



RAILROAD COMMISSION OF TEXAS

INTERNAL AUDIT

October 26, 2016

Ms. Lisa Collier, First Assistant State Auditor
State Auditor's Office
1501 N. Congress Ave.
Austin, Texas 78701

Re: Fiscal Year (FY) 2016 Internal Audit Annual Report

Dear Ms. Collier:

Chapter 2102 of the Texas Government Code requires that each state agency submit an annual audit report to the State Auditor's Office (SAO) by November 1 of each year.

In accordance with the statute, the FY 2016 Internal Audit Annual Report for the Texas Railroad Commission (RRC) is attached. The design of the report and the information contained within the report comply with the form and content requirements prescribed by the SAO.

Should you have any questions regarding this report, please do not hesitate to contact me at (512) 463-6502.

Sincerely,

A handwritten signature in blue ink that reads "Paul S. Delaney".

Paul S. Delaney, CPA
Internal Auditor
Railroad Commission of Texas

Attachments: FY 2016 Internal Audit Annual Report
FY 2017 Internal Audit Plan
Final Report – External Quality Assurance Review

Cc: Kimberly Corley, Executive Director, Railroad Commission of Texas
Drew DeBerry, Governor's Office of Budget, Planning and Policy
Julie Ivie, Legislative Budget Board
Ken Levine, Sunset Advisory Commission

FISCAL YEAR 2016 INTERNAL AUDIT ANNUAL REPORT

I. Compliance with Texas Government Code, Section 2102.015: Posting the Internal Audit Plan, Internal Audit Annual Report, and Other Audit information on Internet Web site

The FY 2017 Internal Audit Plan was approved by the agency's Commissioners on October 25, 2016. In accordance with the reporting requirements of Section 2102.015 of the Texas Government Code, the FY 2016 Internal Audit Annual Report (which includes the FY 2017 Internal Audit Plan) will be posted to the Railroad Commission's website no later than November 1, 2016.

II. Internal Audit Plan for Fiscal Year 2016

- Information Services (Central Records) – Completed on February 11, 2016
- Oil & Gas Division (Technical Permitting) – Completed on September 29, 2016
- Purchasing
- Human Resources

III. Consulting Services and Non-audit Services Completed

None

IV. External Quality Assurance Review (Peer Review)

The RRC's Internal Audit Department received an external quality assurance review during FY 2014. The peer review report is dated August 2014 and a rating of "pass" was received. A copy of the peer review report is attached.

V. Internal Audit Plan for Fiscal Year 2017

An annual risk assessment was performed which took the following risk factors into consideration:

- Strength of internal controls
- Number of years since last audit
- Number of findings on last audit
- Processing of cash payments
- Processing of credit card payments

Based upon the results of the annual risk assessment, the internal auditor developed the FY 2017 Internal Audit Plan. Contract management and other requirements of Senate Bill 20 were given due consideration. The scheduled engagements and their estimated number of hours to complete are shown below.

- Human Resources – 495 hours
- Oil & Gas Division (Drilling Permits) – 535 hours
- Oversight & Safety (Alternative Fuels Safety) – 610 hours

A copy of the agency's approved FY 2017 Internal Audit Plan is attached.

FISCAL YEAR 2016 INTERNAL AUDIT ANNUAL REPORT (*Cont'd*)

VI. External Audit Services Procured in Fiscal Year 2016

None

VII. Reporting Suspected Fraud and Abuse

The Commission is in compliance with the fraud reporting requirements contained in Section 321.022 of the Texas Government Code and Section 7.09 of the General Appropriations Act. The RRC's intranet homepage contains an internal Fraud Hotline to assist any employee who wishes to anonymously report fraud, waste or abuse within the agency. In addition, the website also contains a direct link to the SAO Fraud Hotline in case an employee wishes to send their complaint directly to the state auditor.





RAILROAD COMMISSION OF TEXAS
INTERNAL AUDIT
MEMORANDUM

TO: Chairman David Porter
Commissioner Christi Craddick
Commissioner Ryan Sitton

FROM: Paul S. Delaney, CPA
Internal Auditor

DATE: October 25, 2016

SUBJECT: Proposed Internal Audit Plan for Fiscal Year 2017

October 25, 2016		
APPROVED	DENIED	ABSTAIN
		

Chapter 2102 of the Texas Government Code requires state agencies to develop an annual Internal Audit Plan that is prepared using risk assessment techniques and that identifies the individual audits to be conducted during the year. The Internal Audit Plan must be approved by the agency's governing board or by the administrator of a state agency if the state agency doesn't have a governing board. Once approved, the plan will be included in the agency's 2016 Annual Audit Report, which is due to the State Auditor's Office no later than November 1, 2016.

As per the statute, the Internal Audit Department has performed a risk assessment to determine which areas within the agency should be considered for audit. Based upon that risk assessment, the following areas are recommended for audit in FY 2017:

- Human Resources
- Oil & Gas Division – Drilling Permits
- Oversight & Safety – Alternative Fuels Safety

Your approval of the proposed Internal Audit Plan is requested.

Cc: Kimberly Corley, Executive Director

**REPORT ON THE
EXTERNAL QUALITY ASSURANCE REVIEW
OF THE RAILROAD COMMISSION OF TEXAS
INTERNAL AUDIT DEPARTMENT**

August, 2014



PERFORMED BY

**DARRELL CARTER
INTERNAL AUDITOR
PUBLIC UTILITY COMMISSION OF TEXAS**

**PERFORMED IN ACCORDANCE WITH THE
STATE AGENCY INTERNAL AUDIT FORUM
PEER REVIEW POLICIES AND PROCEDURES**

OVERALL OPINION

Based on the information received and evaluated during this external quality assurance review, it is our opinion that the Railroad Commission's 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 Audit 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.

The Internal Audit Department is well managed internally. In addition, the Department has effective relationships with the Board and is well respected and supported by management. Surveys and 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 Commission, the Executive Director, and the senior managers who participated in the interview process. We would also like to thank each person who completed surveys for the quality assurance review. The feedback from the surveys and the interviews provided valuable information regarding the operations of the Internal Audit Department and its relationship with management.

Darrell Carter, CIA, CRMA
Internal Auditor
Public Utility Commission of Texas
SAIAF Peer Review Team Leader

Date August 12, 2014

BACKGROUND

The Institute of Internal Auditors (IIA) *International Professional Practices Framework*, U.S. Government Accountability Office (GAO) *Government Auditing Standards*, and the Texas Internal Audit 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.

OBJECTIVES, SCOPE, AND METHODOLOGY

The primary objective of the quality assurance review was to evaluate the Railroad Commission Internal Audit Department's compliance with auditing standards and the Texas Internal Auditing Act. Additional objectives included identifying best practices as well as areas where improvement may be needed. The review covered all completed audit and management assistance projects performed by the Railroad Commission's Internal Audit Department from August, 2013 through July 2014.

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.
- Review and evaluation of e-mailed surveys completed by management.
- Interviews with the Internal Audit Director, Internal Audit Department staff, the Executive Director and six staff members.
- 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 Railroad Commission's Internal Audit Department 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 the Department from fulfilling its responsibilities. The detailed results include identification of best practices as well as some opportunities for improvement that the Internal Audit Department may wish to consider.

IIA Code of Ethics

Internal Audit demonstrates its commitment to the IIA *Code of Ethics* by including it in the *Internal Audit Policies and Procedures Manual*, 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. The current charter was signed by the Board and the Executive Director in *June, 2013*. It defines the nature of audit and consulting services and grants the Internal Audit Department unrestricted access to agency records, property, and personnel.

Standard 1100: Independence and Objectivity

The Internal Audit Department is independent both in terms of the agency's organizational structure and the Department's practices. The Internal Audit Director reports directly to the Board, 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.

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 the Department audits. In addition, 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 possess the knowledge, skills, and abilities to perform their responsibilities. All of the staff has at least one relevant professional certification. Internal auditors are required by the Department's policies and procedures to enhance their knowledge, skills, and abilities by obtaining at least 40 hours of continuing professional education each year.

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, and periodic peer reviews, which are communicated to the Board and made available on the agency's Intranet. Each audit report indicates that the work was performed in accordance with *Standards*.

Opportunity for Improvement:

The Railroad Commission's Internal Audit Department should continue to develop and utilize a post audit survey. A post audit survey will allow Internal Audit to obtain feedback from management which can be used to improve the quality of the audit work.

Director's Response:

We agree with the peer reviewer's recommendation. Beginning in FY 2015, post-audit surveys will be conducted at the conclusion of each engagement.

Standard 2000: Managing the Internal Audit Activity

The Internal Audit Director conducts an annual risk assessment that forms the basis for the Annual Audit Plan, which is approved by the Board. Each internal audit report addresses risk and control issues within the agency. The Director has developed policies and procedures to guide the internal audit activity. The Director reports the Department's performance relative to the annual plan in an annual report submitted to the agency's Executive Director, the Commission and in an Annual Report on Internal Audit submitted to the Governor's Office and the State Auditor.

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 Department also evaluates the extent to which operating and program objectives have been achieved.

To comply with the 2002 revision to the IIA *Standards* that requires Internal Audit to contribute to the organization's risk management and governance processes, the Department provides information and assistance to Executive Management and the Board about how the accomplishment of goals is monitored and how accountability is ensured.

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 adequately considered during planning. Risk assessments are used to develop the objectives of each audit. Surveys and 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 analysis. Department policies and procedures contain guidance on sampling techniques.

Audits are properly supervised by the Internal Audit Director. The Auditor-in-Charge for each project monitors the progress of the individual audits. 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 provide management the opportunity to provide additional

RAILROAD COMMISSION OF TEXAS INTERNAL AUDIT DEPARTMENT
EXTERNAL QUALITY ASSURANCE REVIEW – AUGUST, 2014

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 surveys and 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 being audited.

Standard 2500: Monitoring Progress

The agency has a system for monitoring the disposition of audit issues. The status of management's progress in implementing recommendations is reported semi-annually, and the results are made accessible to all levels of management. Additionally, the Department verifies recommendations that have been implemented and assesses their effectiveness during the survey phase of audits and as time permits during the year.

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.

BEST PRACTICES

Internal Audit is a progressive division that 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:

- IA has relationships with executive and division management based on mutual respect and commitment to improving controls within the agency. The IA Director and staff work in concert with executive management on diverse audit assurance and consulting projects.
- The internal auditors are professional and proficient. They collectively hold three professional certifications and two graduate degrees. Certifications held include Certified Internal Auditor and Certified Public Accountant.
- All IA staff members obtain at least 80 hours of continuing professional education each two-year period provided by local professional 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.
- IA has developed the *Internal Audit Policies & Procedures Manual*, an excellent guide that provides direction to staff auditors and assures more consistent IA practices.
- IA 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.

Christi Craddick, Railroad Commission of Texas, Chairman

Milton Rister, Executive Director

Paul Delaney, Internal Audit Director