The Role of the Internal Auditor in Texas School Districts

What you will learn:

- A board’s legal duties with respect to audits
- Difference between the role of internal auditor and the district’s independent auditor
- How to hire an internal auditor
- Confidentiality provisions relevant to an internal auditor’s job duties

Key points:

- The Texas Education Code requires an internal auditor to report directly to the board
- Local policy should address the internal auditor’s access and authority
- Even small districts have the resources to develop internal controls to address risk

The Role of the Internal Auditor in Texas School Districts

The school board has a fiduciary duty to oversee the district’s use of taxpayer dollars. Engaging a qualified professional to conduct regular reviews of the district’s budget and operations can be an important part of the board’s fiscal management. The benefits of hiring an internal auditor also go far beyond balancing the budget. While districts must undergo an independent audit every year, independent auditors are not tasked with looking for fraud, corruption, or inefficient practices; districts must address these areas using internal controls. This article will describe the unique role of the internal auditor and answer some frequently asked legal questions regarding internal auditors in Texas school districts.

1. *What are the board’s legal duties with respect to audits of the district’s financial operations?*

The Texas Education Code requires a school district board of trustees to ensure that the district’s fiscal accounts are audited annually by a certified public accountant (CPA) holding a permit from the Texas State Board of Public Accountancy.¹ A district must file its annual *independent audit* with the Texas Education Agency (TEA) no later than the 150th day after the end of the fiscal year for which the audit was prepared.² TEA provides the necessary guidance for school districts and their auditors to accomplish the independent audit in the *Financial Accountability System Resource Guide,* or “FASRG,” which is adopted by TEA as an administrative rule.³ According to the FASRG, “... audits provide reasonable assurance about whether the financial statements of a school district present fairly the financial position, results of operations, and cash flows of the school district in conformity with generally accepted accounting principles or other bases of accounting.”⁴ Therefore, the independent auditor reviews a district’s financial statements and analyzes whether they accurately represent the district’s financial health for the
period of review. In addition to evaluating the district’s financial statements, the independent audit process is used to determine whether the district is accurately providing information to the state through the Public Education Information Management System (PEIMS), and the audit results are reflected in the district’s Financial Integrity Rating System of Texas (FIRST) rating. 

In contrast, employing an internal auditor is not required by law but is a recommended practice to assist the board in its financial oversight role. The FASRG Purchasing Module recommends that districts periodically review their purchasing processes to ensure that district personnel are following purchasing policies and procedures. Further, TEA recommends that districts with enrollments of 5,000 or more students conduct periodic risk assessments for fraud. An internal auditor may help a district to detect and prevent fraud or mismanagement early on, which may eliminate or reduce the need for intervention by outside agencies. Implementing internal auditing procedures with consistency may also reduce a district’s risk of liability for failure to respond appropriately when internal misconduct is discovered.

2. What kinds of things does an internal auditor do?

According to Steve Shepherd, Chief Internal Auditor for Forth Worth ISD, it is a common misperception that auditors deal only with an entity’s financial structure. Internal auditors can provide numerous types of audits, including: (1) operation or performance audits of a specific activity, such as the district’s payroll function; (2) audits to determine compliance with specific standards such as board policy, contracts, or grants; (3) financial auditing, e.g., review of a district’s activity fund or long term debt; and (4) unique projects or investigations, in which the auditor’s consultation may result in a factual analysis rather than a recommendation or opinion regarding how to improve. Jennifer Land, Director of Internal Audit at Round Rock ISD, says that internal auditors are “specially trained to add value and improve district operations by using a systematic approach.” An internal auditing department can provide objective assurance that a district is managing its operations wisely in accordance with all applicable requirements.

In some districts, internal auditors may assist the district’s independent auditor in preparing the annual report to TEA. The FASRG provides guidance for independent auditors regarding how to evaluate and, if appropriate, use the work of an internal auditor.

3. How can an internal auditor be involved in purchasing and construction?

Internal auditors are frequently involved in reviewing a district’s processes for purchasing goods and services, including construction. Construction is one of the most expensive activities a district may undertake; it also involves a high risk of legal and contractual liability. Risks associated with construction include: contractors’ false claims for materials or labor; substituted materials; kickbacks; bribes; conflicts of interest; non-compliance with laws, regulations or policies; and, of course, simple human error. An internal construction audit can ensure that the district gets what it paid for. If a district does not have an internal auditor, another administrator can be assigned to perform auditing functions in a construction project.
As a preliminary matter, before entering into a binding agreement a school district should review the contract for audit provisions. The FASRG purchasing module advises: “[I]t is essential that any . . . form of contract that might be used as a part of a competitively negotiated or design/build contract arrangement include a full right of the District to audit construction cost.”

Therefore, the district should ensure that construction contracts provide the district with the ability to access and audit the project records. Similarly, contracts for other types of goods or services should not restrict the district’s auditing function.

The district’s internal auditor, or another administrator who is tasked with reviewing the project, should review the construction project documents from beginning to end, including all procurement documents, contracts, addenda, progress reports, and construction meeting minutes. It is crucial that the internal auditor be familiar with the structure of the contracts and know who has the authority to authorize work or payments on behalf of the district. The district should also routinely review invoices and request documentation regarding any unusual costs.

While audits are often performed at the conclusion of a project, for long-term investments it is wise to consider the alternative of a “continuous audit.” Auditing throughout the duration of a project is the best way prevent errors, e.g., overbilling or misdirected payments, from recurring and compounding the loss. In addition, correcting these issues during contract performance may prove to be a simpler task for the district, as contractors have less incentive to issue refunds promptly after the district’s final payment is received.

4. **How should a district hire an internal auditor?**

Under state law, the board of trustees selects the district’s internal auditor. A district looking to hire an internal auditor for the first time may benefit from reviewing how other districts have structured the position. Professional organizations such as the Texas Association of School Business Officials (TASBO) and the Institute of Internal Auditors (IIA) can also assist. TASB HR Services’ model job description for an internal auditor requires applicants to have a bachelor’s degree in accounting, management, finance, or business, as well as knowledge of generally accepted accounting principles (GAAP) and the IIA Code of Ethics. Many employers require internal auditors to hold a CPA license. Other certifications offered by the IIA include Certified Internal Auditor (CIA) and Certified Governmental Auditing Professional (CGAP).

Unlike other district professional employees, internal auditors are not entitled to be employed through contracts under Chapter 21 of the Texas Education Code. Although some districts may extend Chapter 21 contracts beyond the requirements of state law, this approach is not recommended as Chapter 21 contracts incorporate statutory procedures that make termination of employment expensive and time-consuming. A district may employ an internal auditor on an at-will basis. Alternatively, a district may decide to offer an internal auditor a non-Chapter 21 contract that does not incorporate the statutory protections required for teachers and other certified educators. If a district employs an internal auditor, or any other professional, under a non-Chapter 21 contract, this decision should be addressed in local policy. See TASB Policies DCE(LEGAL) and (LOCAL).
5. **What about small districts?**

Small districts that lack the resources to employ a full-time internal auditor may opt to hire a consulting auditor on an independent contractor basis. Under the Professional Services Procurement Act, the board may not select the services of a person who is licensed and registered as a CPA on the basis of competitive bids but must instead award a contract for the professional services based on demonstrated competence and qualifications to perform the services for a fair and reasonable price. The district may issue a Request for Qualifications in order to determine the most qualified provider, based on these factors.

Shepherd cautions that the role of an independent contractor is “inherently limited” and may not provide the same level of objectivity, independence, or thoroughness as a true internal audit function. Nonetheless, these contractors can assist a district in reviewing internal controls.

Even if a district does not hire a dedicated internal auditor, “there’s no reason for small districts to say: just because we’re small, we can’t assess risk,” says Land. According to Land, in many districts an employee without the auditor title may fulfill a limited auditing function simply by perceiving the risk of fraud or mismanagement and taking steps to prevent or reduce the risk. For example, business office staff should be trained and reminded to review invoices carefully and inquire about any irregularities. All districts can “conduct risk assessment, implement controls to reduce risk, train employees and make them aware of controls, and then evaluate and re-evaluate controls annually,” says Land. In many cases, these internal controls can help greatly by either eliminating a problem or laying a foundation for further investigation if outside assistance is needed.

6. **Must a district revise its local policies in order to hire an internal auditor?**

According to the IIA’s “International Standards for the Professional Practice of Internal Auditing” (“Standards”), the “purpose, authority, and responsibility” of an internal audit unit must be defined in a formal document, often referred to as an “internal audit charter.” Though a specific policy is not legally required, the Standards advise the governing board to adopt an internal audit charter consistent with the IIA’s Professional Practices Framework, consisting of the Definition of Internal Auditing, the Standards, and the Code of Ethics. An example of such a charter is the Model Internal Audit Activity Charter (“Model Charter”) published by the IIA, which some districts have adopted as CFC(LOCAL). Though not required by law, a district is well advised to adopt a local policy consistent with these industry guidelines to define the role of an internal auditor. Districts should work with their attorneys to ensure that the internal audit charter is tailored to comply with laws and regulations governing Texas school districts.

7. **To whom does the internal auditor report?**

The Texas Education Code states that a school district’s internal auditor reports directly to the board of trustees. Other than the superintendent, the internal auditor is the only employee under the board’s direct control. This unique status is intended to preserve the independence and objectivity of the auditor position. According to the IIA’s Standards, the chief audit executive for an entity must have “direct and unrestricted access to senior management and the board” in
order to “achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity.” A board’s failure to uphold the legally required reporting structure for an internal auditor can have serious consequences.

As a practical matter, the internal auditor may report administratively to the superintendent or another high level administrator, e.g., chief financial officer, while reporting functionally to the board of trustees. The IIA’s Standards list the following as examples of the board’s responsibilities in a functional reporting relationship:

- Approving the internal audit charter;
- Approving the risk based internal audit plan;
- Approving the internal audit budget and resource plan;
- Receiving communications from the chief audit executive on the internal audit activity’s performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the chief audit executive;
- Approving the remuneration of the chief audit executive; and
- Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

A district’s local policy or procedures may contain additional guidelines to assist staff, officials, and the community in understanding the role and reporting functions of the internal auditor. In some districts, the internal auditor reports to an audit committee composed of members of the board of trustees. A district considering this option should consult with an attorney regarding the application of the Texas Open Meetings Act (OMA) to committee meetings.

8. What laws apply to an internal auditor’s activities?

In general, the laws and rules applicable to an internal audit function depend on the type of audit performed. For example, an internal auditor may review a particular project or operation for compliance with district policy, state or federal grant rules, or contractual obligations. Module 4 of the FASRG contains guidelines applicable to various types of audits, such as attendance audits, and a district’s assessment for the risk of fraud. In a district’s annual independent audit, the FASRG requires independent auditors to evaluate the role of the internal audit function, if any, and consider whether the work of the internal auditor should be used to assist in the independent audit. Further, the FASRG notes, “school districts that provide evidence of proactive steps to adequately diminish the risk of fraud will achieve a more favorable assessment by their independent auditors.”
9. Can an internal auditor access any and all district records?

From time to time, an internal auditor will need to review district information that would not be available to the general public. For example, certain student information may be the subject of an attendance or discipline audit for PEIMS. An internal auditor may also come into contact with sensitive personnel information when reviewing district departments or operations. Inevitably, there will be situations in which district employees feel unsure about the propriety of providing such information to an internal auditor. In these cases, local policy can be useful to establish the scope of the internal auditor’s authority. Some may consider local policy provisions that explicitly authorize an internal auditor to access “any and all district records” to be overly broad. A district is not legally required to adopt this type of policy, though the risk of doing so is minimal in light of the certified internal auditor’s ethical standards and provisions in law that authorize district officials to access confidential information.

The Code of Ethics of the IIA requires internal auditors to be “prudent in the use and protection of information acquired in the course of their duties” and not to “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 organization.” With respect to student records, as a district official an internal auditor’s review of personally identifiable student information for a legitimate educational reason, such as an attendance audit, would fall under an exception to the Family Educational Rights and Privacy Act (FERPA). Therefore, districts are not required to obtain parental consent before sharing student records with the internal auditor for the purposes of fulfilling the auditor’s job duties. Districts that contract with a third party consultant to provide auditing services involving student records should consult with an attorney to ensure that the district’s policy and auditing agreement comply with FERPA regulations regarding contracted service providers.

Addressing the internal auditor’s access to district information and personnel is a wise local decision. For example, a board of trustees that is concerned about confidentiality might adopt a policy that the internal auditor may access any and all district information, except as provided by law. The Model Internal Audit Activity Charter (“Model Charter”) published by the IIA states that the “internal audit activity, with strict accountability for confidentiality and safeguarding records and information, is authorized full, free, and unrestricted access to any and all of [the district’s] records, physical properties, and personnel pertinent to carrying out its engagement.” Districts should work with their attorneys to ensure that local policy addresses the district’s legal duty to preserve the confidentiality of certain records while maintaining the internal auditor’s authority and effectiveness.

10. Is an internal auditor’s report confidential?

The final report of a school district’s auditor is public information. However, information prepared or maintained in conducting the audit or preparing the audit report, including drafts, partial drafts, intra-agency and interagency communications, are excepted from the disclosure requirements of the Texas Public Information Act. A school district that receives a request from a member of the public for this type of information, known as “audit working papers,” must seek permission from the attorney general in order to withhold the information.
There is no exception to the OMA that applies specifically to a board’s discussion with the district’s internal auditor. Therefore, an internal auditor must report to the board in open session unless an exception applies based on the content of the report. For example, depending on the circumstances, an audit report regarding possible fraud or other employee misconduct may be discussed in closed session under the “personnel exception.” A board may also meet in closed session to discuss a security audit.

As with other district personnel, an issue may arise concerning whether it is appropriate for the board to bring the internal auditor into a closed session deliberation. In general, a person who is not a member of the board may only join in closed session deliberations when the board has determined: (1) that the interests of the person are not adverse to the board’s; and (2) that the person’s participation is necessary to the matter at hand. The attorney general has opined that it did not violate the OMA for a county commissioner’s court to bring the county auditor into closed session deliberations regarding real property or personnel as long as the court determined that the auditor’s interests were not adverse to the court’s interests and that the auditor’s participation was necessary to the matter being considered. A board’s consideration of whether the auditor’s presence in closed session is adverse will naturally depend on the reason for the closed session meeting. For example, if a board is going into closed session in order to receive legal advice from its attorney, the board will need to determine that the auditor’s presence is consistent with the attorney-client privilege.

11. How should a district respond to an internal auditor’s findings?

In most cases, says Shepherd, if an internal audit is performed properly, “there should be no need for the board to respond.” Best industry practices dictate that internal auditors regularly communicate with district administrators regarding their findings and recommended corrective action plans during an audit. Often, by the time the findings are reported to the board as an information item, the administration has already addressed the findings and taken any necessary action. According to the IIA’s Model Charter, the internal audit report may include the administration’s response to specific findings and recommendations, corrective action taken or to be taken, a timetable for anticipated completion of corrective action, and an explanation of any corrective action that will not be implemented. Boards in districts that receive an internal audit report with this level of detail will usually not need to take any further action.

On the other hand, Shepherd cautions, “sometimes board action is desirable and necessary.” Land agrees that whether the board should take any action based on the internal auditor’s report “depends on how important is the issue being communicated and whether management has taken actions already.” The board has the duty to assess how the administration is working and should expect the internal auditor’s findings to be addressed promptly. If there is a delay in implementation, it may be necessary for the board to revisit the issue with the superintendent.

When an internal auditor’s report brings difficult news, district decision makers are wise to remember not to blame the messenger. A public employer may be sued by an internal auditor alleging unlawful workplace retaliation on the basis of protected speech. In order to succeed as a legal “whistleblower” under the Texas Whistleblower Act, an employee must report wrongdoing to a law enforcement or regulatory authority with the ability to address the alleged wrongdoing; it is
unlikely that an internal report by, or to, an internal auditor would meet this standard.\textsuperscript{36} In a lawsuit against a public employer alleging retaliation in violation of the First Amendment of the U.S. Constitution, a threshold issue involves whether the employee was speaking pursuant to his or her official duties.\textsuperscript{37} While an internal auditor’s report to a board is provided within the auditor’s official duties, in certain situations a public employee may speak as a private citizen on a matter of public concern, and therefore be entitled to constitutional protection, even though the context of the speech involves facts learned during the performance of official duties.\textsuperscript{38}

Fortunately for Texas school districts, the reporting structure mandated by state law supports the internal auditor’s independence and objectivity. However, districts and their internal auditors must also take measures to prevent workplace retaliation. For the internal auditors, says Land, this means communicating regularly with employees to dispel the myth of the “gotcha” auditor out to get people into trouble: “We are independent in fact and appearance but we know that we are still district employees here for the same purpose. We have to build positive relationships so that our credibility is established.” Districts must also ensure that any adverse employment decision taken against an employee in the internal audit unit is supported by legitimate, documented reasons.

Conclusion

Like any organization, school districts benefit from a dedicated internal audit unit with the primary function of reviewing and improving internal controls. School boards should consider whether creating the position of an internal auditor is appropriate for their districts. In districts without a full-time internal auditor, training employees in the wisdom and best practices of the auditing profession can also help to identify potential risk and ensure that the district works efficiently. In accordance with state law and local policy, internal auditors play an important role in helping districts to achieve local goals and to improve public education in Texas.
5 Tex. Educ. Code § 44.008(b).
12 Tex. Gov't Code §§ 2254.002(b)-003.
23 34 C.F.R. § 99.32(c)(3). See TASB policy FL(LEGAL) and (LOCAL)
26 Tex. Gov’t Code § 552.022(a)(1).
29 Tex. Gov’t Code § 551.074.
30 Tex. Gov’t Code § 551.076.
35 See, e.g. Davis v. McKinney, 518 F.3d 304 (5th Cir. 2008) (reversing denial of summary judgment in part regarding complaints by information systems auditor regarding public university employer’s pattern of discriminatory practices and inadequate response to auditor’s computer pornography investigation).
36 See Canutillo Indep. Sch. Dist. v. Farran, 409 S.W.3d 653 (Tex. 2013) (holding that district transportation director had not satisfied the statutory requirements by reporting alleged improprieties to superintendent, board of trustees, and internal auditor because they lacked enforcement authority outside of the school district).
38 See Lane v. Franks, 2014 WL 2765285 (June 19, 2014) (holding that public employee’s sworn testimony in judicial proceeding was protected citizen speech on a matter of public concern even though testimony involved facts learned as a result of the employment).