yet, it allows for the independent reviews and recommendations needed to enhance and improve the State's information technology activities.

Audit Topic – Cash Controls at Small Agencies and Authorities

In the last issue, we introduced you to the Internal Control Quick Review (Review) process that our State Audit Bureau (Bureau) has developed for smaller entities. Last issue, we talked about common internal control problems that entities encountered in their payroll operations. This issue, we will focus on the cash receipts function.

Basic internal controls normally provide that the cash handling and recordkeeping functions be separated wherever possible to avoid the opportunity for an individual to cover shortages by adjusting

the accounting records. In smaller operations, this separation of duties is not always practical. When this happens, it is important to establish a record of the funds as soon as they are received and to take other measures to control the monies until deposited into the appropriate bank account. Management also needs to be certain that it has communicated clear policies and procedures so that all staff understand their role in the internal control system and then monitor activities closer to ensure that the system is functioning as intended.

Several of the entities OSC has visited did not maintain daily logs of their cash receipts. These entities could show us that all the funds recorded on their accounting records were deposited into the appropriate bank accounts. However, without cash receipt forms or a log of monies received through the mail, they did not have assurance that everything they received was recorded in the accounting records. By assigning a person not involved in the cash functions to open the mail and log any payments received, management could easily create an independent record that

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State Audit Bureau Once Again Receives Unqualified Opinion in Peer Review

Government Auditing Standards require that each audit organization undergo an independent external quality control review at least once every three years to ensure that it has a quality control system in place that provides assurance that established policies, procedures and applicable audit standards are being followed. From October 16–24, a team of auditors from the Illinois, Maryland, Oklahoma, Tennessee, Texas and Wyoming visited the State Audit Bureau under the

auspices of the National State Auditors' Association. This peer review team reviewed SAB's policies, procedures and audit manuals; tested audit staff qualifications and training records; and examined in detail a sample of 11 audits issued during the year ended August 31, 2003. Like each of the review teams that have examined SAB's operations since the peer process began about 20 years ago, this group issued their unqualified opinion that SAB's quality control system has been suitably

designed and complied with to provide assurance of conforming with audit standards. Not only were we gratified to once again receive independent affirmation of the quality of our work, but we value the team's other observations and insights, such as how to get greater utility out of TeamMate, our electronic workpaper program. Their suggestions will help us be more efficient and effective in our future efforts.

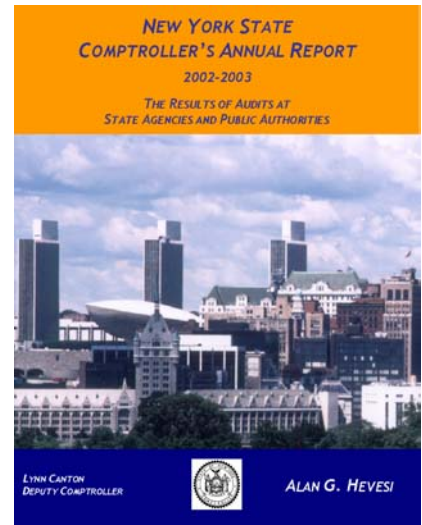
Annual Report of Audit Results

The Comptroller is required by law to prepare an annual report summarizing the results of all audits made at State agencies and public authorities during the previous year. This annual report is to be accompanied by a listing of all such audits made during the preceding five years.

In January 2004, the annual report for the year ended September 30, 2003 and the five-year listing for 1997-2002 will be issued.

- The annual report summarizes the results of 142 audit reports at more than 50 State agencies and public authorities.
- Implementing the recommendations contained in the audit reports issued by the State Audit Bureau during the past year could save New York State taxpayers about \$136 million by reducing costs and increasing revenues. The implementation of these recommendations could also save Federal taxpayers an additional \$93 million.
- We regularly follow up on prior audits to determine whether our recommendations have been implemented. During the past year, we found that State agencies and public authorities generally initiated the changes recommended in our prior audits. Of the 371 recommendations that we followed up on during the past year, 337 (91 percent) had either been fully or partially implemented.

If you would like to receive copies of either publication, contact Dana Newhouse at 518-474-3271 or dnewhouse@osc.state.ny.us. You can also view the annual report and five-year listing at www.osc.state.ny.us.



Internal Controls - Your Life Could Depend on Them

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to the credit card program, did not communicate effectively with staff on program expectations and failed to understand risk concepts – all important components of an effective internal control system.

Studies indicate approximately one-third of American employees have witnessed unethical or illegal conduct in their workplace. Of these, over half did not disclose what they observed. Seventy-one percent of respondents expected that people who reported corruption would suffer for reporting it. For this reason, whistleblowers have typically been reluctant to come forward and disclose inappropriate acts. In fact, 69 percent of public and private sector whistleblowers studied experienced reprisals in the form of lost jobs or forced retirement. We know from our audit

work that employees often know about wrongdoing, but management has not created an environment that allows them to speak up.

Recently, we identified a State employee who decided his sun tanning was more important than the State work he was being paid to do. We observed this employee routinely coming to the upper floor of a parking garage in downtown Albany. This employee would strip down to a pair of shorts, pull out his lawn chair and sit in the sun for several hours a day. We tracked his time and ultimately alerted agency management. But where was this employee’s supervisor? How is it possible that someone can walk off for hours at a time, day-after-day, and not be noticed as missing? We suspect colleagues knew he was missing but did not speak up. Clearly, this agency’s



management team failed to create a positive work environment.

THE INTERNAL CONTROL MYSTIQUE

Because there are many misconceptions about internal control, knowledge sharing is important to maintaining an effective control system. Part of the educational process is to dispel the myths about internal control and present the straight story. Here are just a few myths and the corresponding facts from the Institute of Internal Auditors:

<i>MYTH</i>	<i>FACT</i>
Internal control starts with a strong set of policies and procedures.	Internal control starts with a strong control environment – management has the proper attitude, philosophy and operating style. Ethics are promoted and staff is competent.
Internal control — that’s why we have internal auditors.	Management is the owner of internal control.
Internal control is a finance thing. We do what the Comptroller’s office tells us to do.	Internal control is integral to every aspect of the business.
Internal controls are essentially negative, like a list of “thou shalt nots.”	Internal control makes the right things happen the first time and every time.
Internal controls are a necessary evil. They take time away from our core activities.	Internal controls should be built into, not onto, business processes.
With downsizing and empowerment, we have to give up a certain amount of control.	With downsizing and empowerment, we need different forms of control.
If controls are strong enough, we can be sure there will be no fraud and organizational objectives will be achieved.	Internal controls provide reasonable, but not absolute, assurance that the organization’s objectives will be achieved.

Audit Topic – Cash Controls at Small Agencies and Authorities

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would help them verify that all funds were recorded properly and deposited intact.

We also found several agencies did not immediately place a restrictive endorsement (e.g. For Deposit Only – Account # XXX) on all checks received. Instead, these entities endorsed the checks when they prepared the bank deposit sometimes as much as a week after the payments were received. In addition, some entities stored funds awaiting deposit in unsecured locations, such as unlocked desk drawers or filing cabinets. In these situations, a check could be lost or stolen and possibly deposited into non-entity bank accounts. Management could significantly improve controls by restrictively endorsing checks immediately upon their receipt and ensuring that all funds are stored in

a locked, secure location (safe or locked cabinet) until they can be deposited into the bank.

Some entities were also not reconciling their accounting records and bank statements monthly. When preventive controls like separation of duties cannot be put in place, detection controls like reconciliations and management oversight are critical to timely recognition of errors and irregularities. By not performing bank reconciliations, management had no assurance that all transactions had been properly recorded, either in the accounting records or by the bank. In some cases, we found many unresolved differences between the bank statements and the accounting records at these entities.

Communication is a critical piece of any

internal control system and at some locations, we found control procedures had not been clearly communicated to the staff responsible for the various functions. When people understand their role in the internal control system, along with the roles that others are serving, errors and irregularities are less likely to occur. Some entities we visited did not have written policies and procedures. As a result, staff members had differing views of precisely who was supposed to be doing what. It was no surprise that staff members were not following the policies and procedures that management thought were in place.

In the next issue, we will continue our discussion and focus on some common problems we identified in the revenue billing and collection functions.

Cost Deviations From Bid Specifications

Despite our best efforts to be very specific when composing fee schedules or bid tabulations, bidders, being the creative business entities they are, occasionally send in deviations from the specifications. An agency has the option of rejecting the bid or bids that deviate from specifics. In some cases, rejecting the bid is mandatory because the bid specifications state “deviations from specifications will be rejected.”

However, unless compelled by the specifications, rejecting bids might not always be in the best interest of the state or its taxpayers. If a determination has been made that rejecting the bids is not

in the best interest, the next step is to evaluate cost in a way that ensures fairness is maintained with the business community.

With this goal in mind, how would a purchasing agent or contract specialist handle the following separate bidding scenarios?

- A bid is received for a one-year contract where the bidder, instead of submitting a flat fee bid as requested, offers one rate for the first six months and a second rate for the second six months.
- In another bidding scenario, instead of submitting one mileage rate as

requested, the bidder submits a bid for one rate within a 20 mile radius and a higher rate for outside the 20 mile radius.

- In a final scenario, the bidder offers a flat per item fee as requested, but also offers a quantity discount.

In all these scenarios, general policy dictates that when a bidder offers two prices instead of the requested one price, the bid should be evaluated based on the higher price.

To clarify, assume bids are requested for a one-year contract to acquire drinking cups. Since this is a commodity,

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Financial & Audit Solutions

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an Invitation for Bid (IFB) is issued. The bid tabulation requests a flat per cup cost. When the bids are received, one vendor bids 85 cents per cup for the first six months and \$1 per cup for that last six months with a ten percent quantity discount for purchases over 1,000 cups. In evaluating this bid tabulation, the bid would be evaluated on the higher price, which would be \$1. If, after evaluation of all bids, this is the low cost bid, then the subsequent contract would include the specifics in the bid of 85 cents per cup for the first six months, a dollar per cup for the second six months and the quantity discount as specified.



HAPPY HOLIDAYS!

