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Texas Rehabilitation Commission Effectiveness of Internal Audit Engagement June 1997

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Overall Conclusion

The Internal Audit Department (Department) of the Texas Rehabilitation Commission (Commission) is effective because:

- The Board of Directors (Board) and executive management believe that the internal audit function is effective.
- The Department is perceived as assisting management in the discharge of its duties and responsibilities.
- Department staff members are perceived as professional, independent, and objective; and they perform adequately.
- The Department met minimum requirements in all eight effectiveness criteria developed from the Texas Internal Auditing Act.

However, we identified improvements that could be made in one effectiveness criteria to improve compliance.

In fiscal year 1996, the Department employed 18 auditors and four support staff to provide audit coverage for Commission activities. The Commission is responsible for an operating budget of \$250 million, with more than \$121 million in contract expenditures; the Commission has about 2,468 employees.

Section 1:

Board Involvement in the Internal Audit Function

- The Board can improve its involvement with the Department in the areas of documenting the review of audit reports and incorporating performance measures into the audit plan. No procedure is documented explaining how the Board complies with the Texas Internal Auditing Act requirement that the Board review audit reports.
- The Internal Audit Director regularly provides information to the Board through quarterly written status reports, oral presentations, and other contacts. Although the quarterly status reports notify Board members that audit reports are available for review, Board members generally do not read audit reports. Copies of the *Annual Audit Plan* and the *Internal Audit Annual Report* are furnished to the Board. Management and the Board provide information about risk areas for preparation of the *Annual Audit Plan*.
- The Internal Audit Department has assembled a document that identifies its goals and objectives. The document includes performance measure information. Also, the Board receives information on the performance of the

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Department, but performance measures have not been formally integrated into the *Annual Audit Plan* for Board approval.

Recommendations:

We recommend that the Board improve its participation in managing the internal audit function. The Commission should document how the Board complies with legal requirements to review Department reports. Also, the Board should formally use performance measures in evaluating the effectiveness of the Department.

Management's Response:

The Commission agrees with both recommendations. We will document Board compliance with the legal requirements to review internal audit reports. In addition, Management Audit's performance measures will be incorporated into the Annual Audit Plan for Board review and approval.

Section 2:

The Internal Audit Department Is Effective in Seven Key Criteria

- **Organizing and Managing the Internal Audit Function** - The Commission's internal audit charter establishes the reporting relationship of the Department to the Board and the Commissioner. The Director of the Department prepares the audit plan which is approved by the Board and the Commissioner.

In an effort to improve management of the internal audit function, the Department has produced a document referred to as the "Idealized Design," which documents an ideal internal audit function for the Commission. The document defines the mission, the management style to be used, the customers of the Commission and the Department, the size of the staff, and some measures of performance which can be used to gauge audit efforts.

- **Assessing Entity Risks** - The Internal Audit Department surveys the most important stakeholders to gather concerns and information on auditable units. Executive management actively participates in determining the auditable areas by providing information on risk areas.

The Department has a process for ranking each of the auditable areas and resolving disagreements over ranking issues, which provides information on risk and auditable units. The Department prepares the *Annual Audit Plan* based on the risk assessment model. To assure that elements in the assessment reach the *Annual Audit Plan*, the Department prepares a written reconciliation between the two documents.

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- **Preparation of the Audit Plan** - The Department involves management extensively in determining which auditable activities should be audited. Each auditor is required to assess the ranking of each auditable area that has been defined in the survey process. Audit managers then assemble their respective teams to define a single risk ranking for each auditable area. The *Annual Audit Plan* is a result of this process.
- **Planning and Conducting Audits** - The Department plans and conducts its audits in accordance with Institute of Internal Auditors Standards. To ensure that engagements are performed within standards, the Department has a comprehensive *Audit Procedures Manual* that addresses how to document, manage, and review the audit. Also, the *Audit Procedures Manual* provides guidance on awareness of fraud and abuse responsibilities. The *Audit Procedures Manual* also adds ethical responsibilities to audit staff standards of conduct.
- **Communicating Audit Results** - The Department distributes written reports for each audit to executive management and appropriate levels of line management to ensure implementation of recommendations. Report copies are available for Board members.

Working papers document discussions with the auditees on issues identified and discussed before the final report release and the exit conference. Working papers also document that preliminary responses were obtained from the auditee before the exit conference.

The internal audit reports follow established reporting guidelines and are objective, clear, and timely. The written reports contain all the necessary content elements required by standards.

- **Ensuring Compliance With Audit Standards** - The Department has a written internal quality assurance policy as well as an external peer review completed every three years. The internal review consists of supervisory reviews of the working papers and a sampling of all audit projects on a quarterly basis. Those audits selected are subjected to analysis using an Audit Project Review Checklist.

Every year, each auditor must complete an independence form. During the course of the ensuing year, auditors are expected to report any impairment of their independence to their managers.

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- **Follow-Up on Audit Recommendations** - The Department has extensive documented guidance for the internal audit follow-up process. The procedure is comprehensive and easily followed. The procedures require an audit team to incorporate a preliminary response from the auditee before releasing the audit report. Management's commitment and response can be sufficient to close out the project. In other situations, a written audit response from management within 60 days is required after receiving the audit report.

Also, the auditor in charge is responsible for preparing a matrix of the auditee's response that includes:

- A summary of issues and recommendations
- The auditee's responses
- The auditor's assessment of the adequacy of the auditee's responses and actions

Annually, the Director assigns follow-up projects to assess the status of prior recommendations. These follow-up projects result in comprehensive reports detailing the management actions taken during the year to implement recommendations. The reports include the status of implementation of audit recommendations and answer the following questions:

- Has the recommendation been implemented?
- Is the recommendation in the process of being implemented?
- Is the recommendation being studied by management?
- Has management acknowledged the risk of taking no action on the recommendation?

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:

- Ron Oaks, CGFM (Team Leader)
- Arthur Arispe
- Larry Vinyard, CPA, CIA (Project Manager)
- Leslie Ashton, CPA (Quality Control Reviewer)
- Charlie Hrcir, CPA (Audit Manager)
- Deborah Kerr, Ph.D. (Audit Director)