CHIEF AUDITOR'S OFFICE

An Audit Report for:
TCEQ Chairman Jon Niermann
TCEQ Commissioner Bobby Janecka
TCEQ Commissioner Catarina R. Gonzales
TCEQ Executive Director Kelly Keel

Fiscal Year 2025 Annual Risk Assessment and Audit Plan

August 2024

SFR-118/24/Report 24-811

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Introduction

The Chief Auditor's Office (CAO) appreciates the opportunity to provide our proposal for audit activities at the Texas Commission on Environmental Quality (TCEQ) for Fiscal Year (FY) 2025.

This proposal is the result of a risk assessment process through which the CAO reviewed risks related to internal agency processes, agency expenditures and revenue, and agency information technology. This document presents our proposed audit and advisory service project areas for FY 2025 and outlines our risk assessment methodology. We believe the areas identified for audit will result in the best return on the audit resource investment.

Purpose and Mission

This audit plan is required by the *Texas Internal Auditing Act (Chapter 2102, Title 10, Govt. Code, Vernon's Texas Codes Annotated)*, *Government Auditing Standards*, and the *International Professional Practices Framework* promulgated by the Institute of Internal Auditors (IIA). The CAO 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.

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

Audit Charter and Internal Auditing Definition

The Chief Auditor's Office *Audit Charter* (Charter), approved by the Commission in March 2024, defines the roles of the CAO related to assurance and advisory services performed by the office. The Charter also defines the CAO's mission, scope of activities, responsibilities, authority, independence, professional standards, quality assurance processes, continuing professional development, and reporting relationships.

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 governance, risk management, and control processes.*

Types of Engagements

The CAO performs assurance engagements and consulting engagements.

Assurance Engagements

Most assurance engagements undertaken by the CAO are performance audits or Agreed-Upon Procedure engagements (AUPs). Governmental Auditing Standards define performance audits as follows:

> *"Performance audits provide objective analysis, findings, and conclusions to assist management and those charged with governance and oversight with, among other things, improving program performance and operations, reducing costs, facilitating decision making by parties responsible for overseeing or initiating corrective action, and contributing to public accountability."*

AUP engagements are a form of attestation engagement in which CAO staff are engaged by TCEQ management to issue a report of findings based on specific agreed-upon procedures

applied to specific subject matter. Recommendations for corrective action are not included in AUP reports.

Consulting Engagements

Consulting services are advisory in nature and are performed at the request of the client. These engagements are also known as Advisory Services or Agreed-Upon Procedures and are intended to add value and improve an organization's governance, risk management, and/or control processes. Consulting engagement reports provide information that can be used by management in its evaluation of Program area processes. CAO staff members perform these engagements pursuant to engagement letters signed by its client and assume no management roles or responsibilities.

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."* The COSO[1] Internal Control – Integrated Framework[2] states, *"Risk assessment involves a dynamic and interactive process for identifying and assessing risks to the achievement of objectives."* These risk assessments identify a variety of risks including agency operations, contract management and information technology risks. No additional risks were identified and ranked as "high" that have not been included in the FY 2025 audit plan.

In conducting our risk assessment, the CAO received input from TCEQ Commissioners, Executive Management, Office Directors, selected Division Deputy Directors, and TCEQ staff members. We also evaluated past audits conducted by the CAO and the Texas State Auditor's Office (SAO), the most recent Sunset review of the Agency, as well as issues that were deemed to be of interest to the public, the Governor, and Legislature of the State of Texas.

During this risk assessment process, the CAO identified the universe of audit risks associated with Agency activities and categorized them. We then risk ranked the identified activities using specific elements of risk related to their category, including fraud risk as appropriate. Using these rankings, we identified potential audit projects for each of the high-risk areas. We prioritized each potential project to determine which projects should be included in the proposed audit plan for the upcoming fiscal year.

For Assurance Service purposes, we identified the universe of auditable activities primarily as those activities conducted to address the strategies funded by the *General Appropriations Act* and fees collected by the TCEQ. This universe of auditable activities includes the information technology systems and processes that support the agency's activities. Also included in the universe of auditable activities were all fees collected by the TCEQ and all contracts executed by the agency.

Risk assessment is an ongoing function of the CAO, and we will update our risk assessment as additional information is obtained throughout the coming fiscal year. Our continuous evaluation of agency risks will ensure the most efficient use of audit resources. 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.

Alternative projects were also identified. These projects are additional areas that we believe could benefit from the use of audit resources but did not rise to the top of the list of potential

[1] The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is an initiative of five organizations that provide frameworks and guidance on enterprise risk management, internal control and fraud deterrence. The organizations include: America Accounting Association, American Institute of Certified Public Accountants, Financial Executives International, The Association of Accountants and Financial Professionals in Business, and The Institute of Internal Auditors. (source: www.coso.org)
[2] COSO, *Internal Control – Integrated Framework – Executive Summary* (May 2013), 4.

audit areas. We seek approval to use them as alternative projects in circumstances where additional or substitute projects are required.

Through approval of this proposal, the Commission authorizes the Chairman to approve any amendments to the audit plan that become necessary.

Proposed Audit and Consulting Projects for Fiscal Year 2025

Below are the proposed projects for Audit Services, Information Technology Audits, Advisory Services, and Office-wide Projects to be conducted by the CAO.

Proposed Audit Services Projects:

FY 2024 Carry Over Projects:

24-303 | Review of Salaries Allocated to the Texas Emissions Reduction Plan (TERP) Trust

24-010 | Cybersecurity Threat Detection & Remediation Process

FY 2025 Assurance Projects:

Performance Measures Engagements (4 engagements; Offices of Air, Water, Waste, and Compliance and Enforcement)

Regional Office Review - Central Texas Area

TAC 202 (Information Security Standards) Compliance

CAPPS Financial Audit - Asset Processes

TERP Grant Award Process

Monitoring of Mandatory TERP Reporting

Contract Monitoring (Review of up to 2 contracts to be determined)

Review of Selected CAPPS Financial Processes

FY 2025 Proposed Consulting Project:

Advisory Service - Sunset Follow-up

Proposed Alternative Projects:

TERP Trust Financial Processes

Review of the Enforcement Process

Other CAO Office-wide Projects:

Audit Follow-ups (Fall and Spring)

CAO Quarterly Reports

Client Assistance/Consulting

CAO Annual Internal Audit Report FY 2024

FY 2026 Annual Risk Assessment and Audit Plan

Special Requests from the Commissioners or Executive Director

Fraud, Waste, and Abuse Investigations

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 fiscal year.

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 CAO is provided with an operating budget to cover administrative costs. In the past, when additional resources have been requested for specific audit needs, those resources have generally been made available. The Chief Auditor is confident that if it becomes necessary to request additional resources that our 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 special requests from the Commissioners and/or the Executive Director.

Planning, Administrative & Other

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

Other Services

We plan to continue to have audit staff members participating ex-officio in agency committees and work groups as needed and directed by the Commissioners or requested by Executive Management. We provide advice and suggestions on management issues, concerns, and review draft policies and procedures upon request.

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 Fall and Spring follow-up reports to the Commission 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 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 aid agency staff to the extent that professional and organizational reporting responsibilities allow. The CAO will conduct these services in a manner that allows for maximum audit coordination and efficiency.

Management Controls

Management controls are most effective when they are integrated into the organization's infrastructure and are a fundamental part of management's philosophy. Management is responsible for establishing a system of internal/management controls adequate to reasonably assure that established objectives are accomplished. The COSO *Internal Control - Integrated Framework* states, *"Internal Control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives..."* Performance audits performed by the CAO will include evaluation of established internal controls that are identified as significant to engagement objectives.

Closing

The CAO thanks the TCEQ's Commission, management, and staff for their involvement in the development of this proposal. We look forward to helping TCEQ meet its objectives during this upcoming fiscal year. For further information on the CAO or the FY 2025 Annual Audit Plan, please contact Chief Auditor Mike Hardison, at (512) 550-2652 or by email at mike.hardison@tceq.texas.gov.

Project Team

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Mike Hardison, CPA, CFE, CISA, Chief Auditor

Appendix A

About the Chief Auditor's Office

Organization and Staffing

For FY 2025, the CAO has been authorized 16 full-time equivalent positions: A Chief Auditor, three (3) audit Work Leads, one (1) Senior Investigator, one (1) Executive Assistant, and ten (10) auditors. Our FY 2025 Annual Audit Plan was developed based on the assumption that these staff resources would continue to be available for the remainder of the fiscal year.

CAO staff members collectively have 103 years of agency experience, 248 years of auditing experience, and 19 professional licenses and certifications including:

- Certified Public Accountant (CPA)
- Certified Internal Auditor (CIA)
- Certified Information Systems Auditor (CISA)
- Certified Fraud Examiner (CFE)
- Certified Government Auditing Professional (CGAP)
- Certification in Risk Management Assurance (CRMA)
- Certified Internal Controls Auditor (CICA)

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)
- Association of Certified Fraud Examiners (ACFE)
- Texas State Agency Internal Audit Forum (SAIAF)

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, professional standards require audit departments to have a periodic external quality assurance (peer) review. The most recent peer review report received by the CAO was dated as of July 2023. The CAO received a rating of "Pass/Generally Conforms" from its Peer Reviewer. That rating is the highest possible Peer Review rating and represents the conclusion that the CAO's system of quality control has been suitably designed and complied with to provide reasonable assurance that engagements are performed and reported in conformity with professional standards and applicable legal and regulatory requirements in all material respects. Our next review will be completed during FY 2026.

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.

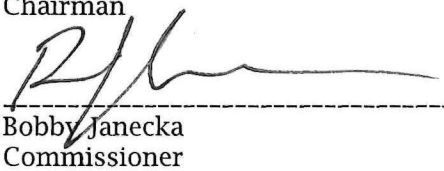
To obtain a hard copy of this TCEQ Audit Report,
please e-mail IntAudit@tceq.texas.gov or call 512-239-0500.

To report Fraud, Waste, or Abuse please e-mail Fraud@tceq.texas.gov
or call 512-239-0700 or 1-877-901-0700.

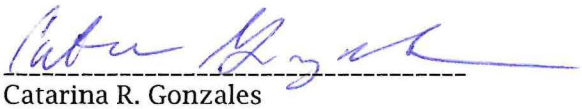
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Annual Risk Assessment and Fiscal Year 2025 Audit Plan
Presented for Approval at the August 28, 2024
TCEQ Commissioner's Agenda

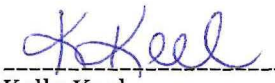
Jon Niermann
Chairman



Bobby Janecka
Commissioner



Catarina R. Gonzales
Commissioner



Kelly Keel
Executive Director

Mike Hardison
Chief Auditor