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Effectiveness of Internal Audit at the Texas Department of Protective and Regulatory Services June 1997

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Texas Department of Protective and Regulatory Services

Detailed Issues and Recommendations

Overall Conclusion

The Internal Audit Division (Division) of the Texas Department of Protective and Regulatory Services (Department) was in compliance with the five effectiveness criteria developed from the Texas Internal Auditing Act that could be evaluated at the time of our audit. Because of the newness of the Division, three criteria could not be evaluated. The Division was actively moving toward compliance with the Texas Internal Auditing Act.

The Division was established in December 1995 with an authorized staff of seven. Previously, audit responsibilities were contracted to the Texas Department of Human Services' Internal Audit Department. All positions in the new Division were filled as of May 20, 1996.

The new Division is making progress in establishing a sound internal audit function. An agency risk assessment was developed and used to develop an audit plan. The Division Director meets the criteria for the position and has written policies and procedures to administer the Division. Additionally, the Division is staffed by qualified personnel.

Subsequent to our audit, the Division Director's position became vacant on January 1, 1997. An acting Director administered the function through April 30, 1997. A new Director has been named effective May 1, 1997. This condition may have impacted the progress being made by the Division in establishing an effective operation.

Section 1:

The Internal Audit Division Appears to be Effective in Five of Eight Effectiveness Criteria

Assessing Agency Risks - The Division conducted a formal risk assessment in development of its fiscal year 1996 audit plan. In preparing the risk assessment, the Division Director developed and conducted formal interviews with agency executive management, the State Auditor's Office Contact Manager, and the Internal Audit Director at the Department of Human Services to determine the high risk areas within the Department. The risk analysis for each auditable activity uses a risk criteria model with assigned weights.

Preparation of the Audit Plan - The fiscal year 1996 audit plan included areas identified in the risk assessment as high priority, as well as follow-up audits and State Auditor's Office assistance. The Division's annual audit plan and a 6,500 hour budget were approved by the Department's Board. Since the internal audit function was not active until midyear, high-risk activities identified but not audited are to be afforded audit coverage by other audit resources or included in the fiscal year 1997 audit plan.

Organizing and Managing the Internal Audit Function - Current Division practices appear appropriately managed in accordance with Institute of Internal Auditing standards, including:

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Detailed Issues and Recommendations

- Appropriate job descriptions exist for all Division staff positions.
- Continuing Professional Education hours are required and provided for in the Division plan.
- Division staff training records are sufficient, complete, and current.
- Independence statements are required and signed by each staff member prior to starting an audit.
- Effort is made to coordinate with outside audit agencies, which is evident in the fiscal year 1996 audit plan and the monthly updates given to the Board.

Ensuring Compliance With Audit Standards - The Division's policies and procedures manual includes a Quality Control section. This section requires Division staff to conduct audits in conformance with Institute of Internal Auditing and Government Auditing Standards as well as personally comply with all required audit, Code of Ethics, and Department standards. The Division Director plans to perform quality control review on work papers and draft reports prior to issuance of the final report.

Management Involvement in the Internal Audit Program - The Division Director reports functionally to the Board on internal audit matters and administratively to the Executive Director. This relationship should ensure independence, promote comprehensive internal audit coverage, and assure adequate consideration of internal audit recommendations. Based on a review of Board minutes, the Board expressed interest in being involved in the internal audit function. The Board requested a "standing internal audit update" on the agenda at all Board meetings. The Division Director has initiated distribution of a monthly status report to all Board members.

Section 2:

Effectiveness in Three Criteria Could Not Be Determined

Effectiveness in three key criteria could not be determined because of the following:

- The internal audit function was established in December 1995.
- The Division was not fully staffed until May 1996.
- The Division had not completed any audits at the time of our fieldwork in June 1996.

The effectiveness criteria that could not be determined include:

- Communicating Audit Results
- Planning and Conducting Audits

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- Follow-Up on Audit Recommendations

Management's Response:

The Department of Protective and Regulatory Services Board and the executive director recognize the value of internal audit and are committed to having an effective internal audit function. We are pleased that your audit found no weaknesses in the five key criteria evaluated as part of your review of our Internal Audit Division. It is our belief that our internal audit function is in compliance with the Texas Internal Auditing Act, including the three key criteria you were not able to review because of the newness of the function. Since your fieldwork in June 1996, we have planned and conducted audits, issued reports, and conducted follow-up on prior audits. High risk activities identified during the 1996 planning process that were not audited in 1996 were considered during the planning process for 1997.

The new director has excellent credentials and eleven years of experience with the State Auditor's Office. The director has the ability to further develop and enhance our internal audit function, and maintain compliance with the Texas Internal Auditing Act. Also, one additional position, an EDP Audit Specialist IV, has been authorized. We are currently in process of filling this new position.

It should be noted that written internal audit policies and procedures were in place last June which were used by internal audit staff. These policies and procedures covered general policies, administrative polices, and working paper policies, including planning, concluding, reporting, and quality control programs.

We appreciate the guidance and consideration demonstrated by staff of the State Auditor's Office during this engagement.

Objectives, Scope, and Methodology

Objectives

The objectives of Evaluating the Effectiveness of Internal Audit were to:

- Evaluate the effectiveness of the State's internal audit departments.
- Determine whether internal audit departments meet the key objectives of internal auditing and assist agency administrators in carrying out their assigned responsibilities.

Scope

The scope of the audit included:

- Evaluating the effectiveness of 12 of the larger state agencies' internal audit departments
- Surveying the board chairs, elected officials, audit committee chairs, and internal audit department directors of the 79 agencies and universities with internal audit departments to obtain their opinions and comments on the effectiveness of internal auditing; and compiling the results of the survey.

Methodology

The methodology used on this engagement consisted of developing criteria, obtaining information on each of the 12 agencies selected for review, analyzing the information, and evaluating the information against the criteria.

Information collected to accomplish the audit objective included the following:

- Interviews with management of oversight agencies
- Interviews with management and staff of individual agencies
- Documentary evidence, including:
 - State statutes
 - Internal auditing standards
 - Government Auditing Standards
 - Agency documents including plans, policies, manuals, reports, memoranda, and other written communications
 - Internal audit reports

Objectives, Scope, and Methodology

Procedures and tests conducted:

Internal audit function information collected in the current fiscal year and the last two completed fiscal years was evaluated against criteria developed from the Texas Internal Auditing Act.

Criteria used:

- Criteria developed from the Texas Internal Auditing Act

The following are the eight basic effectiveness criteria and a brief definition of each:

- **Board/Management Involvement in Internal Audit Function** - The agency's board or elected official and executive management are adequately involved in the internal audit function and in completing their responsibilities under the Texas Internal Auditing Act.
- **Organizing and Managing the Internal Audit Function** - The internal audit director is effective in managing and organizing the internal audit department.
- **Assessing Entity Risks** - A risk assessment is used in the audit planning process and all agency risks are identified and appropriately ranked.
- **Preparation of the Audit Plan** - The audit plan includes those areas identified as high risk, and resources are available to complete the plan.
- **Planning and Conducting Audits** - Audit projects are properly planned, and due professional care is used in performing the audits.
- **Communicating Audit Results** - The results of audits are appropriately communicated in written format to the proper level to ensure corrective action is taken.
- **Ensuring Compliance With Audit Standards** - The internal audit department takes steps to ensure work conforms to audit standards
- **Follow-Up on Audit Recommendations** - The internal audit department follows-up recommendations in audit reports from prior periods.

Objectives, Scope, and Methodology

Other Information

Fieldwork was conducted from April to September 1996. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Government Auditing Standards
- Generally Accepted Auditing Standards

The audit work was performed by the following members of the State Auditor's staff:

- Terry Holderman, MBA (Team Leader)
- Kim Builta, CPA
- Tom McGaha
- Larry Vinyard, CPA, CIA (Project Manager)
- Linda Lansdowne, CPA (Quality Control Reviewer)
- Charlie Hrcir, CPA (Audit Manager)
- Deborah Kerr, Ph.D. (Audit Director)