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Texas Department of Criminal Justice Effectiveness of Internal Audit Engagement June 1997

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Detailed Issues and Recommendations

Overall Conclusion

The internal audit function at the Texas Department of Criminal Justice (Department) met minimum criteria to be effective for the period reviewed. Recommendations to improve the internal audit function's effectiveness were made in six criteria.

The Department has taken positive steps to improve the internal audit function since June 1996. The risk assessment process used to evaluate auditable areas has been revised. The new process will provide management with better documented information about auditable units. This should enhance management's ability to identify the auditable units with the most risk.

A change in the reporting of information to the Board of Criminal Justice (Board) has also been implemented. Board management has changed a policy which limited the Internal Audit Division's (Internal Audit) ability to report recommendations to audit findings. The Board currently receives information on both findings and recommendations.

Prior to June 1996, actions by Department management may have impaired the overall effectiveness of the internal audit function. Although management's participation in managing the internal audit function is imperative, some management actions may have been inappropriate:

- Documentation does not exist to support why unscheduled audits were substituted for other audits in the audit plan. Audits of purchasing controls and contract monitoring were included in the fiscal year 1995 annual plan. Both audits were suspended due to a request by executive management for an audit not originally included in the audit plan.
- Four to seven internal audit positions have been vacant for extended periods of time because of a lack of sufficient space to house the staff.

Texas Department of Criminal Justice has made the following changes to improve the internal audit function:

- A new Director of Internal Audit was named effective June 1, 1996.
- In May 1996, two special projects were initiated to address procurement and contract monitoring.
- The Department participated in a joint project with the State Auditor's Office to address departmental issues.
- The risk assessment process has been improved to include executive and operational managers to better identify auditable activities, potential for loss or risk, and opportunities to achieve benefits in effectiveness and efficiency of programs.

The internal audit function met minimum requirements in seven of eight effectiveness criteria developed from the Texas Internal Auditing Act. However, the function could improve in five effective criteria and may have been ineffective in one of the criteria prior to June 1996.

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Detailed Issues and Recommendations

The internal audit function employs 24 auditors to provide audit coverage for the activities of the Department. The Department is responsible for more than \$73.5 million in revenues, providing about \$308.6 million in contract expenditures, with an operating budget of \$1.55 billion, and more than 39,800 employees.

Section 1:

The Internal Audit Function May Have Been Ineffective in One Effectiveness Criteria Prior to June 1996

Although management's participation in the oversight of the internal audit function is imperative, some of management's actions may not have been appropriate prior to June 1996. No documentation exists to support why one management decision focused resources away from what eventually proved to be a significant contracting problem. Audits of purchasing controls and contract monitoring were included in the fiscal year 1995 annual plan. But both audits were suspended due to a request by executive management for an audit not originally included in the audit plan. The risk assessment, as discussed in Section 2-B, was not sufficient to document risks assigned to specific projects or potential projects.

Additionally, four to seven internal auditor positions have remained vacant for extended periods because space was not available for the additional staff. The effect may have been that sufficient resources were not available to address high-risk auditable units.

Also, as discussed in Section 2-A, management placed restrictions on the reporting of detailed recommendations for a period of time. During the audit fieldwork for this engagement, the Board changed the policy to allow detailed recommendations to be included in the reports to the Board.

The effect of these actions may have impaired the internal audit function's ability to address high-risk auditable areas and provide useful and timely information.

Recommendation:

We recommend that executive management and the Board continue to participate in the oversight of the internal audit function. However:

- Changes to the audit plan should be evaluated with the same risk factors used to develop the plan.
- Management should allocate resources to ensure sufficient staff members are employed to address high-risk areas.

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Detailed Issues and Recommendations

- Audit reports should include information on the findings, recommendations, and other pertinent information.

Management's Response:

Texas Department of Criminal Justice Internal Audit will implement procedures to ensure adequate documentation is maintained to support amendments made to the Annual Audit Plan. As recommended this documentation will include risk factor scoring consistent with that used to develop the Annual Audit Plan.

Texas Department of Criminal Justice Internal Audit will consistently post all vacant positions to ensure sufficient staff positions are available. Currently, all positions have been posted.

As noted in the finding, Texas Department of Criminal Justice Internal Audit has implemented new procedures to ensure detailed recommendations are included in the audit reports. Internal Audit reports will continue to include sufficient detail to ensure management is afforded the information needed to implement remedial action.

Section 2:

The Internal Audit Function Complies With the Minimum Requirements of the Texas Internal Audit Act, but Effectiveness Can be Improved in Five Criteria

Section 2-A:

Communicating Audit Results

As a result of recommendations from a peer review, executive management revised Internal Audit's policy statements. The revised policies allowed Department management to determine whether to include detailed recommendations in the audit reports. This change is considered a restriction since executive management did not allow Internal Audit to report detail recommendations in fiscal year 1996 audit reports.

The issue was discussed with the Board liaison during audit fieldwork. The policy was changed before any significant reports were issued. As of August 1996, the new Director of Internal Audit and Board-Audit Liaison provided copies of new policy statements. The new statements place ultimate responsibility for determining which findings and recommendations to include in internal audit reports with the Director of Internal Audit. The new policy statements appear to conform with standards.

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Detailed Issues and Recommendations

Management's Response:

As noted in the finding Texas Department of Criminal Justice Internal Audit has implemented new procedures to ensure detailed recommendations are included in the audit reports. Internal Audit reports will continue to include sufficient detail to ensure management is afforded the information needed to implement remedial action.

Section 2-B:

Assessing Entity Risks

The Internal Audit Division prepared a risk assessment. However, the risk assessment can be improved to make it a more effective tool for risk management.

Prior to fiscal year 1997, the risk assessment did not clearly identify auditable units or exactly what was being audited. The risk assessment only identified five broad activities. Additionally, risk factors used to rank the broad activities may not have had the appropriate assigned weighting, or appropriate factors may not have been used.

For example, the amount of revenue generated by an activity was not considered a risk factor. Also, information on risk was not gathered from any source below the executive level.

As a result, the risk assessment process may not have effectively identified all significant risks in the Department. If the risk assessment is not complete, the audit plan cannot effectively focus direct audit resources to the highest risk areas.

The risk assessment process for 1997 was started at the time of our fieldwork. The Director of Internal Audit has begun implementing new processes to include a survey of the Board, executive management, and operational managers to determine:

- Auditable activities
- Potential for loss or risk
- Major changes
- Opportunity to achieve benefit

The Director of Internal Audit is planning to rank the auditable areas based upon inherent and control risks.

Recommendations:

We recommend that Internal Audit continue improving the risk assessment process to make it a better risk management tool. Department risk assessments should incorporate information from all levels of the Department to develop auditable units.

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Detailed Issues and Recommendations

The auditable units should be risk-ranked by attributes jointly developed by Internal Audit and executive management. Audit resources should be focused on the highest risk areas.

Management's Response:

As noted in the finding, Texas Department of Criminal Justice Internal Audit implemented procedures during the development of the fiscal year 1997 Annual Audit Plan to ensure the risk assessment was sufficient to identify Auditable Activities; Potential for loss or risk; Major Changes; and Opportunity to achieve benefit. This process will continue for fiscal year 1998 and future years.

As noted in the finding the risk assessment process used to develop the fiscal year 1997 Annual Audit Plan incorporated information from all levels of the agency. This process will continue for fiscal year 1998 and future years.

As noted in the finding the risk assessment ranked the auditable areas based upon inherent and control risks to ensure audit resources are focused on the highest risk areas. This process will continue for fiscal year 1998 and future years.

Section 2-C:

Preparation of the Audit Plan

The Internal Audit Division completed only 38 percent and 23 percent of planned audits for fiscal years 1994 and 1995, respectively. The cause is that Internal Audit may not have analyzed resources well enough to effectively estimate what could be covered in the audit plan. Specifically:

- Audit scope and duration on most projects were not well defined, which caused projects to take much longer than anticipated.
- Planned staff positions used to calculate available audit hours for the audit plan at the beginning of the fiscal year were unfilled during both fiscal years.

The effect is that executive management did not receive the audit services expected.

Recommendation:

We recommend that Internal Audit refine processes to better define audit scope in the audit plan and to better estimate what portion of the audit plan can be completed. Internal Audit can also improve the process for analyzing current and expected resources so that audits can be better planned.

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Detailed Issues and Recommendations

Management's Response:

During the preparation of the fiscal year 1997 Annual Audit Plan more specific scope areas were defined to better estimate what portion of the audit plan can be completed. During the presentation of the Annual Audit Plan to the Audit Committee of the Texas Board of Criminal Justice on September 12, 1996 the Internal Audit Director estimated 15 of the top 20 audits on the Annual Audit Plan were likely to be completed.

During a briefing made during the March 21, 1997 Texas Board of Criminal Justice meeting the Internal Audit Director updated the Annual Audit Plan and estimated 14 of the top 20 audits would be substantially complete by year end with the 15th being deleted due to the inclusion of the auditable activity in one of the previous 14 audits. Texas Department of Criminal Justice Internal Audit will consistently post all vacant positions to ensure sufficient staff positions are available. Currently, all positions have been posted.

Section 2-D:

Organizing and Managing the Internal Audit Function

Although Internal Audit effectively manages some processes, others could be improved. Currently Internal Audit does not track continuing professional education for staff to demonstrate compliance with Government Auditing Standards (GAS). The GAS requires 80 hours of continuing professional education every two years; 24 hours must be directly related to the government environment or government auditing. This is required Internal Audit policy and by the Texas Internal Auditing Act. Also, the board and Executive Director do not use existing annual goals, objectives, and performance measures to evaluate Internal Audit's performance.

Recommendation:

We recommend that the Internal Audit improve management of professional development and performance measures. It should track continuing education to ensure all required standards are being met. Internal Audit, the Board, and the Executive Director should establish criteria by which Internal Audit is to be held accountable.

Management's Response:

The documentation maintained to ensure continuing education requirements are met will be adapted to specifically identify those hours directly related to the government environment or government auditing.

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Detailed Issues and Recommendations

The Texas Board of Criminal Justice Audit Committee will evaluate the performance of the Internal Audit Division based on the goals, objectives and performance measure established in the Texas Department of Criminal Justice Internal Audit Strategic Plan. The Texas Department of Criminal Justice Internal Audit Strategic Plan will be re-evaluated to ensure the goals, objectives and performance measures are appropriate to facilitate this evaluation.

Section 2-E:

Ensuring Compliance With Auditing Standards

Internal Audit does not document how it follows Government Auditing Standards. Testing indicates that Internal Audit does follow *Standards for the Professional Practice of Internal Auditors*, which require a similar quality of work performed. The Texas Internal Auditing Act requires audits to be conducted according to both Government Auditing Standards and *Standards for the Professional Practice of Internal Auditors*.

Recommendation:

We recommend that Internal Audit:

- Incorporate Government Auditing Standards in its policies.
- As previously mentioned, track continuing professional education according to Government Auditing Standards.
- Disclose in audit reports that the work conducted was in accordance with Government Auditing Standards.
- Monitor changes to the standards and make timely changes to policies.

Management's Response:

As noted in the finding the documentation maintained to demonstrate compliance with Government Auditing Standards will be improved. To accomplish this Texas Department of Criminal Justice Internal Audit Policies and Procedures Manuals will be updated to incorporate references to Government Auditing Standards.

The documentation maintained to ensure continuing education requirements are met will be adapted to specifically identify those hours directly related to the government environment or government auditing.

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Detailed Issues and Recommendations

Currently, Texas Department of Criminal Justice Internal Audit Reports cite performance in accordance with Government Auditing Standards. This practice will continue.

Texas Department of Criminal Justice Internal Audit will continue to monitor *standards* for both the Professional Practice of Internal Auditing and *Government Auditing Standards* to ensure any future changes are incorporated into policy in a timely manner.

Section 3:

The Internal Audit Function Is Effective in Two Effectiveness Criteria

- **Planning and conducting audits** - Internal Audit is effective in planning projects. It includes each audit objective identified by *Standards for the Professional Practice of Internal Auditors* when planning audits. Audit work meets objectives of the audit. Findings are supported by working papers and carried to the report. Reports are distributed to the Board, Executive Director, and auditees.

Special projects other than direct audit work are approved by and reported to the Board. Internal Audit follows audit standards for those special projects resulting in the issuance of a report. Special projects represented less than 10 percent of available planned audit hours for fiscal years 1995 and 1994.

- **Follow-Up on Audit Recommendations** - Internal Audit is effective in performing follow-up reviews on recommendations from prior audits. Internal Audit has a follow-up policy which was revised March 1, 1996. Follow-up reports include a brief explanation of delay of action or proposed solutions. Follow-ups typically provide a status report of corrective action taken by management. The status reports include:
 - Action items and identification numbers
 - People primarily responsible for the action item
 - Target date of implementation
 - Action plan status

Objectives, Scope, and Methodology

Objective

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, procedures, 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 were 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.

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

Objectives, Scope, and Methodology

- Generally Accepted Auditing Standards

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

- Scotty Killingsworth, CIA (Team Leader)
- Arthur B. Arispe
- Michelle A. Duncan
- Larry Vinyard, CPA, CIA (Project Manager)
- Linda C. Lansdowne, CPA (Quality Control Reviewer)
- Charlie Hrcir, CPA (Audit Manager)
- Deborah Kerr, Ph.D. (Audit Director)