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EXTERNAL QUALITY ASSURANCE

REVIEW REPORT

OFFICE OF INTERNAL AUDIT

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Executive Summary

Overview

Texas Government Code § 2102 (the Texas Internal Auditing Act) requires the program of internal audit at the Texas Facilities Commission (TFC) to be in conformance with the Institute of Internal Auditor's (IIA) International Standards for the Professional Practice of Internal Auditing (IIA Standards), the IIA's Code of Ethics, the IIA's Definition of Internal Auditing and with the Government Accountability Office's (GAO) Generally Accepted Government Auditing Standards (GAGAS), to be collectively referred to in this report as the *Standards*. These *Standards* require the Office of Internal Audit (OIA) to develop and maintain a Quality Assurance and Improvement Program (QAIP). The QAIP requires both internal and external assessments of the internal audit division. The *Standards* require the results of these assessments to be communicated to those charged with agency governance at least annually for internal assessments and every three years for external assessments. This report presents the results of the external assessment that was conducted in June 2017.

The primary intent of the review was to provide reasonable and objective assurance that the internal audit work being performed meets the requirements of the *Standards.* A secondary objective was to identify whether or not there are opportunities that would enhance the economy and efficiency of the audit process and improve the value of what the internal auditing activity contributes to TFC.

The scope of the review included an evaluation of:
- OIA's reporting relationship and communication with TFC's Commission;
- The department's independence and the objectivity of the audit work performed;
- Existing internal audit policies and procedures;
- The department's risk assessment and annual audit planning process;
- The planning process for individual audit projects;

- The audit methodologies used in performing the work;
- A representative sample of audit workpaper files and reports;
- The workpaper documentation that supported the work performed;
- The support for the conclusions and recommendations in the audit reports;
- How the results of audit are communicated;
- The procedures for following up on audit recommendations; and
- The knowledge, skills, discipline, and training of the staff.

Interviews were conducted with, among others: the Chair and Vice Chair of the Commission and each of the Commission members; the Executive Director; the General Counsel; the Deputy Executive Director of Planning and Real Estate Management; the Deputy Executive Director of Facilities, Design and Construction; the Director of Procurement; the Director of Human Resources; the Director of Information Technology; the Director of Safety and Security, the Chief Auditor; and the audit staff.

Opinion

Based on the work outlined above and on the information received and evaluated during this external review, it is my opinion that the Office of Internal Audit at the Texas Facilities Commission **generally conforms** to the *Standards.*

This opinion, which is the highest of three possible ratings, means that there are relevant structures, policies, procedures, and processes in place that comply with the requirements of both the IIA International Professional Practices Framework and the GAO's Government Auditing Standards in all material respects. Any deviations found between the *Standards* and the OIA policies, procedures, and practices, or the work performed, were judged to be insignificant.

It is important to note that the *Standards* are expressed in terms of broad concepts and objectives rather than detailed procedures, and their application requires the exercise of

professional judgement. The extent of internal audit policies and procedures and the manner in which they are implemented will depend upon a number of factors such as an audit activity's size and organizational structure, the nature of its audit responsibilities, its philosophy with respect to the degree of operating autonomy appropriate for its staff, and the expectations of its governing body. Variances in individual performance and professional interpretation affect the degree of compliance with internal audit policies and procedures; therefore, adherence to all policies and procedures in every case may not be possible. However, compliance does require adherence to prescribed policies and procedures in the majority of situations.

While all the requirements of the *Standards* are in place, there are governance issues beyond the control of OIA that are significantly hindering it from providing independent and objective services to the agency and the Commission. These issues are discussed under Agency Observations that follow.

OIA Observations

The Office of Internal Audit at the TFC consists of the Chief Auditor and two staff positions. The Chief Auditor reports directly to the Commission. It has a well-crafted Audit Charter that defines the department's purpose, authority, and responsibility and establishes it as an independent activity that is in line with the fundamental requirements of the *Standards* and the Texas Internal Auditing Act.

The Chief Auditor has over 25 years of internal auditing experience, and has six certifications relating to the practice of internal auditing that include, CPA (Certified Public Accountant), CIA (Certified Internal Auditor), and CISA (Certified Information Systems Auditor). The audit staff has extensive audit experience and each have multiple certifications, both are CPAs. Interviews with the Chief Auditor and the audit staff indicated that they are committed to finding ways that OIA can better work with agency management in helping it identify how the agency can better achieve its goals and objectives more effectively and efficiently.

As required by the *Standards,* the Chief Auditor has developed an annual risk assessment that, along with input from Commission members, agency leadership, division directors, and staff, is used to create an annual audit work plan. In developing the plan, the Chief Auditor has identified key risks for consideration into the audit plan and has developed an identification model that is used to risk rank key business process / audit areas based on those key risk factors. This audit work plan is then presented to the Commissioners for their approval. Typically the projects on the risk based plan comprise the majority of the work that would be expected to be undertaken by the OIA. At each monthly TFC Commission meeting the Chief Auditor presents a Monthly Status Report that enables the Commission to stay informed on the status of audit projects and the implementation of audit recommendations.

A sample of workpapers were reviewed and showed that the staff is proficient and knowledgeable in the areas they audit. The documentation in the workpapers was professionally done and supports a level of professional care that is appropriate for the complexities of the work being performed. The detail in the workpapers shows that audit projects are well planned; the audit programs outline the audit steps to be performed and are referenced to the documentation that evidences the work was performed; and the work performed supports what is communicated in the audit reports. There was evidence that the workpapers and the audit reports are reviewed by the Chief Auditor before any reports are issued.

Agency Observations

The interviews conducted during this review identified several issues that are hindering the OIA in its efforts to provide independent and objective services to the agency and the Commission. These issues include:

- A belief that the OIA is not independent but is an instrument that is being used to further the political agenda of some Commissioners.

Let me be very clear about the basis for this first comment. This observation came from an interview I had with the Executive Director (ED).

The ED believes that the Commission Chair wants to remove him as the ED. I could not find any direct evidence that the Commission Chair is trying to push this agenda. I also could not find anything in my review of the planning and work performed by the OIA that supports the ED's belief that OIA is out to discredit or provide support for removing the ED. The OIA is operating within the Audit Charter which has been approved by the Commission.

However, because the ED believes this to be the case, the ED has taken the position that the OIA is not independent and has encouraged his staff to not cooperate with the OIA. While there is some antidotal evidence that suggests that this negative attitude towards the OIA existed before the Commission Chair joined the agency, this is the ED's current expressed motivation for discrediting the OIA whenever it makes a comment or observation that could be interpreted to reflect negatively upon the ED's leadership. The ED's strategy appears to be, "When you don't like the message, attack and discredit the messenger". This attitude appears to be at the root of many of the negative observations expressed in the report.

TFC has a very good OIA. Unfortunately the OIA is not getting the cooperation it needs from agency management, and the Commission is not providing the OIA the support it needs to overcome this handicap.

- There is no clear guidance as to what the responsibilities are of the Commission Audit Work Group since the Chief Auditor reports to the Commission as a whole.
- Line management is usually cooperative and collaborative during an audit, agreeing with findings and recommendations. This changes when the Executive Director has management's responses redrafted changing the tone to be

defensive and adversarial. These adversarial management responses to reports are fueling a negative reputational risk for the agency.

- The anti-audit culture appears to be growing, fueled by the recent pushbacks from the Executive Director.

- There is a belief by employees in the agency that information shared with OIA is not confidential. This is being reinforced by a lack of reliable information from senior management addressing what information will be confidential when it is shared with OIA. The fear is that sharing information with OIA may jeopardize an employee's job if management thinks it reflects poorly on them.

Recommendation Summary

While the OIA at TFC generally conforms with the *Standards*, the following comments and recommendations are intended to build on the foundation that is already in place with the objective of improving the value of the audit work being performed by addressing the issues above.

The recommendations are divided into two groups; 1) recommendations made to the Texas Facilities Commission that would strengthen the Commission's governance over the internal audit activity; and 2) recommendations that relate specifically to the OIA and the Chief Auditor that would increase the efficiency and efficacy of the audit work that is performed. An outline of these recommendations is set forth below, followed by a discussion of each.

Part I - Recommendations for the Texas Facilities Commission

1. All requests to the Chief Auditor for information or projects from Commissioners should be approved by the seven-member Commission.

2. The Commission should document the purpose and responsibilities of the Audit Work Group.

3. Commission should have the General Counsel research and document a policy on what information from employees, when shared with OIA, can be expected to be kept confidential.

4. The Commission, working with the Executive Director, the General Counsel and the Chief Auditor, needs to identify and approve procedures the agency and OIA will follow when accessing electronic information considered confidential.

5. The Commission should receive reports regularly from the Chief Auditor on the support and cooperation OIA receives when conducting audit projects and hold the Executive Director accountable when personnel are uncooperative.

Part II - Recommendations for the Office of Internal Audit

1. Continue to define how the TeamMate software tool can be better incorporated into the OIA's work flow.

2. Consider using automated data analysis tools in planning and conducting audit work.

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Richard H. Tarr, CIA, CISA

Recommendations

Part I - Recommendations for the Texas Facilities Commission

1. <u>**All requests to the Chief Auditor for information or projects from Commissioners should be approved by the seven-member Commission.**</u>

The internal audit function in any organization is the Governing Board's (Commission's) and agency management's most effective tool in meeting its responsibilities and in helping the agency effectively and efficiently accomplish its objectives. Both must be confident that the internal audit activity is independent and objective in conducting audits. The value that an internal auditor brings to an organization is directly related to how independent and objective both parties believe the audit activity is when planning, conducting and reporting on the audit work that is undertaken.

Independence is an attribute of the audit function and objectivity is an attribute of the individual auditor. The internal audit activity must be independent, while internal auditors must be objective. Independence creates an environment that maximizes the likelihood of auditor objectivity. Independence within an organization works in two directions. The audit activity must be independent of the areas that they audit and at the same time must be independent from any undue influence from individual Commissioners. The Commission needs to ensure that the Chief Auditor can perform audit activities free from any actual or implied influence that may affect her objectivity, whether from individual Commissioners or agency management.

While a Commissioner can make any request of management for any information they deem pertinent, requests made to the Chief Auditor for information or the initiation projects should be approved by the seven-member Commission to ensure its transparency. The Chief Auditor should not be put in a position where it appears that the agendas of individual Commissioners are being served.

2. The Commission should document the purpose and responsibilities of the Audit Work Group

Currently there is no information available as to what the responsibilities are of the Audit Work Group (AWG). Traditionally audit activities would report to a Governing Board through an Audit Committee that will have an Audit Committee Charter defining their responsibilities in overseeing the internal audit activity and their communication with the Chief Auditor.

It's unclear what authority and/or responsibility the AWG has regarding the Chief Auditor and the OIA. The Charter for the Office of Internal Audit states that the Chief Auditor "is responsible for communicating and interacting directly with the seven-member Commission". This is further supported by the Texas Internal Auditing Act that requires the Chief Auditor to report to the governing board of the agency.

The AWG should not be making decisions on the timing of individual projects, the scope of individual audits, or what the Chief Auditor can put on the OIA agenda at a Commission meeting. In order to preserve the independence of the OIA activity these decisions should be made by the Chief Auditor. Any attempt to govern any decisions in these areas would significantly affect the independence of the OIA.

3. Commission should have the General Counsel research and document a policy on what information from employees, when shared with OIA, can be expected to be kept confidential.

Based on several interviews, there is a lot of uncertainty among many about what information employees can expect to be kept confidential when responding to questions from OIA and what information within the agency is considered confidential. This has resulted in many employees either hesitating when asked or not volunteering

information to OIA that could be a key to the successful completion of an audit project. If it was clear what information agency personnel are expected to share with OIA, and what will be kept confidential, projects could be completed faster and be more complete in their conclusions.

4. **The Commission, working with the Executive Director, the General Counsel and the Chief Auditor, needs to identify and approve procedures the agency and OIA will follow when accessing electronic information considered confidential.**

It has been clearly established in the OIA Charter, approved and endorsed by the Commission, that "OIA is granted unlimited access to all agency operations, records (in any form), physical properties, activities, personnel of the agency and of its contractors and subcontractors pertinent to the performance of its duties". The Charter makes no distinction between confidential and non-confidential information.

In the past, requests for electronic information have been unduly delayed while agency management debated what the procedure should be in granting access to OIA to information that may have had some element of confidentiality attached to it.

It's important for agency personnel to understand that they are expected to respond when OIA makes an information request, whether for confidential information or not. If the information is not confidential, then read-only access should be given immediately. There should not be a need to get anyone's permission because permission has already been granted by the Commission.

The only question that remains is if confidential electronic information is involved, what procedures are agency personnel and OIA expected to follow to insure that the

information remains confidential. Clear procedures for this process should be developed and communicated to all agency personnel and OIA.

5. **The Commission should receive reports regularly from the Chief Auditor on the support and cooperation OIA receives when conducting audit projects and hold the Executive Director accountable when personnel are uncooperative.**

The Chief Auditor should make the Commission aware of when management does not respond in a professional and timely manner to requests for information or responses to audit recommendations or anything else that impedes the OIA in conducting their work. The Executive Director sets the tone for the agency and when that tone is adversarial or undermines the mission of the OIA, the Commission should exercise its oversight responsibility.

Part II – Recommendations for the Office of Internal Audit

None of these recommendations are directed at addressing any deficiency in complying with the *Standards*. These recommendations are intended to enhance the internal audit activity at TFC and improve the efficiency and efficacy of the work it provides to the agency.

1. **Continue to define how the TeamMate software tool can be better incorporated into the OIA's work flow.**

Workpapers document the principal evidence and information obtained as well as the analysis that supports the basis for the observations and recommendations contained in the audit reports. It is important that the workpapers be organized so that they can "stand on their own" in supporting the conclusions and recommendations that are

contained in audit reports. While every audit conducted can be different, and carried out by different auditors, they all should be documented within a common framework. There is no question the work is being professionally conducted, and appropriately reviewed. The department should give consideration to:

- Implementing a numeric indexing method for the department's electronic workpaper folders and files. The index should identify the year and a unique identifier for projects within a year that can then be used to cross reference projects from the audit work plan, to the workpaper files, to the audit reports.

- More clearly identifying the disposition of the items identified in the steps in the audit program.

- Insuring the references forward from the audit steps documented in the workpapers to the items in the report and back to the audit steps are consistent.

- Implementing a standard workpaper sub-index scheme within the workpaper file folders that can identify the individual files that document the procedural steps that were performed within each project.

Chief Auditor Response:

We agree that workpapers should be organized so that they can stand on their own. These suggestions will be very useful to our relatively young team as it seeks ways to standardize workpaper documentation.

2. Consider using automated data analysis tools in conducting audit work.

The department should consider the use of automated data analysis tools to expand on their capabilities to conduct more proactive audit projects. One of the most significant changes that has occurred in the internal auditing profession in the last decade is the

extent to which auditors now recognize the importance of data analysis and the automation of audit and control testing procedures through the use of information technology (IT) data analysis tools.

Traditionally, an auditing department's testing of controls and compliance has been performed on a retrospective and cyclical basis, often months after business activities have occurred. Testing procedures are often based on a sampling approach and have included activities such as reviews of transactions, policies, procedures, approvals, and reconciliations. This approach has only afforded auditors a narrow scope of evaluation and can be late in heading off errors in business performance or regulatory compliance.

Data analysis is a method that can be used to perform control and risk assessments on a more extensive and frequent basis. The use of IT tools, like ACL and IDEA would allow auditors to more fully understand critical control points, rules, and exceptions. By conducting an analysis of the data, auditors will be able to analyze key business systems for both anomalies at the transaction level and for data-driven indicators of control deficiencies and emerging risks. Data analysis results could also be integrated into the department's risk assessment process, enabling the department to more effectively determine where the risks are in various business processes and aid in the follow-up of specific audit recommendations.

Chief Auditor Response:

We agree that data analytic tools could exponentially improve audit coverage and improve auditor understanding of key business processes and risk. OIA plans to seek resources for data analysis tools after the issue of OIA's access to agency electronic databases is fully resolved.