



Chief Auditor's Office

An Audit Report for:

TCEQ Chairman Kathleen Hartnett White
TCEQ Commissioner Larry R. Soward
TCEQ Commissioner H.S. Buddy Garcia
TCEQ Executive Director Glenn Shankle

The TCEQ FY2008/2009 Biennial Audit Plan

August 2007

Report # 07-811

Chief Auditor's Office

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Texas Commission on Environmental Quality

FY2008/2009 Biennial Audit Plan

**Presented for Approval at the August 08, 2007
TCEQ Commissioners' Agenda**

Kathleen Hartnett White
Chairman, TCEQ

Glenn Shankle
Executive Director, TCEQ

H.S. Buddy Garcia
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Introduction

The Chief Auditor's Office appreciates the opportunity to provide our vision for audit activities at the Texas Commission on Environmental Quality (TCEQ) for the FY2008/2009 biennium.

This proposal is the result of a risk assessment process through which the Chief Auditor's Office conscientiously assessed risks related to internal agency processes as well as agency expenditures and revenue. We believe the areas identified for audit will result in the best return on the audit resource investment. This document presents our proposed internal and external audit project areas for the FY2008/2009 biennium and outlines our risk assessment methodology.

Purpose and Mission

This audit plan is required by the Texas Internal Auditing Act (Chapter 2102, Title 10, Govt. Code), *Government Auditing Standards*, and the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors (IIA).

The Chief Auditor's Office provides assurance and advisory services that help the Commissioners and management meet agency goals and objectives. We provide independent and objective information, analyses, and recommendations to assist management in effecting constructive change, managing business risk and/or improving compliance and accountability of the regulated community and business partners.

Audit Charter and Internal Auditing Definition

The Chief Auditor's Office Audit Charter, approved by the Commissioners, clearly defines the dual focus of Chief Auditor's Office on internal and external audit services. The Charter also defines our vision and philosophy, mission, scope of activities, responsibilities, authority, independence, professional standards, quality assurance processes, continuing professional development and reporting relationships.

While the focus of internal and external audit services differs, we believe all of the audit services provided by the Chief Auditor's Office fit under the definition of internal audit. As defined in the Charter, internal auditing encompasses the examination and evaluation of the adequacy and effectiveness of the agency's system of internal control and the quality of performance in carrying out the goals and objectives of the agency. The Texas Internal Auditing Act adopts the Institute of Internal Auditor's (IIA) definition of internal audit:

An independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

For more background information on Chief Auditor's Office, please see **Appendix A**.

Risk Assessment

Risk assessment, as defined by the IIA, is a "systematic process for assessing and integrating professional judgments about probable adverse conditions and/or events."

In conducting our risk assessment, the Chief Auditor's Office received input from TCEQ Commissioners, Executive Management, Deputy Directors and most Division Directors and Section Managers. All agency employees had the opportunity to provide input into our risk assessment through a formal, anonymous survey process.

For **internal audit** purposes, the Chief Auditor's Office identified the universe of auditable activities primarily as those activities conducted to address the strategies funded by the Appropriations Act.

Using the information gathered and our professional judgment, we grouped the universe of auditable activities into two major categories:

- Operational/Program
- Information Technology

We then risk ranked all identified activities within each category using specific elements of risk related to that category, including fraud risk. From this ranking, specific project topics were identified for each of the high risk areas. Lastly, we prioritized each potential project to determine which projects should be included in the proposed audit plan.

For **external audit** purposes, the universe of auditable activities included all expenditures made by the agency and all revenue due to the agency, excluding general operating costs.

We reviewed that universe and ranked the expenditure areas using the following elements of risk:

- Programs' recommendations for audits
- Dollar amount of revenues and expenditures
- Audit Staff's judgment based on prior audit experience
- Programs' oversight of vendors' compliance

We also reviewed the revenue areas using the following elements of risk:

- Estimated dollar amount of revenue
- Potential for underpayment of fees
- Audit Staff's judgment based on prior audit experience
- Programs' recommendations for audits

To ensure adequate coverage of both revenue sources and various agency expenditures, we evaluated risk in three major categories and selected projects in each of these major categories:

- Texas Emissions Reduction Grants and Contracts (TERP/LIRAP)
- Remediation, Reimbursements and Grant (RRG) Contracts
- Fee Payer Revenue

We then reviewed the TCEQ contracts for risks based on current expenditures, amount of oversight, types of deliverables, and other factors.

We will update our risk assessment as additional information is obtained and expenditures occur throughout the biennium. Our continuous evaluation of contracts will ensure the most efficient use of audit resources.

The risk assessment process included review of the project areas by the Chief Audit Executive to assure adequate coverage of risk and to avoid inappropriate duplication of coverage. The results of the process are presented in the following tables.

The Chief Auditor's Office will review the audit plan at the end of FY 2008. We will consult with the Commissioners and executive management to adjust the plan as needed based on priorities, management requests, workloads, changes in operations, and availability of audit resources. Through approval of this proposal, the Commissioners authorize the Chairman to approve any amendments to the audit plan that become necessary.

***P*roposed Audit Projects for Fiscal Years 2008/2009**

Audits in progress at the end of FY 2007 will be carried over to FY 2008. Following are the proposed audit projects and proposed alternative projects for the Chief Auditor's Office for the 2008/2009 biennium. Alternative projects are additional project areas that we believe could potentially benefit from the use of audit resources, but did not rise to the top of the list of potential audit areas. We typically complete these projects in circumstances where additional or substitute projects are required. The projects are presented as proposed and alternative Internal Audit Projects, External Audit Projects and Chief Auditor's Office-wide Projects.

| Proposed Internal Audit Project Areas |
|---|
| Remediation Division Management Control Audit |
| Waste Permits Division Management Control Audit |
| IT Project Management |
| Data Standards |
| IT Software Acquisition |
| General IT Controls / Data Security |
| IT Software Portfolio Management |
| Oracle Database Security |
| TERP- Grant Award Process |
| TERP- Grant Award Compliance |
| TERP- Monitoring Process |
| LIRAP- Advisory Service |
| RBIS- Advisory Service |
| Utilities & Districts Advisory Service |
| Environmental Impacts of the TCEQ Headquarters |
| Contract Initiation Process |
| Telework Program |
| Effectiveness of Advisory Boards |
| Contract Management Process |
| Field Operations - Regional Administrative Reviews (8 Projects) |
| Cost Recovery Follow-up |
| Agency Employee Funds (4 Projects) |

| Proposed Alternative Internal Audit Project Areas |
|--|
| Salary Administration |
| Monitoring Operations Management Control Audit |
| HB 1516 - Service Level Agreement |
| Electronic Information Retention Practices |
| Fleet Maintenance |
| Electronic Desktop Databases |
| TMDL Process |
| TERP Grant Award Compliance (2 Projects) |
| Radioactive Materials Division - Advisory Service |
| Employee Complaint Process |
| Protection of Portable IT Assets |
| Virtual Private Network Security |
| STEERS Project Management |
| Oracle Database Security (2 Projects) |
| Division Administrative Reviews |
| Regional Administrative Reviews |

| |
|---|
| Proposed External Audit Project Areas |
| Texas Emissions Reduction Plan / Low Income Vehicle Assistance Program |
| TERP Grant/Rebate Contracts (11 Projects) |
| New Technology Research & Development Contracts (2 Projects) |
| Low Income Vehicle Assistance Program (4 Projects reviewing multiple recipients) |
| Remediation, Reimbursements & Grant (RRG) Contracts |
| Solid Waste Management Grants |
| Petroleum Storage Tank Program Reimbursements (2 Projects) |
| Superfund Contracts |
| Total Maximum Daily Load Contracts |
| Dry Cleaning Facilities Remediation Contracts |
| Water Quality Clean Rivers Contracts |
| Ambient Air Monitoring Grants & Contracts |
| Biowatch Grant Contracts |
| Fee Payer Revenue |
| Hazardous Waste Management Fees (2 Projects) |
| Commercial Class 1 Management Fees |
| Municipal Solid Waste Fees |
| Dry Cleaner Solvent Fees (2 Projects) |
| Air Emissions Fees |
| Water Utility Regulatory Assessment Fees |

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| Proposed Alternative External Audit Project Areas |
| Texas Emissions Reduction Plan / Low Income Vehicle Assistance Program |
| TERP Grant/Rebate Contracts (Additional Projects as resources allow) |
| Low Income Vehicle Assistance Program (Additional Projects as resources allow) |
| Remediation, Reimbursements & Grant (RRG) Contracts |
| Contract Performance Audits (based on additional risk assessment of TCEQ contracts) |
| Additional Reimbursement Audits |
| Galveston Bay & Estuaries Contracts |
| Councils of Governments |
| Local Air Grants – Air Pollution Programs |
| Fee Payer Revenue |
| Watermaster Assessment Fee |
| Consolidated Water Quality Fee (WWI + WQA) |
| Hazardous Waste Generation Fee (HWG) |

At management's request, the Chief Auditor's Office developed a proposal to provide additional audit coverage of TERP and LIRAP reimbursements. If additional audit resources are provided, we anticipate auditing 80-100 TERP / LIRAP recipients per year. This would be greater audit coverage than with the current contract audit firm at a substantially lower cost. This projection is based on dedicating 4 full-time auditors (1 current FTE and 3 additional FTEs) to these initiatives. We estimate that 20 recipients can be audited for each additional audit resource.

Lastly, as an additional option, the Texas State Auditor's Office (SAO) has given preliminary indication that they are willing, under contract with TCEQ, to audit 20 TERP recipients in FY 2008. However, the SAO has estimated that the cost for auditing these 20 recipients as \$307,200 plus expenses.

| |
|---|
| Proposed Chief Auditor's Office-wide Project Areas |
| Self Assessment and Coordination of the Quality Assurance Review of the Chief Auditor's Office |
| Quality Assurance Reviews of Other Agencies (3 Projects) |
| Fraud, Waste and Abuse Investigations |
| Fraud, Waste and Abuse Refresher Training – Agency-wide |
| Internal Environment Survey - Advisory Service |
| Special Requests from Executive Director or Commissioners (2 Projects) |
| Proposed Alternative Chief Auditor's Office-wide Project Areas |
| Special Requests from Executive Director or Commissioners |

Acceptable Level of Risk

We believe that completing the projects proposed above, or appropriate alternatives, will reasonably cover the risks identified by the risk assessment.

While the list of proposed projects results from our consideration of a wide-ranging scope of auditable activities, it does not address or provide coverage for all TCEQ components or systems. Our goal is to optimize our resources to provide reasonable coverage in the areas we believe require the most attention.

Due to a variety of factors, some significant activities that might warrant review may not be carried forward to the list of proposed audit projects, but they did receive consideration.

Ultimately, we cannot address every risk area. It is important for the Commissioners and executive management to understand the limitations of the audit coverage and the attendant risks for areas not audited. In our opinion, this listing of proposed projects allocates audit resources to the most important priorities and significant risks of TCEQ and allows flexibility to address other risk areas that may become known during the biennium.

However, according to the Texas Internal Auditing Act, it is the governing board's responsibility to conclude whether resources are adequate to address the identified risks. Specifically, Senate Bill 1694 of the 78th Legislative Session amended the Texas Internal Auditing Act to require the governing board of a state agency to periodically review the resources dedicated to the audit program and determine if adequate resources exist to ensure that risks identified in the annual risk assessment are adequately covered within a reasonable time frame.

The Chief Auditor asserts that staff resources are adequate to address the high risk areas linked to proposed audit projects. Any additional audit coverage would require additional staff resources. Besides staff resources, the Chief Auditor's Office is provided with an operating budget to cover administrative costs. Budget limitations are not expected to have an impact on our ability to address the risks identified in this plan. In the past, when additional resources have been requested for specific audit needs, those resources have generally been made available. The Chief Audit Executive is confident that if it becomes necessary to request additional resources during this biennium, that request will be addressed in good faith.

Contingency

While we will always work to address any appropriate special requests, we have specifically set aside resources for two special requests from the Executive Director or the Commissioners.

Planning, Administrative & Other

A percentage of the total available audit hours is allocated to planning, administrative and other special projects. These projects include advisory services, follow-up and external auditor liaison duties.

Advisory Services

The auditing profession has gone through a redefinition of its focus of activities and has moved toward providing more advisory services to management. This has been our course of action for the past nine years. We continue to have staff members participating in agency committees and work groups as needed. We provide advice and suggestions on management issues, concerns, and draft policies and procedures. We welcome the opportunity to work proactively with agency management to assure proper controls are built into the agency processes as they are designed.

Follow-Up

Follow-up is an important part of our audit effort and is required by professional standards. The status of all recommendations is presented in mid-year and annual follow-up reports to the Commissioners and executive management. Follow-up reporting continues until all recommended actions and management action plans are implemented or the specific risk reported is otherwise mitigated or accepted.

External Auditor Liaison

The Chief Audit Executive serves as the liaison with the Texas State Auditor's Office (SAO), the Environmental Protection Agency's Office of the Inspector General (EPA-OIG), and other external audit groups having oversight responsibility for TCEQ activities. Audit staff will assist these external entities on their projects as appropriate. Our goal in the role of liaison is to provide assistance to the extent that professional and organizational reporting responsibilities allow. The Chief Auditor's Office will conduct examinations in a manner that allows for maximum audit coordination and efficiency.

Management Controls

Management is responsible for establishing a system of internal/management controls adequate to reasonably assure that established objectives are accomplished. During the 2008/2009 biennium, the Chief Auditor's Office will continue to provide agency managers with information on internal control processes and procedures. We have used, to good response, a model developed by the UT System Audit Office. The Levels of Internal Control Model contains the following control tiers:

- Level 1 Controls (Operating Controls)
- Level 2 Controls (Monitoring Controls)
- Level 3 Controls (Oversight Controls)
- Level 4 Controls (Internal Audit)

This model identifies the four levels of internal control and relates them to the three dimensions of transactions, time, and involvement in the process. The model and its application within TCEQ are shown in **Appendix B**.

Management controls are most effective when they are built into the organization's infrastructure and are a fundamental part of management's philosophy. Use of the model supports quality and empowerment initiatives, avoids unnecessary costs, and enables a quick response to changing conditions.

Closing

The Chief Auditor's Office thanks the TCEQ Commissioners for their consideration of this proposal. We look forward to helping TCEQ meet its objectives during this biennium.

For further information on the Chief Auditor's Office or the FY2008/2009 Biennial Audit Plan, please contact Steve Goodson, Chief Audit Executive at (512) 239-0780 or by email at sgoodson@TCEQ.state.tx.us.

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Appendices

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Appendix A

About the Chief Auditor's Office

Organization and Staffing

In FY 2007, the Chief Auditor's Office (CAO) was authorized eighteen-and-three-quarters (18.75) full-time equivalent positions: a Chief Audit Executive, two audit managers, one senior investigator, one administrative services coordinator, thirteen auditors, and one three-quarters-time auditor. Our FY2008/2009 Biennial Audit Plan was developed based on the assumption that these staff resources would be available for the coming biennium.

CAO staff members collectively have 118 years of agency experience, 154 years of auditing experience, four graduate degrees, and twenty-five professional certifications including:

- Certified Internal Auditor (CIA)
- Certified Information Systems Auditor (CISA)
- Certified Fraud Examiner (CFE)
- Certified Public Accountant (CPA)
- Certified Government Auditing Professional (CGAP)
- Certification in Control Self-Assessment (CCSA)

Additionally, one staff member is a candidate for the Certified Information Systems Auditor credential (has passed CISA Exam) pending completion of two years of information technology auditing.

Professional Organizations

CAO staff members actively participate in professional auditing and information systems organizations. These groups are excellent sources for obtaining information on auditing, accounting, and other professional issues:

- Institute of Internal Auditors (IIA)
- Information Systems Audit and Control Association (ISACA)
- Texas State Agency Internal Audit Forum (SAIAF)
- Association of Certified Fraud Examiners (ACFE)

Quality Assurance

Quality assurance is an important component in providing high quality auditing services. We conduct supervisory and quality assurance reviews of each project and the resulting audit report.

Additionally, audit standards require audit departments to have a periodic external quality assurance (peer) review. Prior to consolidating into the Chief Auditor's Office, both audit units were reviewed and received the rating of fully complies. Our next peer review will occur in FY 2008 and will include the entire Chief Auditor's Office.

Performance Measures

Chief Auditor's Office performance measures follow:

- Completion of 100% of the approved audit plan, allowing for appropriate project substitutions and amendments (Output).
- Percentage of prior audit recommendations that are in the process of being implemented or have been implemented. Combined performance target is 89% (Outcome).

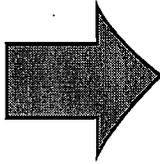
Additionally, the Chief Audit Executive uses the following to measure performance:

- By month and year: Percentage of time spent on Administration (15%); Professional Development (6%); Leave (17%); and Audit Projects (62%)
- For each project: Establishing and meeting realistic deadlines and budgeted hours to achieve audit objectives.

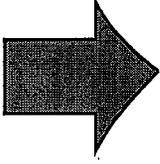
Levels of Internal Control

Appendix B

Items Affected



Involvement in Process



Isolated Items

Subset of Sample

Sample of Transactions

Every Transaction

Time

Internal Audit

Oversight Controls

Monitoring Controls

Operating Controls

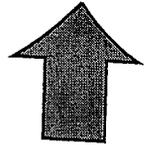
None

Little

Some

Totally

Real Time Soon After Periodically Annually



UT System
Audit Office
David B. Crawford
7/28/99

TCEQ Mission Statement

The Texas Commission on Environmental Quality strives to protect our state's human and natural resources consistent with sustainable economic development. Our goal is clean air, clean water, and the safe management of waste.

Chief Auditor's Office Mission Statement

The mission of the Chief Auditor's Office is to provide assurance and advisory services that help the Commissioners and management meet agency goals and objectives. We provide independent and objective information, analyses, and recommendations to assist management in effecting constructive change, managing business risk and/or improving compliance and accountability of the regulated community and business partners.

To obtain a copy of this report, please email ewhite@tceq.state.tx.us or call 512-239-0500.

