

October 23, 2013

Ms. Cynthia Villa
Chair, Board Audit and Finance Subcommittee
Texas Department of Information Resources
300 West 15th Street, Suite 1300
Austin, Texas 78701-1649

Dear Ms. Villa,

At the request of Andrew Dimas, Director of Internal Audit and as directed by The Texas Internal Auditing Act (the Act), Institute of Internal Auditors (IIA), and Generally Accepted Government Auditing Standards (GAGAS), we conducted an external quality assessment of the Internal Audit Department (Internal Audits) at the Texas Department of Information Resources (DIR). Our review was conducted September 18-20, 2013, and covered departmental activities from September 2012 through the date of our work. Members of the review team were Kimberly K. Hagara, CPA, CIA, CISA, CRMA, Associate Vice President, Audit Services, The University of Texas Medical Branch and Dale Hernandez, CIA, CGAP, CFE, CGFM, CCSA, CICA Internal Auditor, Texas State Preservation Board.

The principal objectives of the quality assurance review were to assess Internal Audit's conformity with auditing standards and the Act and to appraise the quality of their operations. Government auditing standards require these reviews at least every three years. A periodic external quality assurance review, or peer review, of the internal audit function is an essential part of a comprehensive quality assurance program. This quality assurance review was performed in accordance with State Agency Internal Audit Forum (SAIAF) Peer Review guidelines and to identify opportunities to enhance Internal Audit's management and work processes, as well as its value to the Texas Department of Information Resources.

Overall Opinion:

Based on the information received and evaluated during this external quality assurance review, it is our opinion that the Texas Department of Information Resources Internal Audit Department receives a rating of "pass" and is in compliance with the Institute of Internal Auditors (IIA) *International Professional Practices Framework* and Code of Ethics, the United States Government Accountability Office (GAO) *Government Auditing Standards*, and the *Texas Internal Auditing Act* (Texas Government Code, Chapter 2102). This opinion, which is the highest of the three possible ratings, means that policies, procedures, and practices are in place to implement the standards and requirements necessary for ensuring the independence, objectivity, and proficiency of the internal audit function.

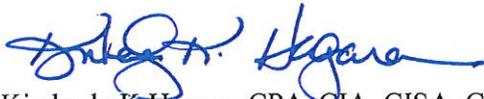
We found that the Internal Audit Department is independent, objective, and able to render impartial and unbiased judgments on the audit work performed. The staff members are qualified, proficient, and knowledgeable in the areas they audit. Individual audit projects are planned using risk assessment techniques; audit conclusions are supported in the working papers; and findings and recommendations are communicated clearly and concisely.

Internal Audit is generally well managed and has developed effective working relationships with the Board Audit and Finance Sub-committee and DIR leadership. Interviews conducted during the quality assurance review indicate that management considers Internal Audit a useful part of the overall agency operations and finds that the audit process and report recommendations add value and help improve the agency's operations.

Acknowledgements:

We appreciate the courtesy and cooperation extended to us by the Internal Audit Director, Internal Audit staff, the members of the Board Audit and Finance Subcommittee, the Executive Director, and the senior managers who participated in the interview process. The feedback from the interviews provided valuable information regarding the operations of the Internal Audit Department and its relationship with management.

Sincerely,



Kimberly K Hagara, CPA, CIA, CISA, CRMA
The University of Texas Medical Branch
Team Leader

c: Andrew Dimas

BACKGROUND

The Institute of Internal Auditors (IIA) International Professional Practices Framework, U.S. Government Accountability Office (GAO) Government Auditing Standards, and the Texas Internal Auditing Act require that internal audit functions obtain external quality assurance reviews to assess compliance with standards and the Act and to appraise the quality of their operations. Government auditing standards require these reviews at least every three years. A periodic external quality assurance review, or peer review, of the internal audit function is an essential part of a comprehensive quality assurance program. This quality assurance review was performed in accordance with State Agency Internal Audit Forum (SAIAF) Peer Review guidelines.

This is the first quality assurance review since the establishment of the Internal Audit Department in the fall of 2009. Significant progress has been made in the initial maturation of the function including: defining policies, processes, and procedures; establishing and uniformly applying management and professional practices within the internal audit function; aligning with the organization's business and risks; beginning to integrate as a team player providing advice on performance and management of risk; and conforming with IIA Standards. When considered in context of the IIA's various maturity models, Internal Audit is currently moving from an Emerging/Infrastructure (Level 2) to an Established/Integrated (Level 3) function. The implementation of additional strategic framework elements, expanded audit skillsets, performance metrics, and the establishment of a full quality assurance program will enhance the natural expected maturation of the program.

OBJECTIVES, SCOPE, AND METHODOLOGY

The primary objective of the quality assurance review was to evaluate the Texas Department of Information Resources Internal Audit Department's compliance with auditing standards and the Texas Internal Auditing Act. Additional objectives included identifying leading practices as well as areas with opportunities for enhancement may be needed. The review covered all completed audit and management assistance projects performed by the Texas Department of Information Resources Internal Audit Department from September 2012 through August 2013.

The work performed during the review included:

- Review, verification, and evaluation of the self-assessment prepared by the Internal Audit Department according to SAIAF guidelines.
- Interviews with the Internal Audit Director, Internal Audit Department staff, the Executive Director, six senior managers, and two Board members including the Chairman of the Board Audit and Finance Subcommittee.
- Review and evaluation of audit working papers.
- Review of Internal Audit's policies and procedures, annual risk assessment, annual audit plan, and other relevant documents.

DETAILED RESULTS

The results of the quality assurance review for the Texas Department of Information Resources Internal Audit Department (Internal Audit) are presented in the order of the *Standards for the Professional Practice of Internal Auditing*. No significant weaknesses were identified during the review that would prevent Internal Audit from fulfilling its responsibilities. The detailed results include identification of best practices as well as some opportunities for enhancement improvement that Internal Audit may wish to consider as the program continues to mature.

IIA Code of Ethics

Internal Audit demonstrates its commitment to the IIA *Code of Ethics* by referencing it in the Internal Audit Charter, attending periodic ethics training classes, and practicing ethical behavior in the course of daily work. In addition, the agency's Ethics Policy and fraud hotline are indications of an organization-wide commitment

to accountability and integrity.

Standard 1000: Purpose, Authority, and Responsibility

The purpose, authority, and responsibility of Internal Audit have been defined in a charter that is consistent with auditing standards. Although, the current charter was signed by the Board and the Executive Director in October 2010, it is in the process of being updated. It defines the nature of audit and consulting services and grants Internal Audit unrestricted access to agency records, property, and personnel.

Opportunity for Enhancement:

The Audit Charter indicates the Internal Auditor will have access to the agency's Executive Director. Review of the organizational chart and discussions with Board members indicated the Internal Auditor has a dotted line and administrative reporting relationship with the agency's Executive Director. Consideration should be given to modifying the language of the Audit Charter to more accurately reflect this relationship. Additionally, consideration should be given to annually reviewing and approving the Audit Charter.

Director's Response:

Internal Audit concurs with this enhancement to add clarity to the Internal Audit Charter regarding reporting relationships. Internal Audit and Executive management along with the Audit and Finance Subcommittee are currently reviewing proposed Audit charter revisions, and plan to present a draft Audit charter for Board approval at the October 31, 2013 Board meeting. Internal Audit will discuss consideration of annually reviewing and approving the Audit Charter with the Audit and Finance Subcommittee and Executive management.

Standard 1100: Independence and Objectivity

Internal Audit is independent both in terms of the agency's organizational structure and departmental practices. The Internal Audit Director reports directly to the Board Finance and Audit Subcommittee, which provides sufficient authority to promote independence and to ensure adequate consideration of audit reports and appropriate action on audit issues and recommendations. Removal of the Internal Audit Director requires Board approval.

Additionally, the charter helps ensure continued independence by specifying that internal auditors must remain free of operational and management responsibilities that could impair their ability to make independent reviews of all areas of the agency's operations. None of the internal auditors has had prior responsibility for any areas that Internal Audit audits. Additionally, auditors are required to sign independence statements for each audit they perform.

Standard 1200: Proficiency and Due Professional Care

The internal auditors individually and collectively generally possess the knowledge, skills, and abilities to perform their responsibilities. All of the auditors maintain multiple professional certifications including those as a Certified Internal Auditor, Certified Government Auditing Professional, Certified Public Accountant, Certified Fraud Examiner, or Certified Government Financial Manager. Although they are members of Information Systems Audit and Control Association (ISACA), none of the staff is a Certified Information Systems Auditor although one staff member has indicated an interest in pursuing this certification. The internal auditors are required by their certifications to continually enhance their knowledge, skills, and abilities by obtaining annually at least 40 hours of continuing professional education.

Opportunity for Enhancement:

While efforts are being made to ensure the department has the appropriate skillsets to perform information technology audits, the Department could benefit from an experienced Certified Information Systems Auditor (CISA). Consideration should be given to expanding the staff to

include a CISA or establishing a co-sourcing arrangement for additional expertise in this area when warranted by the audit plan.

Director's Response:

Internal Audit concurs with this opportunity for enhancement. While Internal Audit staff currently seeks training and certification in the areas of information technology (IT), the department and the agency would benefit greatly if it had an experienced CISA on staff. Internal Audit has leveraged existing DIR staff with significant IT knowledge to assist Internal Audit as appropriate. Internal Audit will consult with Executive management to determine the department's options for acquiring additional IT audit experience.

Standard 1300: Quality Assurance and Improvement Program

The Internal Audit Director has implemented a quality assurance and improvement program to help ensure that Internal Audit adds value and improves the agency's operations and to provide assurance that the Department complies with Standards and the IIA Code of Ethics. The quality assurance program involves auditor performance evaluations, recently established practice of auditee surveys after each audit, and the planned practice of regular peer reviews, which are communicated to the Board and senior leadership.

Standard 2000: Managing the Internal Audit Activity

The Internal Audit Director conducts an annual risk assessment forming the basis for the Annual Audit Plan. The annual plan is presented to the Audit and Finance Subcommittee and approved by the Board. The Director reports the Department's performance relative to the annual plan regularly to the agency's Executive Director, Audit and Finance Subcommittee, and Board. Based on the QAR team's review and understanding of the audit plan completion reports, engagement budget overruns, and engagement cycle time for the fiscal year 2012 and 2013 audit plans, there appears to be a need for improvement in either the annual auditing planning process or individual engagement scope management. While the annual plans appear to be addressing identified organizational risk, neither plan was completed due to budget overruns of completed projects which could result in insufficient risk coverage. The budget overruns can generally be attributable to either ineffective initial engagement time estimations or project scoping. Since this is a newer audit function, many of the audit projects are first time projects requiring more auditor planning, understanding, and time when developing the audit program to address the risks identified. The current time estimation process during the development of the audit plan does not appear to adequately consider these factors. We noted the completed engagements appear to have very comprehensive scopes, requiring significant additional audit work than initially may have been planned. Although a formal policies and procedures manual has not been developed, Internal Audit utilizes numerous templates to guide the internal audit activity. Additionally, an Annual Report on Internal Audit is submitted to the Governor's Office, Sunset Commission, Legislative Budget Board and the State Auditor.

Opportunity for Enhancement:

During the annual risk assessment and audit planning process, consideration should be given to identifying a preliminary scope for each engagement to allow for more realistic engagement time budgets. This approach may result in an overall reduction of proposed annual risk based audit projects due to the limited departmental resources. The Audit and Finance Subcommittee should consider the risk tolerance of the Board in determining whether this approach results in too much unaddressed risk. Alternate considerations could include either further refining of anticipated project scope or adding internal audit staff to ensure there is adequate audit coverage of identified risk based on the Board's risk tolerance.

Director's Response:

Internal Audit concurs with the enhancement. During the risk assessment and planning process, Internal Audit will identify the preliminary scope and continue to consult with the Audit and Finance

Subcommittee to discuss the possibility of unaddressed risk and the Board's risk tolerance while also improving engagement time budgets. Internal Audit will discuss with the Audit and Finance Subcommittee and Executive management alternatives to ensure adequate audit coverage to address any additional risk.

Standard 2100: Nature of Work

Internal Audit evaluates risks related to financial and operating information as well as the effectiveness and efficiency of operations, safeguarding of assets, and compliance with laws and regulations. The Internal Audit Department also evaluates the extent to which operating and program objectives have been achieved.

Standard 2200: Engagement Planning

During planning, internal auditors consider the objectives of the activity being reviewed and the related risks and controls. Resources needed for each audit are considered during planning. Risk assessments are used to develop the objectives of each audit. Interviews conducted during this quality assurance review indicated that the objectives of audits are clearly communicated to the auditees. An Audit Plan and an Audit Program are documented and approved for each audit. The scope of audits is adequately planned and documented in planning documents and audit reports.

Standard 2300: Performing the Engagement

Internal auditors evaluate and document sufficient, reliable, and relevant information to achieve their audit objectives. Results and conclusions are based on an appropriate level of analysis.

Audits are properly supervised and monitored by the Internal Audit Director. The Internal Audit Director attends planning meetings, approves all control documents, and reviews working papers to ensure sufficiency of evidence and compliance with Standards.

Standard 2400: Communicating Results

Audit results are communicated in a timely manner. Potential findings are communicated throughout the audits, which give management the opportunity to provide additional information and/or to start taking corrective action. Audit results are presented to management before they are finalized in a report, which helps ensure there is agreement about the areas for improvement and the recommended solutions.

Audit reports contain the audit objectives, results, conclusions, recommendations, and management's responses and action plans. The results of our interviews with management indicated that internal audit reports are accurate, objective, clear, concise, and complete. The Internal Audit Director distributes internal audit reports to the Board, to Executive Management, and to management of the activity audited.

Standard 2500: Monitoring Progress

The agency has established a system for monitoring the disposition of audit issues. The status of management's progress in implementing recommendations is periodically reported, and the results are made accessible to all levels of management.

Standard 2600: Resolution of Senior Management's Acceptance of Risks

During the quality assurance review, no instances were identified of management accepting an inappropriate level of risk that would require the Internal Audit Director to notify the Board.

LEADING PRACTICES

Internal Audit is dedicated to continuous improvement. During the quality assurance review, we observed a number of practices that demonstrate outstanding commitment and professionalism. These leading practices

include the following:

- Internal Audit has developed relationships with executive and division management based on mutual respect and commitment to improving controls within the agency.
- The internal auditors are professional and proficient. They collectively hold five different professional certifications. Certifications held include Certified Internal Auditor, Certified Public Accountant, Certified Fraud Examiner, Certified Governmental Accounting Professional, and Certified Governmental Financial Manager.
- All Internal Audit staff members obtain at least 40 hours of continuing professional education annually provided by auditing organizations including the State Auditor's Office (SAO) and local chapters of the Institute of Internal Auditors (IIA), the Information Systems Control and Audit Association (ISACA), the Association of Certified Fraud Examiners (ACFE), and the Association of Government Accountants (AGA). Agency managers stated in interviews that the internal auditors are competent professionals and are committed to public service.
- Internal Audit summarizes its audit engagement planning process in a comprehensive manner to include the identification of potential risks, testing methodology, preliminary interviews, and audit objectives and scope.
- Internal Audit develops quality observations and valuable recommendations.