

**Internal Audit Plan
Fiscal Year 2018
Texas Racing Commission**

MONDAY RUFUS & CO., P.C.

CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS

Table of Contents

	<u>Page</u>
Transmittal Letter	2
Purpose	3
Background Information	3
Internal Audit Plan Methodology	8
Internal Audit Plan	10
Reporting	11
Appendix A: Organizational Chart	12
Appendix B: Risk Assessment	13

MONDAY RUFUS & CO., P.C.
Certified Public Accountants & Advisors

Member: American Institute of Certified Public Accountants

October 3, 2017

Commissioners of the
Texas Racing Commission
Austin, Texas

Dear Commissioners:

As required by the Internal Auditing Act (Texas Government Code, Section 2102.008), we have prepared the audit plan for Fiscal Year 2018.

We prepared a risk assessment to determine the areas in the Texas Racing Commission that should be considered for audit. Based on that risk assessment, our audit plan for Fiscal Year 2018 is shown below:

• Texas Bred Incentive Programs – Associations	80
• Texas Bred Incentive Programs – TxRC's Policies & Procedures	80

Total Hours	160

Your approval of the audit plan is required.

Sincerely,



Monday N. Rufus, CISA, CPA
Audit Director
MONDAY RUFUS & CO., P.C.

I. Purpose

The Purpose of this internal audit plan is to document the development, risk assessment, scope of assignments, and implementation timetable for fiscal year 2018 internal audit activities. This document will serve as a primary tool to carry out internal audit responsibilities in an efficient manner and prioritize the audit areas based on risk assessments agreed to by the Commissioners of the Texas Racing Commission (Agency). Due to the nature, scope and timing of audit procedures contemplated here, planning for specific aspects of the audits is a continuing process. Accordingly, the plan will be revised as necessary and reviewed at least annually.

This plan has been prepared to meet planning guidelines as required by both generally accepted auditing standards and the standards for the Professional Practice of Internal Auditing as determined by the Institute of Internal Auditors, Inc.

II. Background Information

The Texas Racing Commission regulates all aspects of pari-mutuel horse and greyhound racing through licensing, on-site monitoring, and enforcement. Statute and rule require the Commission to:

- License racetracks that offer racing and the people directly involved with pari-mutuel wagering who work at the racetracks or own race animals.
- Allocate race dates, supervise the conduct of all races, monitor the health and safety of the race animals, and conduct drug tests to ensure the animals race without prohibited substances.
- Oversee all pari-mutuel wagering activity, approve simulcasts, test the totalisator systems (complex computer systems that tally and calculate pari-mutuel wagers), and ensure the proper allocation and distribution of revenue generated by pari-mutuel wagering.
- Administer the Texas Bred Incentive Programs, which provides economic incentives to support a healthy and vigorous breeding industry in the state.

The Racing Act allows pari-mutuel wagering on horse and greyhound racing and provides for the strict regulation and control of pari-mutuel wagering in connection with that racing.

Principal responsibilities of the Commission are to:

1. Adopt rules and regulations for conducting racing involving wagering;
2. Administer and enforce all laws, rules, and regulations affecting horse racing, greyhound racing, and pari-mutuel wagering;
3. Adjudicate disciplinary matters arising from the enforcement of those laws and regulations dealing with horse racing and greyhound racing and pari-mutuel wagering; and
4. Regulate and supervise each racing meeting conducted in the state of Texas, the operations of racetracks, and the participants in a race meeting.

Extensive rulemaking authority is granted to the Commission throughout the Racing Act. The rulemaking authority vested in the Texas Racing Commission is authorized for administration and enforcement purposes.

The Racing Commission consists of seven members appointed by the governor with the advice and consent of the Senate to serve overlapping six-year terms. Five members must represent the general public and have general knowledge of business or agribusiness. At least one of those appointed members may be a veterinarian, and being licensed as a veterinarian satisfies the requirement that the person have general knowledge of business or agribusiness. One member must have special knowledge or experience related to horse racing and one member must have special knowledge or experience related to greyhound racing. In addition to the appointed members, there are two ex-officio members, the Chair of the Public Safety Commission and the Commissioner of Agriculture. The Governor appoints the chair and the members elect the vice-chair.

The Commission appoints an Executive Director who serves at the pleasure of the Commission. The Agency's operating budget is prepared and approved by the Commission on an annual basis, whereas the State legislative appropriation request is determined every two years. Both the budget and appropriations are reviewed and approved by the State Legislature.

The 82nd Legislature, Regular Session, passed House Bill 2271 which altered the Commission's method of finance eliminating outstanding uncashed winning tickets as a source of revenue. The Commission is now self-funded from fees assessed to racetracks and occupational licenses from the entities it regulates and is typically appropriated only General Revenue – Dedicated funds. Approximately 46% of the expenditures are passed through the Agency to the official breed registries for the Texas Bred Incentive Programs. Funds collected by the Agency are directly utilized for operations, and not passed on to the State.

The agency's structure consists of an executive group and support staff headed by the Executive Director and a Deputy Executive Director responsible for regulating field staff.

A. Executive Group

- i. **Executive Director** - The Executive Director supervises agency activities as a whole and manages the Finance, Information Technology and Racing Oversight operations. The Executive Director oversees development of agency operating policies and procedures and ensures that the agency's regulatory responsibilities are carried out. The Executive Director represents the agency before the Legislature and other governmental agencies and serves a primary role in external relations with industry stakeholders, regulators in other states, and a national regulatory association.

The Executive Director, with the assistance of the General Counsel's staff oversees coordination of the evaluation of racetrack license applications, the race date allocation process, and assesses administrative penalties against racetrack licensees. The Executive Director's office is also responsible for other

administrative functions including responding to public information and media requests.

- ii. **General Counsel** – The General Counsel advises the Commissioners and staff on legal and regulatory enforcement issues affecting the agency. The General Counsel coordinates all aspects of Commission meetings and rulemaking proceedings and also represents the agency before the State Office of Administrative Hearings when prosecuting appeals from decisions made by the Board of Stewards/Judges and disciplinary cases initiated by the Executive Director.
- iii. **Finance** – This department is responsible for agency finance and administrative functions to include budget, accounting, purchasing, personnel, human resources, travel coordination and related administrative functions.

Staff members prepare the biennial Legislative Appropriations Request, (LAR), the operating budget, the annual financial report, reports on performance measures, and other administrative reports. Staff members in this area are responsible for the agency's purchasing, personnel, human resources and travel coordination activities.

- iv. **Department of Information Technology (IT)**
The IT department develops and maintains the agency's network, database and Web site. IT recommends and supports all hardware and software necessary for the day-to-day activities of the Commission. The Commission's custom programs and database operate twenty-four hours a day, seven days a week, providing staff, licensees, the Department of Public Safety (DPS), the Texas A&M Veterinary Medical Diagnostic Laboratory and the general public with up-to-date information regarding all aspects of the Commission's regulatory programs.

B. Divisional Information

The Agency's operational staff is organized into different departments within Racing Oversight which have specific duties and responsibilities in carrying out the overall mission of the Agency. The racing oversight is focused on enforcement and oversight of day-to-day racetrack operations. The members of this division make up the agency's presence at Texas tracks. The Deputy Executive Director supervises personnel directly responsible for regulating the conduct of live racing and is responsible for the following teams: Licensing, Investigations, Stewards/Judges, Veterinarians/Drug Testing and Pari-mutuel Auditors.

- **Licensing**

Staff in licensing issue occupational licenses to all people in positions that afford the person an opportunity to influence pari-

mutuel wagering and to those who will likely have significant access to the restricted areas of a racetrack. Licensing staff at each racetrack help maintain the integrity of the industry by ensuring that all appropriate participants are licensed and in good standing.

To ensure that all participants in racing are properly licensed, the Commission has more than fifty categories of occupational licenses. Stable and kennel area occupations – jockeys, owners, kennel owners, trainers and grooms – must secure licenses, as must racetrack employees.

- **Investigations**

The investigators, coordinate enforcement of the Commission's Rules and the Texas Racing Act.

Investigations are conducted on animal drug positives, criminal histories returned on license applicants, illegal wagering, use and possession of contraband, drug abuse and narcotics trafficking, and other illicit activities that could affect the integrity of pari-mutuel racing.

Drug testing of licensees suspected of using illegal drugs while performing their duties has become an important aspect of regulating the industry. If a licensee tests positive for an illegal controlled substance or alcohol, the licensee faces a suspension and must seek professional help.

- **Stewards/Judges**

The department includes stewards at horse tracks and judges at greyhound tracks. The judges and stewards monitor the conduct of live races and enforce the Racing Act and the Commission's Rules of Racing. The stewards and judges have broad authority to resolve matters arising during a race meeting. They may redistribute purses, issue fines up to \$25,000 and suspend licensees for up to five years.

- **Veterinarians**

The Veterinary Medical Director oversees this department, supervising the veterinarians and test barn supervisors working at the racetracks.

Employees in this department inspect all race animals before a race to ensure they are sound to compete, inspect the stable and kennel

areas for animal health and safety issues, and implement the Commission's race animal drug testing program.

The Veterinary Medical Director also serves as a liaison between the Commission and veterinary-related organizations and agencies, such as the Texas Animal Health Commission, the American Association of Equine Practitioners, and the Texas Veterinary Medical Association.

- **Pari-mutuel Auditors**

The pari-mutuel auditors protect the interest of the wagering public and industry participants by assuring the proper collection and distribution of funds in accordance with the Act and providing reliable information on wagering. The auditors review, verify and report all live and simulcast wagering activity at the racetracks to ensure the public is paid the correct amount on each winning wager. The auditors perform daily audits and verifications of handle, earned purse, paid purse, outs balances, deposit reports and requests for simulcast approval in compliance with the Interstate Horse Racing Act (IHA). The audit staff ensures the daily collection of the escrowed horse purse funds earned from interstate cross-species wagers placed at greyhound racetracks and the allocation of these funds to the various horse racetracks based on Commission-approved formulas.

C. The Agency's Legislative Appropriations Request for fiscal year 2018 is as follows:

	<u>August 31, 2018</u>
License/Regulate Racetracks	\$ 385,941
Texas Bred Incentive Program	3,325,343
Supervise & Conduct Live Races	545,741
Monitor Licensee Activities	235,247
Inspect & Provide Emergency Care	364,152
Administer Drug Tests	215,181
Occupational Licensing Program	412,016
TEXASONLINE	19,185
Monitor Wagering and Compliance	373,795

Central Administration & Other Support Services	753,512
Information Resources	509,511
Supplemental Appropriation made in Riders	<u>0</u>
Total	<u>\$ 7,139,624</u>

III. Internal Audit Plan Methodology

This section summarizes the methodology used in preparing the fiscal year 2018 internal audit plan. In order to understand the Agency and develop our risk assessment process, we reviewed the Agency's:

- Enabling Legislation
- Strategic plan
- Legislative appropriations request/operating budget
- Prior internal audit reports
- Reports from the State Auditor's Office
- Sunset Commission Report
- Other documents available to us

In planning internal audit procedures, financial, operational, as well as compliance issues are considered in determining processes/systems of interest. Functional areas that cross many divisions and the interaction between divisions are key criteria in the process of identifying areas of interest. Agency financial reports, planning documents, laws, rules, and regulations, in addition to soliciting input from management and commission members, were all considered in developing the list of areas of interest. Upon completion of this list, each area was subjected to our risk analysis process.

The following Agency processes/systems have been considered during the development of the areas of interest list:

- Cash receipts and fee processing
- Cash Disbursements
- Payroll and Personnel Processes
- Reporting – Key Performance Measures
- Budgeting and Reporting
- Licensing application and registrations
- Complaints/Investigation process
- Pari-mutuel Auditing Process
- EDP Wagering Reviews/Audits
- Business Continuity/Disaster Recovery
- Information Systems - Security
- Information Technology System Development

- Drug testing
- Inspection Program
- Compliance Administrator
- Racing Administration
- Texas Bred Incentive Programs – Associations
- Texas Bred Incentive Programs – TxRC’s Policies and Procedures
- Equine Research
- Historically Underutilized Businesses (HUB)
- Fixed Asset Management

There are numerous other areas that may be identified during the process of performing internal audit procedures during the year. Continuing input from both the Commissioners and management will be essential in identifying additional or new areas of risk that should be considered in the future.

Our risk assessment was performed through the consideration of various factors, including:

1. Exposure Level (Adverse impact of errors within the process/unit)
2. Complexity of unit (Volatility of activities)
3. Materiality (Financial and Non Financial Impact)
4. Results of last audit (Positive, Some Findings, Negative)
5. Extent of other coverage or oversight (More coverage, Some coverage, No coverage)
6. Quality of internal controls/adherence to laws (Excellent, Good, & Poor controls)
7. Changes in systems and processes (More changes, Some changes, No changes)
8. Normal audit interval (Audited in last 1 year, 2-4 years, >4 years or Never)

All of the above factors were considered in assessing risk and were taken into consideration for each process/system as to their impact on the Agency. Once each area of interest was evaluated, it was assigned a risk factor of high, moderate or low. The following is the result of our risk assessment process.

Processes Identified as High Overall Risk

Texas Bred Incentive Programs – Associations
 Texas Bred Incentive Programs – TxRC’s Policies and Procedures
 Racing Administration
 Personnel Processes
 Business Continuity/Disaster Recovery
 Reporting – Key Performance Measures
 Information Systems – Security

Processes Identified as Moderate Overall Risk

Cash Receipts and Fee Processing
 Inspection Program

Pari-mutuel Auditing Process
 Complaints/Investigation Process
 Cash Disbursements
 EDP Wagering Reviews/Audits
 Historically Underutilized Businesses (HUB)
 Budgeting and Reporting
 Drug Testing
 Information Technology System Development

Processes Identified as Low Overall Risk
 Fixed Asset Management
 Equine Research
 Compliance Administrator

IV. Internal Audit Plan

The internal audit plan is designed to provide a review of all areas considered risky. Although the plan is structured in this manner, it should not prevent the review of areas on a more frequent basis, in the case of future restructuring or development of new processes/systems. Also, special reviews might be added in the future as requested by the Commissioners or when deemed necessary by the internal audit function after performance of in-depth review of the specific divisions/systems and approval by the Commission.

Internal audit activities will be primarily concerned with documenting, testing and evaluating each division or system's internal control policies and procedures and the quality of performance in carrying them out. This will include reporting conditions and suggestions to management and evaluating management's response and plans for corrective actions. Opportunities for improved efficiency identified as a result of performing internal activities will be communicated to management and the Commissioners as part of the reporting process. Internal Audit reviews for the fiscal year ending 2018 are planned for the following processes/systems:

<u>Fiscal Year 2018</u>	<u>Hours</u>
• Texas Bred Incentive Programs – Association	80
• Texas Bred Incentive Programs – TxRC's Policies & Procedures	80

Total Hours	160

This audit will take place from October 2017 through August 2018 with final reporting occurring in September 2018. The above plan does not preclude the internal audit function from identifying and assessing risk relating to new divisions or systems added to the Agency.

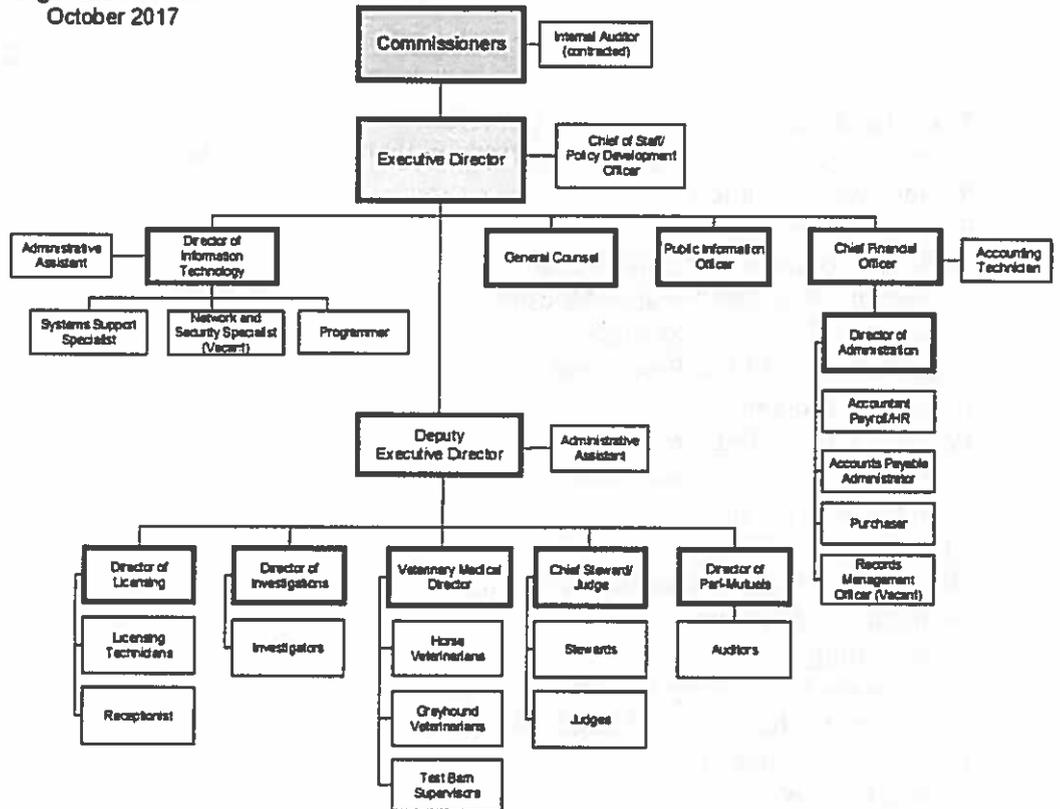
These processes/systems were identified for review through risk assessment methodology. As discussed above, this methodology included personnel inquiries, identifying financial and non-financial risk, identifying interaction of divisions amongst each other, identifying rules and regulations various divisions must comply with and identifying the volume of transactions and personnel involved with each division.

V. Reporting

In compliance with the Texas Internal Auditing Act, the annual internal audit report will be filed with the Governor, the Legislative Budget Board, the Sunset Advisory Commission, the State Auditor, the Commissioners of the Agency, and the Agency's Executive Director by November 1, 2018. The annual internal audit report will be in the form specified by the State Auditor.

Appendix A: Organizational Chart

TEXAS RACING COMMISSION Organizational Chart October 2017



Appendix B: Risk Assessment

High = 38 and up
Med = 30-37
Low = less than 30

	<u>Weighed Risk</u>
Texas Bred Incentive Programs – Associations	39
Texas Bred Incentive Programs – TxRC’s Policies and Procedures	39
Racing Administration	39
Personnel Processes	39
Business Continuity/Disaster Recovery	39
Reporting – Key Performance Measures	39
Information Systems – Security	39
Cash Receipts and Fee Processing	37
Inspection Program	37
Pari-mutuel Auditing Process	37
Complaints/Investigation Process	35
Cash Disbursements	33
EDP Wagering Reviews/Audits	33
Historically Underutilized Businesses (HUB)	33
Budgeting and Reporting	32
Drug Testing	31
Information Technology System Development	30
Licensing Applications and Registrations	29
Fixed Asset Management	28
Equine Research	28
Compliance Administrator	28

TEXAS RACING COMMISSION

Internal Audit Charter

TEXAS RACING COMMISSION
INTERNAL AUDITING CHARTER

MISSION

The mission of the internal audit function is to provide independent, objective assurance, and consulting services designed to add value and improve the Texas Racing Commission's operations. The internal audit function helps Texas Racing Commission accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The scope of work of the internal audit function is to determine whether the Texas Racing Commission's network of risk management, control, and governance, processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- Risks are appropriately identified and managed
- The systems of internal control established to ensure compliance with Texas Racing Commission's policies, procedures, laws, and regulations are adequate and functioning as intended.
- Interaction with the various governance groups occurs as needed.
- Significant financial, managerial, and operating information is accurate, reliable, and timely.
- Resources are acquired economically, used efficiently, and adequately protected.
- Program, plans, and objectives are achieved.
- Quality and continuous improvement are fostered in the Texas Racing Commission's control processes.
- Significant governmental or regulatory issues impacting the organization are recognized and addressed properly.

ESTABLISHMENT

The internal auditing function is established for the Texas Racing Commission ("Agency") in accordance with Texas Government Code, Title 10, Chapter 2102, and the Texas Internal Auditing Act. The Agency governing Commission ("Commission") shall appoint the Internal Auditor. The Internal Auditor shall report directly to the Commission or Audit Committee on all matters, other than administrative matters, that require the decision of the Executive Director.

The Internal Auditor shall establish those internal auditing policies and procedures necessary to assist management in the accomplishment of the Agency's objectives and to ensure compliance with applicable laws and regulations.

PROFESSIONALISM

The internal audit function will govern itself by adherence to The Institute of Internal Auditors' mandatory guidance including the Core Principles for the Professional Practice of Internal Auditing, the Definition of Internal Auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing.

ATTRIBUTE STANDARDS

Purpose, Authority and Responsibility - 1000

Purpose

The internal auditing function is 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.

Assurance services are defined as objective examinations of evidence for the purpose of providing an independent assessment on risk management, control, or governance processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements.

Consulting services are advisory and related client service activities, the nature and scope of which are agreed upon with the client and which are intended to add value and improve an organization's operations. Examples include counsel, advice, facilitation, research, and training.

Authority

The Internal Auditor is authorized to direct a broad, comprehensive program of internal auditing within the Agency. The internal auditing function is authorized to have full, free, and unrestricted access to all of the agency's functions, facilities, personnel, property, records (in any form) or other resources deemed by the Internal Auditor to be relevant to the subject under review. Agency personnel shall cooperate with the internal auditing function by providing access to records and other resources and by assisting in compiling information within their purview. Due consideration shall be given to the benefits and costs of gathering audit evidence so that optimal use will be made of the Agency's resources.

Responsibility

The Internal Auditor is responsible for ensuring that the internal auditing function conforms to the internal auditing requirements of the *Texas Internal Auditing Act*, generally accepted governmental auditing standards established by the Comptroller General of the United States, and the mandatory elements of the International Professional Practices Framework as promulgated by the Institute of Internal Auditors: Core Principles for the Professional Practice of Internal Auditing, Code of Ethics, *International Standards for the Professional Practice of Internal Auditing (Standards)*, and the Definition of Internal Auditing.

Definitions

The Internal Auditor should discuss the Definitions of Internal Auditing, the Code of Ethics, the Standards, and the Core Principles for the Professional Practice of Internal Auditing with senior management and the Commission:

- Internal Audit is 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.
- Code of Ethics are principles relevant to the profession and practice of internal auditing, and Rules of Conduct that describe behavior expected of internal auditors. The Code of Ethics applies to both parties and entities that provide internal audit services. The purpose of the Code of Ethics is to promote an ethical culture in the global profession of internal auditing.
- Standards are professional pronouncements promulgated by the Institute of Internal Auditors that delineate the requirements for performing a broad range of internal audit activities, and for evaluating internal audit performance.
- The Internal audit function is required to demonstrate integrity, competence and due professional care, be objective and free from undue influence (independence), align with the strategies, objectives, and risk of the Commission, appropriately positioned and adequately resourced, demonstrate quality and continuous improvement, communicate effectively, provide risk-based assurance, be insightful, proactive, and future-oriented, and promote organizational improvement.

Standards of Conduct

The Internal Auditor will respect the value and ownership of information that he or she receives and will not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

The Internal Auditor shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the Agency.

Independence and Objectivity - 1100

The internal audit activity must be independent, and internal auditors must be objective in performing their work. Independence is the freedom from conditions that threaten the ability of the internal audit activity or the Internal Auditor to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the Internal Auditor has direct and unrestricted access to senior management and the Commission. The internal auditing function shall be free of all operational and management responsibilities that would impair the ability to independently review all aspects of the Agency's operations. The internal auditing function shall not develop or install procedures, prepare records, or engage in any other activity normally subject to internal auditing review.

The Internal Auditor shall not have authority or responsibility over any of the activities or persons under review so that objectivity will not be impaired. Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made.

Organizational Independence - 1110

The Internal Auditor shall dual-report to the Executive Director and the Commission or Audit Committee to allow the internal audit activity to fulfill its responsibilities. The Internal Auditor must confirm to the Commission, at least annually, the organizational independence of the internal audit activity. The internal audit activity and Internal Auditor must be free from interference in determining the scope of internal auditing, performing work, and communicating results. The Internal Auditor must communicate and interact directly with the Commission.

Direct Interaction with the Commission - 1111

The internal auditor must communicate and interact directly with the Commission or its designated Committee.

Internal Auditor's Roles Beyond Internal Auditing – 1112

If the roles and/or responsibilities of the internal auditor fall outside of internal auditing, safeguards must be in place to limit impairments to independence or objectivity.

Individual Objectivity – 1120

Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest. A conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfill his or her duties impartially. A conflict of interest exists even if no unethical or improper act results. A conflict of interest can create an appearance of impropriety that can undermine confidence in the internal auditor, the internal audit activity, and the profession. A conflict of interest could impair an individual's ability to perform his or her duties and responsibilities objectively.

Impairment to Independence or Objectivity – 1130

If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment. Impairment to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations, such as funding.

Proficiency and Due Professional Care – 1200

Engagements must be performed with proficiency and due professional care.

Proficiency - 1210

The Internal Auditor shall maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications, or supplement with contract services, to meet the requirements of this charter.

Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.

The Internal Auditor must obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement.

Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the Agency, but are not expected to have the

expertise of a person whose primary responsibility is detecting and investigating fraud.

Internal auditors must have sufficient knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work. However, not all internal auditors are expected to have the expertise of an internal auditor whose primary responsibility is information technology auditing.

The Internal Auditor must decline the consulting engagement or obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement.

Due Professional Care – 1220

Internal auditors must apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility.

Internal auditors must exercise due professional care by considering the:

- Extent of work needed to achieve the engagement's objectives;
- Relative complexity, materiality, or significance of matters to which assurance procedures are applied;
- Adequacy and effectiveness of governance, risk management, and control processes;
- Probability of significant errors, fraud, or noncompliance; and
- Cost of assurance in relation to potential benefits.

In exercising due professional care, internal auditors must consider the use of technology-based audit and other data analysis techniques.

Internal auditors must be alert to the significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

Internal auditors must exercise due professional care during a consulting engagement by considering the:

- Needs and expectations of clients, including the nature, timing, and communication of engagement results;

- Relative complexity and extent of work needed to achieve the engagement's objectives; and
- Cost of the consulting engagement in relation to potential benefits.

Continuing Professional Development – 1230

Internal Audit shall conform to The Professional Practices Framework as promulgated by the Institute of Internal Auditors which includes The International Standards for the Professional Practice of Internal Auditing and the Code of Ethics, and to generally accepted government auditing standards. In addition, Internal Audit shall conform to requirements found under the Texas Internal Auditing Act (Chapter 2102, Texas Government Code). Internal Audit shall also comply with all policies and procedures of the Agency.

The professional staff of the Internal Audit Division shall maintain technical competence by attending a minimum of 40 hours annually of continuing professional education courses as required by the governing Commissions which regulate the professional designations of Certified Public Accountant and Certified Internal Auditor as appropriate. Ordinary and necessary expenses of maintaining the above-named professional designations will be paid for by the Agency. Other relevant certification programs may also be supported on a case-by-case basis.

Quality Assurance and Improvement Program - 1300

The Internal Auditor shall maintain an effective quality assurance and improvement program to include supervision, training, internal reviews, and periodic comprehensive external peer reviews to ensure compliance with the Texas Internal Auditing Act and professional standards.

The quality assurance and improvement program must include both internal and external assessments. The internal assessments must include:

- Ongoing monitoring of the performance of the internal audit activity; and
- Periodic reviews performed through self-assessment or by other persons within the Agency with sufficient knowledge of internal audit practices.

External assessments must be conducted at least every three years in accordance with Government Auditing Standards by a qualified, independent reviewer or review team from outside the Agency. The Internal Auditor must discuss with the Commission:

- The need for more frequent external assessments; and
- The qualifications and independence of the external reviewer or review team, including any potential conflict of interest.

The Internal Auditor must communicate the results of the quality assurance and improvement program to senior management and the Commission.

Use of “Conforms with the International Standards for the Professional Practice of Internal Auditing” - 1321

The Internal Auditor shall conduct his or her activities in a manner that is consistent with the following standards:

- International Standards for the Professional Practice of Internal Auditing, the Institute of Internal Auditors, Inc.
- Code of Ethics, the Institute of Internal Auditors, Inc.
- Government Auditing Standards
- Texas Internal Auditing Act
- Policies of the Agency

The Internal Auditor may state that the internal audit activity conforms with the *International Standards for the Professional Practice of Internal Auditing*, *Code of Ethics*, and generally accepted governmental auditing standards only if the results of the quality assurance and improvement program support this statement.

When nonconformance with the Standards or Code impacts the overall scope or operation of the internal audit, the Internal Auditor must disclose the nonconformance and the impact to senior management and the Commission.

Disclosure of Nonconformance – 1322

When nonconformance with the Code of Ethics or the *Standards* impacts the overall scope or operation of the internal audit activity, the Internal Auditor must disclose the nonconformance and the impact to senior management and the Commission.

PERFORMANCE STANDARDS

Managing the Internal Audit Activity – 2000

The Internal Auditor must effectively manage the internal audit activity to ensure that it adds value to the Agency.

The Internal Auditor must:

- establish risk-based plans to determine the priorities of the internal audit activity, undertaken at least annually.

- communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and the Commission for review and approval. The Internal Auditor must also communicate the impact of resource limitations.
- ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan.
- establish policies and procedures to guide the internal audit activity.

Consulting Engagements – 2010.c1

The internal auditor should consider accepting propose consulting engagements based on the engagement's potential to improve management risks, add value, and improve the Texas Racing Commission's operations. Accepted engagements must be included in the Internal Audit Plan.

Coordination – 2050

The Internal Auditor should share information and coordinate activities with other internal and external providers of assurance and consulting services to ensure proper coverage and minimize duplication of efforts.

Reporting to Senior Management and the Commission – 2060

The Internal Auditor must report periodically to senior management and the Commission on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting must also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the Commission. For reporting purpose, Senior Management shall consist of the Executive Director and Chief Financial Officer.

External Service Provider and Organizational Responsibility for Internal Auditing - 2070

When an external service provider serves as the internal audit activity, the provider must make the Agency aware that the Agency has the responsibility for maintaining an effective internal audit activity.

Nature of Work - 2100

The Internal Auditor shall evaluate the effectiveness and contribute to the improvement of governance, risk management, and control processes using a systematic and disciplined approach.

The scope of the internal auditing function shall encompass examination and evaluation of the adequacy and effectiveness of both the Agency's systems of internal control and the quality of performance in carrying out assigned responsibilities. Periodic audits of the Agency's major systems and controls, including accounting systems and controls, administrative systems and controls, and electronic data processing systems and controls shall be conducted. Internal auditing activities include, but are not limited to:

- Reviewing and appraising the reliability and integrity of accounting, financial, and operating information, and the means used to identify, measure, classify, and report such information.
- Reviewing and appraising the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations that could have a significant impact on operations and reports, and determining the extent of compliance.
- Reviewing and appraising the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
- Reviewing and appraising operations and programs to determine whether results are consistent with established objectives and goals and whether the operations and programs are carried out as planned.
- Appraising the economy and efficiency with which resources are employed.
- Appraising the Agency's effectiveness in meeting its statutory duties.
- Reviewing the planning, design, development and implementation of major information systems to determine whether adequate controls are incorporated in the systems.
- Reviewing for the potential existence of fraud and abuse, and reporting to proper authorities when detected.

Governance - 2110

The Internal Auditor must assess and make appropriate recommendations for improving the Agency's governance process in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the Agency;
- Ensuring effective organizational performance management and accountability;

- Communicating risk and control information to appropriate areas of the Agency; and
- Coordinating the activities of and communicating information among the Commission, external and internal auditors, and management.

The internal audit activity must evaluate the design, implementation, and effectiveness of the Agency's ethics-related objectives, programs, and activities.

The internal audit activity must assess whether the information technology governance of the Agency supports the Agency's strategies and objectives.

Consulting engagement objectives must be consistent with the overall values and goals of the Agency.

Risk Management – 2120

The Internal Auditor shall assist the Agency in identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.

The Internal Auditor shall evaluate risk exposures relating to the Agency's governance, operations, and information systems regarding the:

- Achievement of the organization's strategic objectives;
- Reliability and integrity of financial and operation information;
- Effectiveness and efficiency of operations and programs;
- Safeguarding of assets; and
- Compliance with laws, regulations, policies, procedures, and contracts.

The Internal Auditor must evaluate the potential for the occurrence of fraud and how the Agency manages fraud risk.

During consulting engagements, the Internal Auditor shall address risk consistent with the engagement's objectives and should be alert to the existence of other significant risks. Internal auditors must incorporate knowledge of risks gained from consulting engagements into their evaluation of the agency's risk management processes.

When assisting management in establishing or improving risk management processes, internal auditors must refrain from assuming any management responsibility by actually managing risks.

2130 – Control

The Internal Auditor must assist the Agency in maintaining effective controls by evaluating its effectiveness and efficiency and by promoting continuous improvement. The Internal Auditor must evaluate the adequacy and effectiveness of controls in responding to risks within the Agency's governance, operations, and information systems regarding the:

- Achievement of the organization's strategic objectives;
- Reliability and integrity of financial and operation information;
- Effectiveness and efficiency of operations and programs;
- Safeguarding of assets; and
- Compliance with laws, regulations, policies, procedures, and contracts.

The Internal Auditor should ascertain the extent to which operating and program goals and objectives have been established and conform to those of the Agency.

The Internal Auditor should review operations and programs to ascertain the extent to which results are consistent with established goals and objectives to determine whether operations and programs are being implemented or performed as intended.

During consulting engagements, the Internal Auditor must address controls consistent with the engagement's objectives and be alert to significant control issues.

Engagement Planning - 2200

Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations.

In planning the engagement, internal auditors must consider:

- The objectives of the activity being reviewed and the means by which the activity controls its performance;
- The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level;
- The adequacy and effectiveness of the activity's governance, risk management, and control processes compared to a relevant control framework or model; and
- The opportunities for making significant improvements to the activity's

governance, risk management, and control processes.

Objectives must be established for each engagement and the established scope must be sufficient to satisfy the objectives of the engagement.

Internal auditors must determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources.

Internal auditors must develop and document work programs that achieve the engagement objectives.

Performing the Engagement - 2300

Internal auditors must identify, analyze, evaluate, and document sufficient information to achieve the engagement's objectives.

Internal auditors must consider concerns relating to the protection of personally identifiable information gathered during audit engagements as advances in information technology and communications continue to present privacy risks and threats. Privacy controls are legal requirements in many jurisdictions.

Internal auditors may use analytical procedures to obtain audit evidence. Analytical procedures involve studying and comparing relationships among both financial and nonfinancial information. The application of analytical procedures is based on the premise that, in the absence of known conditions to the contrary, relationships among information may reasonably be expected to exist and continue. Examples of contrary conditions include unusual or nonrecurring transactions or events; accounting, organizational, operational, environmental, and technological changes; inefficiencies; ineffectiveness; errors; fraud; or illegal acts.

Internal auditors must identify sufficient, reliable, relevant, and useful information to achieve the engagement's objectives and must base conclusions and engagement results on appropriate analyses and evaluations. Internal auditors must document relevant information to support the conclusions and engagement results.

Engagements must be properly supervised to ensure that objectives are achieved, quality is assured, and staff is developed.

The Internal Auditor must control access to engagement records. The Director must obtain the approval of senior management and/or legal counsel prior to releasing such records to external parties, as appropriate.

Communicating Results, Criteria for Communicating, and Quality of Communications – 2400, 2410 and 2420

The Internal Auditor must communicate the results of engagements to the appropriate parties. The Director is responsible for communicating the final results to parties who can ensure that the results are given due consideration.

The Internal Auditor shall report directly to the Commission or Audit Committee. The Internal Auditor shall report to the Executive Director for administrative matters.

The Internal Auditor must communicate audit findings and recommendations with appropriate levels of management prior to issuing final reports. Communications must include the engagement's objectives and scope as well as applicable conclusions, recommendations, and action plans. Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the Agency. Communications must be accurate, objective, clear, concise, constructive, complete, and timely.

The Internal Auditor must exercise caution when communicating noncompliance with laws, regulations, and other legal issues. Developing policies and procedures regarding the handling of those matters as well as a close working relationship with other appropriate areas (e.g., legal counsel and compliance) is strongly encouraged.

The Internal Auditor shall issue a final written report that incorporates management's responses to audit findings and recommendations. Copies of the final report shall be provided to appropriate members of management, the Executive Director, the Audit Committee, and Commissioners.

Final communication of engagement results must, where appropriate, contain the auditors' opinion and/or conclusions. When issued, an opinion or conclusion must take account of the expectations of senior management, the Commission, and other stakeholders and must be supported by sufficient, reliable, relevant, and useful information. Internal auditors are encouraged to acknowledge satisfactory performance in engagement communications.

If a final communication contains a significant error or omission, the Internal Auditor must communicate corrected information to all parties who received the original communication.

If the Internal Auditor comes into possession of critically sensitive information that is substantial to the Agency and poses significant potential consequences, and deems the new information substantial and credible, the Internal Auditor shall communicate the information – in a timely manner – to senior management and the Commission. If the Director, after those discussions, concludes that senior management is exposing the Agency to an unacceptable risk and is not taking appropriate action, he or she must present the information and the differences of opinion to the Commission. The typical chain-of-command communication scenario may be accelerated for certain types of sensitive occurrences because of laws,

regulations, or common practices, and Director may communicate the information to persons outside the normal chain of command or even outside the Agency.

The Internal Auditor shall follow-up on reported findings to ensure that appropriate and timely management resolution of audit issues has occurred. Management shall be responsible for deciding the appropriate actions to be taken in response to reported audit findings. The Internal Auditor shall provide follow-up reports on all significant findings to the Executive Director, Audit Committee, and Commissioners. Follow-up reports shall include significant audit findings where senior management has decided to assume the risk of not correcting the reported condition because of cost or other considerations.

When releasing engagement results to parties outside the Agency, the communication must include limitations on distribution and use of the results. If not otherwise mandated by legal, statutory, or regulatory requirements, prior to releasing results to parties outside the Agency the Internal Auditor must assess the potential risk to the Agency, consult with senior management and/or legal counsel as appropriate, and control dissemination by restricting the use of the results.

The Internal Auditor is responsible for communicating the final results of consulting engagements to the Agency. During consulting engagements, governance, risk management, and control issues may be identified. Whenever these issues are significant to the Agency, they must be communicated to senior management and the Commission.

Engagement Disclosure of Nonconformance – 2431

When nonconformance with the Definition of Internal Auditing, the Code of Ethics, or the Standards impacts a specific engagement, communication of the results must disclose the:

- Principle or rule of conduct of the Code of Ethics or Standard(s) with which full conformance was not achieved;
- Reason(s) for nonconformance; and
- Impact of nonconformance on the engagement and the communicated engagement results.

Overall Opinions - 2450

When an overall opinion is issued, it must take into account the expectations of senior management, the Commission, and other stakeholders and must be supported by sufficient, reliable, relevant, and useful information.

Monitoring Progress - 2500

The Internal Auditor must establish and maintain a system to monitor the disposition of results communicated to management.

The Internal Auditor must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

The internal audit activity must monitor the disposition of results of consulting engagements to the extent agreed upon with the client.

Communication of Risks – 2600

When the internal auditor concludes that senior management has accepted a level of residual risk that may be unacceptable to the organization, the internal auditor must discuss the matter with senior management. If the internal auditor determines that the matter has not been resolved, the internal auditor must communicate the matter to the Commission.

Adrienne Courtney
Chief Financial Officer
Texas Racing Commission

Chuck Trout
Executive Director
Texas Racing Commission

This Charter was approved by the Texas Racing Commission
on _____, and replaces any previously approved versions.

John T. Steen III, Chair
Texas Racing Commission

