

MANAGEMENT**OBJECTIVE(S)**[Return to Table of Contents](#)

To ensure that the internal audit function is assisting entity administrators and the board by furnishing independent analyses, appraisals, and recommendations about the adequacy and effectiveness of:

- the entity's systems of internal control policies and procedures
- the quality of performance in carrying out assigned responsibilities

BACKGROUND

The Texas Internal Auditing Act establishes requirements for a program of internal auditing for the state entities. The Act became effective September 1, 1989, and was amended to include annual reporting requirements effective September 1, 1991. The affected state entities shall conduct a full-time program of internal auditing. The program should have an annual audit plan, prepared using risk assessment techniques, which identifies the individual audits to be conducted during the year. The plan should include periodic audits of the entity's major systems and controls. These include the systems and controls for accounting, administrative, and electronic data processing.

The Act requires the internal audit program to conform to:

- The Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors (IIA)
- Generally accepted government auditing standards, (GAO)
- The Certified Internal Auditor Code of Professional Ethics
- The Statement of Responsibilities of Internal Auditing (IIA)

DEFINITIONS**(in alphabetical order)**

The **Act** means the Texas Internal Auditing Act.

The **Administrator** means the executive head of a state agency.

Audit is defined in the Texas Government Code annotated, Chapter 321. The types of audits set out in the Code are described as:

- **financial audits**
- **compliance audits**
- **economy and efficiency audits**
- **effectiveness audits**
- **investigations**

The term **board** includes boards of directors, audit committees of such boards, heads of agencies to whom internal auditors report, and any other designated governing bodies of organizations.

The terms **director of internal auditing** and **director** identify the top position in an internal audit department.

Generally accepted government auditing standards (GAGAS) (the "Yellow Book"). These standards are to be followed by auditors and audit organizations when required by law, regulation, agreement, contract, or policy. The standards

pertain to auditors' professional qualifications, quality of audit effort, and are characteristic of professional and meaningful audit reports.

Internal auditing is described in the Statement of Responsibilities of Internal Auditing as an independent appraisal activity within an organization for the review of operations as a service to management. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls.

Standards for the Professional Practice of Internal Auditing differentiate among the varied responsibilities of the organization, the internal audit department, the director of internal auditing, and internal auditors. The Standards encompass:

- The independence of the internal audit department from the activities audited and the objectivity of internal auditors.
- The proficiency of internal auditing work.
- The scope of internal auditing work.
- The performance of internal auditing assignments.
- The management of the internal audit department.

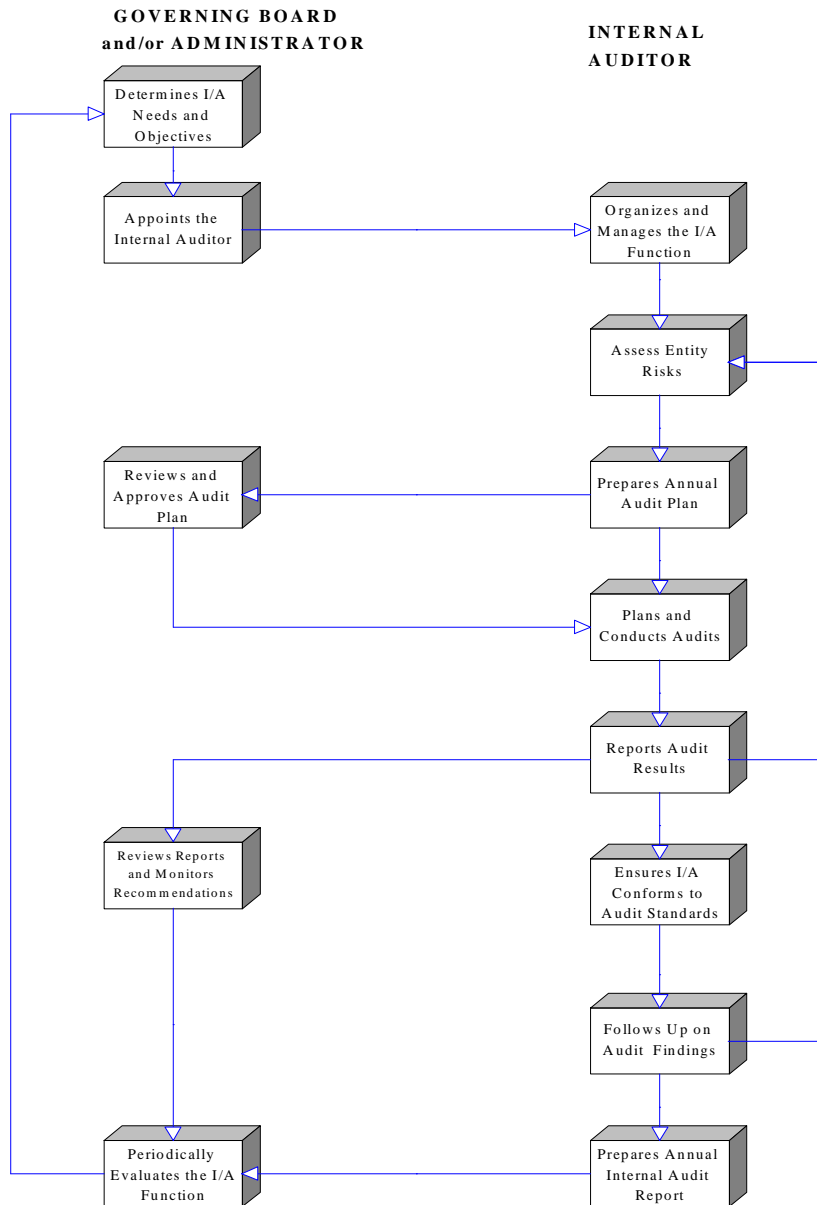
State Agency includes a department, board, bureau, institution, commission, or other agency of the State.

OVERVIEW OF THE PROCESS

The basic phases of establishing and maintaining an internal audit function for the state entities are:

- Determine internal audit needs and objectives.
- Appoint an internal auditor.
- Organize and manage the internal auditor function.
- Assess entity risks.
- Prepare the annual audit plan.
- Review and approve the audit plan.
- Plan and conduct the audits.
- Report the results of the audits.
- Ensure the function conforms to audit standards.
- Review reports and monitoring implementation of recommendations.
- Follow up on actions taken on recommendations.
- Prepare the annual internal audit report.
- Periodically evaluate the internal audit function.

The basic process for establishing and maintaining an internal audit function is set out for the board, or administrator, and the internal auditor:



PROCEDURES

Suggested procedures, organized according to the elements of a finding, are listed below. They should be expanded or tailored to fit the specific entity being reviewed.

Note: The following procedures and the process described above are normative, rather than prescriptive. That is, they represent "average" or baseline thinking since they assemble information which repeatedly appeared in the various resources used to prepare this module. Do not be too hasty or literal in applying a given criterion or procedural step to a specific entity. While omissions or variations may be obvious, judgment must still be used to determine whether such omissions or variations are material.

**Review criteria:
General criteria**

The internal audit program must meet the requirements of the Texas Internal Auditing Act. The Act requires the internal audit programs meet the following standards:

- The Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors (IIA)
- Generally accepted government auditing standards, (GAO)

The Project Procedures Manual (PPM) for the Texas State Auditor’s Office includes the evaluation process for compliance with the financial auditing standards of GAGAS. *The PPM* also addresses procedures to determine compliance with the requirements of SAS 65: The Auditor’s Consideration of the Internal Audit Function in an Audit of Financial Statements. See also:

- Procedures for relying on the work of others as set out in the *PPM*.
- The SAO has developed audit materials to satisfy SAS 65. The materials are in the form of audit programs and questionnaires and are available in the Statewide Audit Materials Package.

Specific criteria

Management and audit criteria related to the specific phases of the internal audit function is in the Texas Internal Auditing Act.

Determine Internal Audit Needs and Objectives

- The board, or the administrator of an entity without a board, should determine the needs and objectives of the internal audit function.
- The Act requires state entities to conduct a full-time program of internal auditing.
 - The Act applies to state agencies that meet one or more of the following criteria:
 - ... have an operating budget exceeding \$10 million annually
 - ... have a staff of more than 300 employees
 - ... receive and process cash items greater than \$10 million
- The program of internal auditing shall include:

- periodic audits of the entity's major systems and controls including:
 - ... accounting systems and controls
 - ... administration systems and controls; and
 - ... electronic data processing systems and controls.
- economy and efficiency audits and program result audits as directed by the board.

Appoint an Internal Auditor

- The board of the entity, or the administrator for an entity without a board, shall appoint the internal auditor.
- The internal auditor must be:
 - a certified public accountant or certified internal auditor
 - have at least three years of auditing experience

Organize and Manage the Internal Audit Function

- Duties of the internal auditor
 - report to the entity's board
 - prepare a written charter for the internal audit department
 - develop an annual audit plan
 - conduct audits specified in the plan
 - prepare audit reports
 - prepare the annual internal audit report
 - conduct quality assurance reviews and periodically take part in an external peer
 - comply with statutory requirements of state agency internal auditors

Assess Entity Risks

- The annual audit plan shall be prepared using risk assessment techniques.
- The risk assessment should be conducted annually. The process should be reviewed and updated throughout the year.

Prepare the Annual Audit Plan

- The program should have an annual audit plan
 - prepared using risk assessment techniques
 - identifying the individual audits to be conducted during the year
 - approved by the board or administrator
- The plan should include periodic audits of the agency's major systems and controls. These include the systems and controls for:
 - accounting
 - administration
 - electronic data processing

Review and Approve the Audit Plan

- The audit plan shall be approved by the board of the entity, or the administrator for an entity without a board.

Plan and Conduct the Audits

- Internal audits should be performed with proficiency and due professional care.
 - Staffing - The internal audit department should provide assurance that the technical proficiency and educational background of internal auditors are appropriate for the audits to be performed. (Standard 210)
 - Knowledge, Skills, and Disciplines - The internal audit department should possess or should obtain the knowledge, skills, and disciplines needed to carry out its audit responsibilities. (Standard 220)
 - Due Professional Care - Internal auditors should exercise due professional care in performing internal audits. (Standard 280)
- The scope of internal auditing should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities.
 - Reliability and integrity of information. (Standard 310)
 - Compliance with policies, plans, procedures, laws or regulations. (Standard 320)
 - Safeguarding assets. (Standard 330)
 - Economic and efficient use of resources. (Standard 340)
 - Accomplishment of established goals and objectives for programs or operations. (Standard 350)
- Audit work should include planning the audit, examining and evaluating information, communicating results, and following up.
 - Planning the Audit - Internal audit should plan each audit. Planning should be documented and should include (Standard 410):
 - ... Establishing audit objectives and scope of work.
 - ... Obtaining background information about the activities to be audited.
 - ... Determining the resources necessary to perform the audit.
 - ... Writing an audit program.
 - ... Determining how, when, and to whom the audit results will be communicated.
 - Examining and Evaluating Information - Internal auditors should collect, analyze, interpret, and document information to support audit results. (Standard 420)

Report the Results of the Audits

- Communicating Results - Internal auditors should report the results of their audit work. A signed, written report should be issued after the audit examination is completed. (Standard 430)

Ensure the Function Conforms to Audit Standards

- The Act requires the internal audit program to conform to:
 - the Standards for the Professional Practice of Internal Auditing
 - generally accepted government auditing standards
 - the Certified Internal Auditor Code of Professional Ethics
 - the Statement of Responsibilities of Internal Auditing of the Institute of Internal Auditors
- Supervision - The internal audit department should provide assurance that internal audits are properly supervised. (Standard 230)
- Quality Assurance - The internal audit director should establish and maintain a quality assurance program to evaluate the operations of the internal audit department (Standard 560). The program should:
 - provide adequate supervision for the staff
 - establish internal quality assurance review procedures
 - provide for external or peer reviews

Review Reports and Monitor Implementation of Recommendations

- The entity's board or the administrator must review audit reports.
- Internal auditors should determine that corrective action was taken or that the board or administrator has assumed the risk of not taking corrective action on reported findings. (Standard 440)

Follow up on Actions Taken on Recommendations

- Follow Up - Internal auditors should follow up to learn that appropriate action has been taken on reported audit findings. (Standard 440)

Prepare the Annual Internal Audit Report

- The director of internal audit should submit activity reports to senior management and to the board annually or more frequently as necessary. (Standard 110)
- The internal auditor shall prepare an annual report that meets the requirements of the Act.

Periodically Evaluate the Internal Audit Function

- Quality Assurance - The director of internal auditing should establish and maintain a quality assurance program to evaluate the operations of the internal audit department (Standard 560). This program should:
 - establish internal quality assurance review procedures
 - provide for external or peer reviews

Assess Condition:
Determine the actual

process used

Conduct interviews, observe operations, and identify and collect available documentation to gain an understanding of the entity's internal audit function. Consider external reviews of the function to avoid duplication of evaluations. Gather information on how the entity views the actual internal audit function.

Reviewing the following operations accomplishes this:

- determining internal audit needs and objectives
- appointing an internal auditor
- organizing and managing the internal auditor function
- assessing entity risks
- preparing the annual audit plan
- reviewing and approving the audit plan
- planning and conducting the audits
- reporting the results of the audits
- ensuring the function conforms to audit standards
- reviewing reports and monitoring implementation of recommendations
- following up on actions taken on recommendations
- preparing the annual internal audit report
- periodically evaluating the internal audit function

Determining internal audit needs and objectives

- Review the Methodology module for Policy Environment.
- Review the requirements of the Texas Internal Auditing Act.
- Determine if the needs and objectives of the internal audit function have been identified.

Appointing an internal auditor

- Review the Human Resources Methodology Module - Recruitment and Selection.
- Determine if the board, or the administrator for agencies without a board, appointed the internal auditor.
- Review the minutes of the board meetings or the audit committee meetings.
- Determine that the director is either a certified public accountant or a certified internal auditor.
- Verify that the director has at least three years of auditing experience.

Organizing and managing the internal auditor function

- Decide if the status of internal auditing is sufficient to permit accomplishment of its objectives. Proper organizational status enhances the independence and objectivity of internal auditing.
- Determine if the director has the support of management and the board of directors. Without support, cooperation of auditees may be lacking.
- Determine if the director of internal auditing is responsible to an officer with sufficient authority to promote and ensure:
 - internal auditing independence
 - broad audit coverage

- adequate consideration of audit reports
- appropriate action on audit recommendations
- Determine if the board appointed the director:
 - The director has direct, regular communication with the board.
 - Such communication includes annual activity reports.
- Discover if there is a formal, written charter that defines internal auditing's purpose, authority, and responsibilities.
- Determine that the charter:
 - Establishes the department's position within the entity
 - Defines the scope of internal auditing activities
 - Authorizes access to records, personnel, and physical properties relevant to the performance of audits
- Determine the reasons for having a charter include:
 - Documenting a commitment by executive management to internal auditing
 - Defining the organizational and reporting relationships between internal auditing and others within the entity
 - Defining the authority or responsibilities of internal auditing
 - Outlining the scope of internal auditing activities
 - Providing a basis for organizing and staffing the internal audit function
 - Providing an authoritative guide to audit planning, including the setting of goals and objectives
 - Authorizing access by internal auditors to all records, personnel, and properties required to carry out their responsibilities
 - Providing a basis for evaluating overall audit effectiveness
- Determine if these topics are included in the charter:
 - Primary goals, or objectives and goals, of internal auditing
 - Approval by the board or the administrator
 - Authority granted to internal auditing
 - Basic responsibilities of internal auditing (scope of work)
 - Organizational status of internal auditing
 - Relationships, both internal and external, of internal auditing to others
 - Reporting relationships
 - Responsibility to follow up on audit findings and recommendations
- Determine if the director is responsible for the entire internal audit function, including:
 - Accomplishment of audit objectives set by management and the board
 - Development of a charter approved by the board and the administrator
 - Development of an annual audit plan to meet internal auditing objectives and goals
 - Development of a program to select and develop audit personnel

- Development of written policies and procedures to guide audit staff
- Effective use of internal audit resources
- Conformity of audit work with applicable standards
- Coordination with external auditors
- Review and approval of all audit reports
- Establishment and maintenance of a quality assurance program

Assessing entity risks

- Risk Assessment Process
 - Determine if the internal audit department conducted a formal risk analysis of the entity.
 - Determine how audit segments were identified.
 - Determine if all major areas were included by reviewing:
 - ... Organizational charts
 - ... The telephone directory and post office box listing, if available
 - ... Lists of major MIS systems or applications
 - ... Senior management's responses to inquiries regarding major risk areas of the entity
 - ... Recent external auditor management comments
 - ... Charts of accounts
 - ... Any other applicable entity documentation (such as LARs, planning documents, etc.)
 - Identify any major areas of the entity that were not included as audit segments.
 - Determine if adequate supporting documentation was maintained so that the process used to determine audit segments can be verified. Determine if:
 - ... The risk analysis was documented and retained.
 - ... Information was obtained to support risk analysis (auditee interviews or questionnaires, reviews of financial statements, reviews of prior internal audit reports, and review of external auditor recommendations).
 - Determine if MIS systems or applications were appropriately included as audit segments.
 - Determine if activities performed by each audit segment were defined and described adequately.
 - Determine the appropriateness of the size and number of audit segments (too detailed or too general, too many or too few, inconsistent between different areas in the entity, logical division of systems or areas).
 - Discover if the methodology appropriately considered the following elements.
 - ... The date and results of the last audit

- ... Financial exposure
- ... Potential loss and risk
- ... Requests by management
- ... Major changes in operations, programs, systems, and controls
- ... Opportunities to achieve operating benefits
- ... Changes to and capabilities of the audit staff
- Review updates made to the risk assessments.
 - ... Determine if risk assessments were periodically updated (based upon subsequent audit results, changes in audit segments, legislative changes).
 - ... If applicable, review updates to the risk assessments as a result of reevaluation. Trace any changes to revised audit plans.
- Compare the risk analysis with the SAO risk analysis prepared for the entity to determine that all risks have been identified.
- If risk analysis was not performed, assess the methodology that is currently being used to determine audit priorities.

Preparing the annual audit plan

- Determine whether the internal audit department developed an audit plan based on the analysis of risk.
- Determine how the results of the risk analysis were used to develop audit plans.
- If risk is based on calculations or assigned values, determine if these were properly and accurately included in the planning process.
- Determine if audit plans were reviewed and approved by the board of directors and management.
- Determine if changes to the audit plans were reviewed and approved by the board of directors and management.
- Determine how changes in staff and their capabilities were considered in developing the audit plans.
- If applicable, determine if the internal audit department adequately coordinated with other audit groups.
- Review management comments from the most recent external audit reports and determine how the internal auditors addressed the areas where critical findings were cited.
- Determine that the audit director adequately documented his or her review of the planning process.
- Review the audit reports issued:
 - Review the listing of issued audit reports.
 - On a test basis, review the audit working papers and reports to verify the accuracy of the dates the audit began, fieldwork was completed, reports were issued, and audit hours. Confirm that dates and hours recorded on the list are sufficiently accurate to be used for other analysis.

- Prepare an analysis of the timeliness of reports by comparing start dates, fieldwork completion dates, and audit report dates. Where significant time lags exist, determine the causes and evaluate whether improvement is desirable.
- **Completion of Audit Plans**
 - Review the audit plans for the current and prior years.
 - Review the listing of audits currently in progress.
 - Review information on the status of audits in progress, including actual or expected completion dates.
 - For audit plan projects included in the prior year's plan which were not executed, determine whether they were appropriately carried forward to future years and that rescheduled dates seem appropriate.
 - Compare approved audit plans with reports issued and audits in progress and complete the following for the prior year. Indicate any assumptions made or unusual situations noted regarding the statistics.
 - Determine if variances of actual hours over budgeted hours for individual audit projects adversely affected the coverage of audit plans.
 - Determine the number of hours spent on special projects and administrative work.
 - Determine whether hours used for special projects and administrative work adversely affected the coverage of audit plans.
 - Determine if staff vacancies and turnover adversely affected coverage of audit plans.
 - Determine if any other factors adversely affected the coverage of the audit plan (carry-over audits or follow-up audits which were not budgeted as part of the audit plans).

Reviewing and approving the audit plan

- Determine if the annual audit plan has been approved by the board or the administrator of a state entity without a board.
- Determine if changes or amendments to the annual audit plan have been approved by the board or the administrator.

Planning and conducting the audits

- Determine the appropriate steps for review from the appendix to this module (Internal Audit: Appendix).
- Consider these sections:
 - Professional Proficiency - Standard 200
 - Scope of Work - Standard 300
 - Performance of Audit Work - Standard 400

Reporting the results of the audits

- Determine the appropriate steps for review from the appendix to this module, Communicating Results - Standard 430 (Internal Audit: Appendix).

Ensuring the function conforms to audit standards

- Determine that the internal audit function conforms to the following:
 - The Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors (IIA).
 - ... Independence (Standard 100)
 - ... Professional Proficiency (Standard 200)
 - ... Scope of Work (Standard 300)
 - ▶ Reliability and integrity of information (Standard 310)
 - ▶ Compliance with policies, plans, procedures, laws or regulations (Standard 320)
 - ▶ Safeguarding assets (Standard 330)
 - ▶ Economic and efficient use of resources (Standard 340)
 - ▶ Accomplishment of established goals and objectives for programs or operations (Standard 350)
 - ... Performance of Audit Work (Standard 400)
 - ... Management of the Internal audit department (Standard 500)
 - The review guidelines for the Standards are included in the manual *Quality Assurance for Internal Audit. (Quality Assurance Review Manual for Internal Auditing. Altamonte Springs, Fl. The Institute of Internal Auditors, Inc. Location: Methodology Project Information Resources Folders.)*
 - The Certified Internal Auditor Code of Professional Ethics
 - The Statement of Responsibilities of Internal Auditing (IIA)
(The review guidelines for the Code of Professional Ethics and The Statement of Responsibilities of Internal Auditing are also included in the manual *Quality Assurance for Internal Audit.)*
 - Generally accepted government auditing standards, (GAO) general standards include:
 - ... Qualification (Standard 3.3)
 - ... Independence (Standard 3.11)
 - ... Due Professional Care (Standard 3.26)
 - ... Quality Control (Standard 3.31)
 - The review guidelines for the GAGAS are included in the manual *NSAA Peer Review Program. These include guidelines for financial, performance and EDP audits. (National State Auditors Association. NSAA Peer Review Program. Lexington,*

Kentucky, National Association of State Auditors, Comptrollers, and Treasurers, 1991. Location: Methodology Project Information Resources Folders.)

Reviewing reports and monitoring implementation of recommendations

- Determine that the board and the administrator reviewed the audit reports.
 - Review minutes of the board or audit committee meetings.
 - Review the internal audit status reports to the board.
- Determine if:
 - the recommendations have been carried out
 - the status of the recommendations not implemented
 - the reason for not implementing any recommendation

Following up on actions taken on recommendations

- Determine if the internal auditor performed follow-up reviews on recommendations.
- Select appropriate steps for review from the appendix to this module, Follow Up - Standard 440 (Internal Audit: Appendix).

Preparing the annual internal audit report

- Determine if the internal auditor prepared and submitted an annual report to:
 - the Governor
 - the Legislative Budget Board
 - the Sunset Advisory Commission
 - the State Auditor
 - the entity's board
 - the administrator
- Determine that the report contains:
 - a copy of the annual audit plan
 - a list of audits completed
 - an explanation of any deviations from the audit plan
 - a narrative description of the significant findings and recommendations for each audit
 - a narrative description of management actions taken in response to the audit findings and recommendations
 - a table listing the audit recommendations and the five-year fiscal impact for each recommendation
 - a table listing the audit recommendations from the previous fiscal year's report and the status of each recommendation
 - a statement of the last date on which an external peer review of the entity's internal audit program was conducted
- Confirm that each recommendation showed whether:
 - the recommendation has been implemented
 - the recommendation is in the process of implementation

- action on implementation of the recommendation has been delayed
- the entity does not intend to take action on the recommendation
- The report must emphasize the findings in important areas that are difficult to quantify, including weaknesses in management controls or quality of services.

Periodically evaluating the internal audit function

- Review the charter for the goals and objectives of the internal audit department.
- Review the Annual Audit Report for accomplishments and deviations from the audit plan.
- Determine if an external or peer review has been performed in the last three years.
 - Review the peer review to detect if any weaknesses cited have been corrected.
 - If they have performed no peer review, determine the reason and when a review will be scheduled.
- If a review according to the requirements of SAS 65: The Auditor’s Consideration of the Internal Audit Function in an Audit of Financial Statements, has been performed, review to detect if they cited any weaknesses.

Determine the strengths and weaknesses of the actual process

Using the tailored criteria, the understanding of the entity's internal audit function gained above, and the procedures in this section, analyze the actual function to determine if it:

- is designed to accomplish the management objective(s) (this module, page 1)
- has controls that provide reasonable assurance that the internal audit function will work as intended
- is implemented and functioning as designed
- is actually achieving the desired management objective(s)

Suggested procedures for each of these four analysis steps are detailed below. In executing these procedures, remember to identify and analyze both strengths and weaknesses.

Identify and review the steps in the actual internal audit function to determine if the function is designed to accomplish the management objective(s). Possible procedures include, but are not limited to the following:

- Determine if all major steps in the criteria are included in the actual internal audit function. If steps are missing, determine if their absence is likely to have a materially negative effect on the internal audit function at the entity.
- Determine if all the steps in the internal audit function appear to add value. If there are steps that do not appear to add value, try to get

additional information on why they are included in the internal audit function.

- Review the order of the steps in the internal audit function to determine if it promotes productivity.
- Review the level of technology used in the internal audit function to determine if it is up-to-date and appropriate to the task. Besides computer, electronic, communications, and other mechanical technology, you should also consider what kinds of management technology are used (Gantt charts, process maps, decision matrices, etc.). See the [appendix](#) to the module on Problem-Solving and Decision-Making for more information.

Identify the controls over the internal audit function to determine if they provide reasonable assurance that the function will work as intended. These controls should be appropriate, placed at the right point(s) in the process, timely, and cost effective. Possible procedures include, but are not limited to:

- Draw a picture of the internal audit function, the controls, and the control objectives. Flowcharts of the function can help identify inputs, processes, and outputs.
- Determine if the control objectives are in alignment with the overall management objective(s) (this module, page 1).
- Identify the critical points of the internal audit function (i.e. those parts of the function most likely to determine its success or failure or expose the entity to high levels of risk) and the controls related to them. Consider whether the controls are:
 - in the right location within the entity
 - timely (real time, same day, weekly, etc.)
- Compare the cost of the control(s) to the risk being controlled to determine if the cost is worth the benefit.
- Determine what controls are in place for monitoring and evaluating the overall effectiveness of the internal audit function and making sure that changes are made in the function if it does not yield the desired results.
- Identify, describe, and assess the process used to gather input from employees who might reasonably discover flaws in the function.

Review observations, interviews, documentation, and other evidence and design specific audit procedures as needed to determine if the internal audit function and/or the controls have been implemented and are functioning as designed. Depending upon the objectives of the project, these procedures may include both tests of controls and substantive tests, more information on which is found in *The Hub*, pp. 2-B-8, ff. Possible procedures include, but are not limited to:

- Determine if any evidence of management override exists.
- Determine the actual internal audit function and compare to the official function.

Review and analyze any reports used by the entity to monitor the outcome(s) of the internal audit function and/or any other information available to determine if the function is actually achieving the desired management objective(s) (this module, page 1). Possible procedures include, but are not limited to:

- Analyze these internal audit function reports over time for trends.
- Discuss any apparently material negative or positive trends with management.
- Determine if and how management acts upon these trend reports and what changes, if any, were made in the function or controls as a result. Some function refinements, especially those affecting entity mission, goals, and outcome measures, may need to wait until the next appropriation cycle.

Determine causes

Determine what circumstances, if any, caused weaknesses in the internal audit function. Possible procedures include, but are not limited to:

- Determine if the participants in the function understand the entity's mission, goals, and values and support them through their management of the function.
- Determine if the participants understand their purpose and role in the function.
- Determine if the relationship between the internal audit function and other entity functions is clear.
- If the internal audit function occurs at multiple locations, determine the nature and scope of the communication and coordination among them.
- Determine if the function has adequate human, dollar, time, information, and asset resources. If they appear inadequate, determine if entity resources have been allocated according to the materiality of the function relative to other entity processes.
- Determine if the entity has considered using alternative resources such as industry associations, non-profit organizations, academic institutions, or other governmental entities to meet its resource needs.
- Determine if resources available to the internal audit function have been allocated and used in a manner consistent with the importance of that resource to the function.
- If there are negative trends in the reports used to monitor the outcome(s) of the internal audit function, determine if these reports are communicated to and used by the appropriate parties to make appropriate changes.

Determine what internal or external constraints or barriers, if any, must be removed in order to overcome these identified weaknesses. Possible procedures include, but are not limited to:

- Review the applicable entity, state, or federal laws or regulations to determine if any of them prevent the necessary changes from being made in the internal audit function.
- Determine if any key employees are unwilling to change the function and why they are unwilling.

Determine effect

Compare the internal audit process with a recommended alternative and determine if each weakness is material. Alternatives can be developed by using the criteria contained in this module, applying general management principles to the process, using the processes at comparable entities. Materiality can be measured by comparing the dollar cost, impact on services (either quantity or quality), impact on citizens, or the impact on risks. Measurements can be quantitative, qualitative, or both. Procedures include, but are not limited to:

- Identify performance benchmarks for similar internal audit functions and compare actual performance.
- Estimate the cost of the function, the alternatives, and compare.
- Estimate the quantity and quality of the internal audit services provided by the actual function and compare it to alternative programs.
- Identify the risks associated with the internal audit function. Measure and compare with alternative audit functions.

Develop recommendations

Develop specific recommendations to correct weaknesses identified as material in this section. In developing these recommendations, consider the tailored criteria, kind of process, and control weakness identified. Causes and barriers, effects, and additional resources are listed at the end of this module. Possible procedures included, but are not limited to:

- Identify alternative solutions used by other entities.
- Identify solutions to removing the barriers.
- Provide general guidelines as to the objectives each solution should meet, then the entity can tailor the solution to its specific situation.
- Provide specific information, if available, on how each recommendation can be implemented.

RESOURCES**Articles**

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Allison, Dwight L. Jr. "Internal Auditors and Audit Committees." *Internal Auditor* 51:1:50-55, February 1994. Location: Methodology Project Information Resources Folders

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Bruno, Francis A. "An Approach to Quality Internal Auditing." *Internal Auditor* 51:4:60-63, August 1994. Location: Methodology Project Information Resources Folders

Chester, F. Lloyd. "When 'Good' Isn't Good Enough." *Internal Auditor*, 50:4:30-34, August 1993. Location: Methodology Project Information Resources Folders

Coderre, David G. "Seven Easy CAATT." *Internal Auditor* 51:4:28-32, August 1994. Location: Methodology Project Information Resources Folders

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Cuzzetto, Charles E. "Lean, Mean, Auditing Machines." *Internal Auditor* 51:6:26-30, December 1994. Location: Methodology Project Information Resources Folders

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Data Sources

Information and reports to consider for review of the internal audit function:

From the Entity

- Annual Financial Reports
- Management letter from the statewide audit
- Other independent audit reports
- Entity organization chart indicating position of internal audit function.
- Statement of responsibilities of board (or a similar document) and relevant board minutes indicating relationships between the board and the internal audit function

The Internal Audit Function

- Internal audit charter (or a similar document)
- Statement of goals of internal audit function
- Internal audit organization chart
- Annual report for the internal audit function
- Internal audit status reports (sample)
- Detailed activity reports (sample)
- Summary reports to management
- Reports to board (sample)
- Documentation of internal and /or external reviews of the internal audit function
- Policies, Plans, and Procedures
 - Internal audit plans long- and short-range
 - Internal audit policies and procedures manual (or a similar document)
 - Internal audit programs (sample)
 - Internal audit planning memorandum for individual audits (or a similar document, sample)
 - Internal audit reports (sample)
- Personnel
 - Position descriptions
 - Internal audit training program documentation
 - Documentation of internal and/or external reviews of internal audit continuing education and on-the-job training programs

Government Performance Measures (GPM)- A data base of information about the use and audit of alternative government performance measures is available on Internet. The data base is part of an Institute of Internal Auditors Research Foundation-funded study. It can be accessed with the assistance of Lisa Roberts (4987) in the SAO library. This data base currently provides references and abstracts of more than 150 works related to GPM and comprises reference of articles, books, chapters of books, presentations, government documents, and any other identified sources that depict the use of government-related performance measures. Summary abstracts of all identified sources written since 1980 are

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included with an author, title, and reference citation. As additional abstracts are discovered or published, the data base will be updated.

The following staff members have specialized training or ongoing interest in Internal Auditing:

SAO Employee	Title/Function
Leslie P. Ashton, CPA	SAO Internal Audit Coordinator
William D. Hastings, CPA Terry Hazel, CIA	Evaluating the Effectiveness of the Internal Audit function
Carol A. Noble, CISA	Former SAO Internal Audit Coordinator
William L. Smith, CIA	Statewide Review of Internal Auditing
J. Scott Killingsworth, CIA	Module Writer/Editor
Carleton S. Wilkes, CPA	Reviewer

Periodicals

CPA Journal

Published monthly by the New York Society of Certified Public Accountants
Location: The University of Texas, Perry-Castañeda Library (HF 5601 N54)

CPA Letter

Published monthly by the American Institute of Certified Public Accountants
Location: SAO Library

FASAB News

Published monthly by the Financial Accounting Standards Advisory Board
Location: SAO Library

Federal Update

Published monthly by the National Conference of State Legislatures
Location: SAO Library

GAO Journal

Published quarterly by the United States General Accounting Office
Location: SAO Library

GAO Reports and Testimony

Published monthly by the United States General Accounting Office
Location: SAO Library

Government Accountant's Journal

Published quarterly by the Association of Government Accountants
Location: SAO Library

Internal Auditor

Published monthly by the Institute of Internal Auditors
Location: SAO Library

Internal Auditing

Published quarterly by Warren, Gorham, and Lamont
Location: SAO Library

Journal of Accountancy

Published monthly by the American Institute of Certified Public Accountants
Location: SAO Library

Journal of Accounting, Auditing, and Finance

Published quarterly by Warren, Gotham, and Lamont
Location: The University of Texas, Perry-Castañeda Library (HF 5601 J6873)

Journal of Business Ethics

Published monthly by D. Reidel Publishing Company
Location: The University of Texas, Perry-Castañeda Library (HF 5387 J68)

NASACT News

Published bimonthly by the National Association of State Auditors, Comptrollers,
and Treasurers
Location: SAO Library

Risk Analysis

Published quarterly by the Society for Risk Analysis and Plenum Publishing
Location: The University of Texas, Perry-Castañeda Library (T 174.5 R55)

Today's CPA

Published bimonthly by the Texas Society of Certified Public Accountants
Location: SAO Library

**Professional Associations
and Research Entities**

American Accounting Association
Sarasota, Florida
(813) 921-7747

American Institute of Certified Public Accountants
New York, New York
(212) 596-6200

Association of Government Accountants
Alexandria, Virginia
(703) 684-6931

Financial Managers Society
Chicago, Illinois
(312) 578-1300

Government Finance Officers Association
Washington, D.C.
(202) 429-2750

Governmental Accounting Standards Board
Norwalk, Connecticut
(203) 847-0700

Institute of Internal Auditors
Altamonte Springs, Florida
(403) 830-7600

National Conference of State Legislatures
Washington, D.C.
(202) 624-5400

National Society of Public Accountants
Alexandria, Virginia
(703) 549-6400

United States General Accounting Office
Washington, D.C.
(202) 512-6000

Texas Association of Certified Public Accountants, Austin Chapter
Austin, Texas
(512) 452-9439

Related Modules

Human Resources
Mission
MIS I: Managing Information
MIS II: Managing Information Technology
Organization
Performance Measures
Policies and Procedures
Risk Assessment

Related Reports

Statewide Report on Internal Auditing, May 1988. (SAO Report No. 8-084)
Statewide Review of Internal Auditing, February 1991. (SAO Report No. 1-054)
Internal Auditing in State Agencies: 1992 Progress Report, December 1992.
(SAO Report No. 3-024)
Spotlight On Internal Auditing: Fiscal Year 1993, December 1993. (SAO
Report No. 94-013)
A Report on: Evaluating the Effectiveness of Internal Audit, November 1994.
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