

COUNCIL'S PEER REVIEW PROGRAM

EXTERNAL QUALITY ASSESSMENT

OF

NORTH CAROLINA

COMMUNITY COLLEGE SYSTEM OFFICE

INTERNAL AUDIT FUNCTION

April 2017

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April 12, 2017

State Board of Community Colleges, Chairman of the Accountability and Audit Committee
President Jimmie Williamson, Ph.D., System President
Bryan Jenkins, CPA, Internal Audit Director
North Carolina Community College System Office

Greetings:

I have completed an External Quality Assessment (QA) of the North Carolina Community College System Office's Internal Audit Function as required every five years by the Institute of Internal Auditors (IIA) *International Standards for the Professional Practice of Internal Auditing (Standards)*. The objectives of the QA were:

1. To assess conformance with the IIA *Standards*;
2. To assess the effectiveness of the Internal Audit activity in providing services to the management of the North Carolina Community College System Office; and
3. To identify opportunities for improving the Internal Audit Program at the North Carolina Community College System Office.

I am fully independent of the North Carolina Community College System Office and have the necessary knowledge and skills to undertake this engagement. I am a seasoned audit professional with 25 years of audit experience and hold the following credentials: Certified Internal Auditor (CIA) and Certified Public Accountant (CPA). Additionally, I administer a statewide peer review program for the North Carolina Council of Internal Auditing¹ and have participated in over 20 quality assurance reviews.

Overall, it is my opinion that the North Carolina Community College System Office's Internal Audit Function **generally conforms** to the IIA *Standards*. I noted opportunities for improvement that will enhance conformance with the *Standards* and improve the effectiveness of the Internal Audit Function. These are described in a following sections of this report.



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¹ Six-person board made up of the State Controller, State Auditor, State Budget Director, Attorney General and Secretaries of Administration and Revenue to establish policies to ensure the success of internal audit within North Carolina State Government.

TABLE OF CONTENTS

INTRODUCTION	1
PURPOSE AND OBJECTIVES.....	1
OPINION AS TO CONFORMANCE TO THE STANDARDS.....	1
SCOPE AND METHODOLOGY	2
RECOMMENDATIONS AND OBSERVATIONS.....	2
PART I — NOTABLE ACCOMPLISHMENTS.....	3
PART II — MATTERS FOR CONSIDERATION OF MANAGEMENT.....	3
1. Observation: Internal Audit Resources	3
2. Observation: Functional Report	4
PART III — ISSUES SPECIFIC TO THE INTERNAL AUDIT ACTIVITY	5
1. Observation: Quality Assurance and Improvement Program.....	5
2. Observation: Annual Risk Assessment and Audit Plan	7
3. Observation: Lack of Supervision.....	8
4. Observation: Engagement Planning	9
5. Observation: Client Corrective Action Plans	10
6. Observation: Monitoring Corrective Action	11
7. Observation: Evaluate and Contribute to Improving the Governance Process	11
PART IV— OBSERVATION OF PROCESS IMPROVEMENT OPPORTUNITIES	13
1. Process improvement: Guest or Contracted Auditor.....	13
2. Process improvement: Stakeholder Satisfaction	14
3. Process improvement: Accountability and Audit Committee Charter	14
4. Process improvement: Fraud, Waste and Abuse Hotline	14
5. Process improvement: Policy and Procedure Manual	15
ATTACHMENT A: Standards Conformance Form – Overall Evaluation Summary	16

INTRODUCTION

PURPOSE AND OBJECTIVES

As requested by the Internal Audit Director (Director), we conducted a quality assessment of the internal audit function (IA) at the Community College System Office (System Office). The principal objectives of the Quality Assessment (QA) were to:

- Assess IA’s conformity to The Institute of Internal Auditors (IIA) *International Standards for the Professional Practice of Internal Auditing (Standards)*
- Evaluate IA’s effectiveness in carrying out its mission (as set forth in its charter and expressed in the expectations of the System Office management)
- Identify opportunities to enhance IA’s management, work processes, and value to the System Office
- Identify noteworthy accomplishments

OPINION AS TO CONFORMANCE TO THE STANDARDS

It is our overall opinion that the System Office IA activity ***Generally Conforms***. For a detailed list of conformance to individual *Standards*, please see Appendix A. While improvement opportunities exist in various areas, they did not preclude this assessment. The following major standards were judged to Generally Conform to the *Standards*.

- 1000--Purpose, Authority and Responsibility
- 1100--Independence and Objectivity
- 1200--Due Professional Care
- 2000--Managing the Internal Audit Program
- 2100--Nature of Work
- 2300--Performance of the Engagement
- 2400--Communication of Results
- 2600--Resolution of Senior Management Acceptance of Risk

The following major Standards were judged as Partially Conforms to the *Standards*.

- 1300--Quality Assurance and Improvement Program
- 2200--Engagement Planning

The following major Standards were judged as Does Not Conform to the IIA *Standards*.

- 2500--Monitoring Progress

The IIA’s Quality Assessment Manual suggests a scale of three ratings, “Generally Conforms,” “Partially Conforms,” and “Does Not Conform.” “Generally Conforms” is the top rating and means that an IA activity has a charter, policies, and processes that are judged to be in conformance with the *Standards*. “Partially Conforms” means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies did not preclude the IA activity from performing its responsibilities in an acceptable manner. “Does Not Conform” means deficiencies in practice are judged to be so significant as to seriously impair or preclude the IA activity from performing adequately in all or in significant areas of its responsibilities.

SCOPE AND METHODOLOGY

As part of the preparation for the QA, the Director prepared documents with detailed information and sent surveys to a representative sample of the System Office staff and senior management. A summary of the survey results (without identifying the individual survey respondents) have been furnished to Director. Prior to commencement of the onsite work by the peer review team on February 22, 2017, the team lead worked with the Director to gather additional background information, select executives for interviews during the onsite field work, and finalize planning and administrative arrangements for the peer review. Extensive interviews with the System Office management and IA staff were conducted. We also reviewed IA's risk assessment and audit planning processes, audit tools and methodologies, engagement and staff management processes, and a representative sample of IA's working papers and reports.

RECOMMENDATIONS AND OBSERVATIONS

Recommendations and observations are divided into four groups:

1. Observations that recognize best practices employed by IA leading to a level of performance beyond generally conforming to the mandatory guidance of the IIA.
2. Recommendations that concern the organization as a whole and suggest actions by senior management. Some of these are matters outside the scope of the peer review, as set out above, which came to our attention through the surveys and interviews. We include them because we believe they will be useful to management and because they impact the effectiveness of IA and the value it can add.
3. Recommendations that relate to IA structure, staffing, deployment of resources, and similar matters that should be implemented within IA, with support from senior management.
4. Observations of process improvement opportunities for IA to consider in its continuous improvement efforts. These do not indicate a lack of conformance to mandatory IIA guidance. They are offered as suggestions for the continued growth of IA's successful practice.

Significant recommendations are set forth below.

PART I — NOTABLE ACCOMPLISHMENTS

None

PART II — MATTERS FOR CONSIDERATION OF MANAGEMENT

1. **Observation:** Internal Audit Resources

Standard: 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. *Interpretation:* *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.* (Standard 1130)

The chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan. *Interpretation:* *Appropriate refers to the mix of knowledge, skills, and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimizes the achievement of the approved plan.* (Standard 2030)

Condition: The Community College System Office (System Office) has a sole audit function. Based on the most current performance evaluation less than 20% of the auditor's time relates to internal auditing creating a scope limitation. The remaining time is used to perform management functions creating an independence impairment.

Scope limitation occurs when internal audit does not have enough resources to perform necessary assurance and consulting engagements to reduce the System Office exposure to risk. The North Carolina Council of Internal Auditing established a best practice to have a minimum of two full-time auditors within an internal audit function. Presently, the System Office has the equivalent of less than .20 FTE for internal auditing. Also, OSBM internal audit staffing analysis conducted in 2014, identify the minimal requirement of 2.4 internal auditors for System Office. This is a cursory review to identify the minimal number of internal audit positions needed, not the optimal. A more in-depth analysis, including the review of high and medium risk areas identified during the risk assessments, will help determine the optimal number of internal auditors needed to effectively mitigate risk.

The lack of resources is compounded by the Internal Audit Director (Director) functioning as the Executive Officer for the State Board, overseeing the Community College Foundation and having responsibility for operations of the Compliance Services work unit. Less than 250 hours per year is devoted to developing a risk-based audit plan and conducting internal audits. Internal audit used these hours to complete all aspects of the EAGLE program leaving no time to develop a robust risk assessment or conduct assurance engagements of high-risk areas/programs/process. The lack of a robust risk assessment and limited assurance engagements can expose the System office to higher unmitigated risk.

Overseeing operational functions at the System Office creates an independence impairment since internal audit cannot conduct any engagements in areas they oversee. Compliance Services is a key part of risk management at the System Office. Internal Audit can provide no assurances to management that this program operates efficiently and effectively since it is under the Director's authority. Also, the Director is responsible for accounting functions related to the Community College Foundation. Finally, last year the internal auditor spent at least 40% of their time supporting the State Board half of which was dedicated to the search for a new president. These areas are management functions and internal audit should not have oversight or perform activities related to these areas.

In FY 2007, the Office of the State Auditor issued a report² on the status of internal auditing in State Government. The report identified management's improper use of internal auditors since auditors were assigned management functions. This report supported the General Assembly's passage of the Internal Audit Act in FY 2008. The intent of the Act is to ensure internal auditors follow auditing standards instead of being assigned management functions. The Act created the North Carolina Council of Internal Auditing which highly supports using internal auditors for providing assurance engagements to reduce risk within an agency and not to perform management functions.

Recommendation: To ensure conformance with the Internal Audit Act; adequate coverage of high and/or medium risk areas; and the ability to address ad hoc items such as allegations and request from management, the State Board and Community College System Office President should:

- Remove the management functions under the responsibility of the Director to eliminate impairments and increase resource availability; and
- Consider providing additional resources to Internal Audit to reduce risk exposure within the System Office.

Response: System Office management concurs with the notion of the Internal Audit function lacking adequate resources and experiencing limitations as mentioned in the Observation. To address the challenge, the System President, with the support of the State Board, will remove the duties related to the North Carolina Community Colleges Foundation from the Director and reassign the duties to a newly created position, Vice President for Public Relations and Foundation Affairs. Doing so will increase resource availability for the Director. Secondly, the System President has begun implementing a plan to reorganize the Internal Audit function by creating a new position having a 100% focus on internal audit. These two (2) actions should increase resource availability and lead to more emphasis on the internal audit function.

2. **Observation:** Functional Report

Standard: The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity. Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:

- Approving the internal audit charter;

² Performance Audit: *Internal Auditing in North Carolina Agencies and Institutions*, September 2006.

- 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. (Standard 1110)

Condition: The IIA Standard 1110 and associated Practice Advisory and Implementation Guides address how to facilitate organizational independence by functionally report to a board and administratively reporting to the CEO of an organization. The Accountability and Audit Committee (Committee) are performing functional duties by reviewing and approving the internal audit's charter, plan, and performance. However, the audit charter states the Director of Internal Audit (Director) reports functionally to the System Office President which conflicts with the actual duties performed by the Committee.

Recommendation: To strengthen organizational independence in fact and appearance, the State Board and Community College System Office President should consider requiring the Director to report functionally to the Accountability and Audit Committee. The internal audit charter would need to be modified to reflect this change. The actual duties of the Committee would remain unchanged.

Response: System Office management concurs with this observation and will require the Director to report functionally to the Accountability and Audit Committee of the State Board of Community Colleges while reporting administratively to the System President and Chief of Staff.

PART III — ISSUES SPECIFIC TO THE INTERNAL AUDIT ACTIVITY

1. **Observation:** Quality Assurance and Improvement Program

Standard: The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity. *Interpretation:* A quality assurance and improvement program is designed to enable an evaluation of the internal audit activity's conformance with the Definition of Internal Auditing and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement. (Standard 1300)

The quality assurance and improvement program must include both internal and external assessments. (Standard 1310)

Internal assessments must include:

- Ongoing monitoring of the performance of the internal audit activity.
- Periodic self-assessments or assessments by other persons within the organization with sufficient knowledge of internal audit practices.

Interpretation: Ongoing monitoring is an integral part of the day-to-day supervision, review, and measurement of the internal audit activity. Ongoing monitoring is incorporated into the routine

policies and practices used to manage the internal audit activity and uses processes, tools, and information considered necessary to evaluate conformance with the Code of Ethics and the Standards. Periodic assessments are conducted to evaluate conformance with the Code of Ethics and the Standards. Sufficient knowledge of internal audit practices requires at least an understanding of all elements of the International Professional Practices Framework. (Standard 1311)

The chief audit executive must communicate the results of the quality assurance and improvement program to senior management and the board. Disclosure should include:

- The scope and frequency of both the internal and external assessments.
- The qualifications and independence of the assessor(s) or assessment team, including potential conflicts of interest.
- Conclusions of assessors.
- Corrective action plans.

Interpretation: The form, content, and frequency of communicating the results of the quality assurance and improvement program is established through discussions with senior management and the board and considers the responsibilities of the internal audit activity and chief audit executive as contained in the internal audit charter. To demonstrate conformance with the Code of Ethics and the Standards, the results of external and periodic internal assessments are communicated upon completion of such assessments, and the results of ongoing monitoring are communicated at least annually. The results include the assessor's or assessment team's evaluation with respect to the degree of conformance. (Standard 1320)

Condition: The internal audit function has not fully implemented the requirements of the Quality Assurance Improvement Program (QAIP). Internal assessments are missing from the QAIP. Internal assessments are comprised of two interrelated parts: ongoing monitoring and periodic self-assessment. Ongoing monitoring provides assurance that the processes in place are working effectively to ensure quality is delivered on an audit-by-audit basis. A well-designed periodic self-assessment program provides the Internal Audit Director with information related to conformance with the *Standards*. The QAIP should document and define a systematic and disciplined approach to the periodic self-assessment process, including how to accomplish the periodic self-assessments and define the scope of activity for each interim year between the external quality assessments. Results of the QAIP must be reported annually and any nonconformance with the *Standards* must be report to the board and senior management which there was no evidence of this reporting requirement.

The Internal Audit Director has attempted to meet the spirit of the *Standards* but a lack of resources (discuss in Part II, Observation #1) creates limitation to fully conform with these *Standards*. The Internal Audit Director has recently developed a QAIP policy however it will be extremely challenging for the Internal Audit Director to fully devote the time and effort needed to implement a systematic process to assess the quality and perform on-going monitoring of the internal audit function.

Recommendation: To ensure quality assurance and continuous improvement is embedded in the internal audit function the Director should implement a process that includes internal assessments and annually communicate to the Committee and senior management as to the results of the QAIP. The Director's communication should include results of on-going monitoring; any periodic self-assessment or external assessment; and nonconformance issues. To conform with the reporting

requirement, the Director can request the Committee to create a standing annual agenda item to discuss the outcome of internal audit's QAIP.

The following publications will provide guidance to improve the QAIP:

- 2012 IIA Practice Guide – Quality Assurance and Improvement Program
- 2011 IIA Practice Guide – Assisting Small Internal Audit Activities in Implementing the International Standards for the Professional Practice of Internal Auditing
- 2010 IIA Practice Guide – Measuring Internal Audit Effectiveness and Efficiency
- 2017 IIA Implementation Guide 1300 through 1322

Response: The Director will address the Quality Assurance and Improvement Program (QAIP) by formalizing the process. Also, the Director will develop measures to assess efficiency and/or effectiveness. Once developed, the measures will be reported to senior management along with the Accountability and Audit Committee of the State Board of Community Colleges as well as the full membership of the State Board of Community Colleges on an annual basis.

2. **Observation:** Annual Risk Assessment and Audit Plan

Standard: The chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization's goals. *Interpretation:* The chief audit executive is responsible for developing a risk-based plan. The chief audit executive takes into account the organization's risk management framework, including using risk appetite levels set by management for the different activities or parts of the organization. If a framework does not exist, the chief audit executive uses his/her own judgment of risks after consideration of input from senior management and the board. The chief audit executive must review and adjust the plan, as necessary, in response to changes in the organization's business, risks, operations, programs, systems, and controls. (Standard 2010)

The internal audit activity's plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process. (Standard 2010.A1)

Condition: The mandatory EAGLE program is used as the risk assessment for developed of the risk-based audit plan. The EAGLE program is not a robust risk assessment but instead focuses on compliance of internal controls over financial reporting. This program can be incorporated into the annual risk assessment but omits some fundamental risk factors such as, strategic, operational and information technology risk.

The EAGLE program identifies financial accounts as auditable units which leave the audit universe incomplete. A complete audit universe catalogs all auditable units for an agency which can be a topic, project, division, department, function, or process. A risk ranking should be assign to each auditable unit. These rankings are used to develop the annual audit plan along with consideration of senior management and State Board member's input.

In addition, engagement risk must be assessed and considered when developing the audit objective for engagement that are not included on the audit plan.

Recommendation: To ensure a value-add approach to internal auditing, the Director should develop a robust risk assessment process which should be used to establish the risk-based audit

plan. This process must be formally documented and can be included in the policy and procedure manual. The IIA has many publications that can aid in the development of a robust risk assessment to establish a risk-based audit plan which include:

- The Internal Auditor’s Guide to Risk Assessment
- Audit Planning
- Enterprise Risk Management
- Becoming a Strategic Internal Auditor: Tying Risk to Strategy
- Enterprise Risk Management and COSO
- 2008 GTAG 11 – Developing the IT Audit Plan
- Practice Advisory 2010-1 – Linking the Audit Plan to Risk and Exposures

Response: The Director will work with members of the Executive Leadership Council to include Chief of Staff, Chief Technology Officer, Chief Finance Officer, Chief Academic Officer, and General Counsel to develop a robust risk assessment process which will consider all areas of risk to include, among others, compliance, financial reporting, strategic, operational, and information technology. The EAGLE risk assessment will continue to be utilized as part of the new process. However, the risk assessment process will be expanded and address the major risk areas within the System Office. The planned completion date for the overhaul is June 30, 2018.

3. **Observation:** Lack of Supervision

Standard: Work programs must include the procedures for identifying, analyzing, evaluating, and documenting information during the engagement. The work program must be approved prior to its implementation, and any adjustments approved promptly. (Standard 2240.A1)

Engagements must be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed. (Standard 2340)

Condition: There is no evidence of supervision throughout the audit process. It is challenging for sole audit functions to conform with all *IIA Standards*. The *Institute of Internal Auditors* published a practice guide³ to aid small audit functions with conformance of *IIA Standards*. This publication rates the degree of challenge “high” for small shop to conform with *IIA Standard 2340*. The guidance includes: a review may be performed by others in the organization with suitable audit or alternate professional backgrounds in subject areas of the conducted audit and reviews must be performed timely.

Other methods are to team up with another small audit function to perform reviews, or the CAO may conduct a self-review, which is a less effective method for ensuring the quality of work.

Recommendation: To ensure the quality of internal audit work and conclusions are adequately supported in reports, the Director should establish a process to address supervision of all audit work. Working in a small internal audit function presents specific challenges with regards to engagement supervision and working paper reviews. These challenges are further compounded in a sole auditor function. In sole auditor function, the internal auditor may seek assistance from other parts of the organization to undertake quality assurance activities, provided this does not impact the independence of internal audit. The Director also may look to peers in other organizations for

³ Assisting Small Internal Audit Activities in Implementing the *Standards*, 2011.

support. Using checklists can assist in providing assurance over audit quality.

Response: The Director understands this observation. Inherent challenges exist for an internal audit function with a single auditor. Some of these challenges may be mitigated, however. The System Office plans to assist the Director by creating a new position having a 100% focus on internal audit. The creation and assignment of this position to the internal audit function will afford the Director the opportunity to address and enhance the supervision of all internal audit work.

4. **Observation:** Engagement Planning

Standard: Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations. (Standard 2200)

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 framework or model; and
- The opportunities for making significant improvements to the activity's governance, risk management, and control processes. (Standard 2201)

Internal auditors must establish an understanding with consulting engagement clients about objectives, scope, respective responsibilities, and other client expectations. For significant engagements, this understanding must be documented. (Standard 2201.C1)

Internal auditors must conduct a preliminary assessment of the risks relevant to the activity under review. Engagement objectives must reflect the results of this assessment. (Standard 2210.A1)

Internal auditors must consider the probability of significant errors, fraud, noncompliance, and other exposures when developing the engagement objectives. (Standard 2210.A2)

In performing consulting engagements, internal auditors must ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop reservations about the scope during the engagement, these reservations must be discussed with the client to determine whether to continue with the engagement. (Standard 2220.C1)

Condition: Some engagements were missing engagement plans or audit programs. Existing plans had limited information related to risk and scope/timing. Audit planning is a key component to assuring the success and timeliness of an engagement and documentation serves multiple purposes. It aids the planning and performance of the audit, it facilitates and supports review, it helps demonstrate the application of the requirements of *International Professional Practice Framework*, and it supports the evaluation of the sufficiency and appropriateness of evidence obtained and conclusions drawn.

Recommendation: To ensure audits are performed efficiently and effectively, the Director should document the audit plan which include the objective, scope, timing and include an assessment of

risk prior to developing the audit program. Plans and programs are fluid documents and changes should be documented.

Response: The Director currently prepares a Planning Memo prior to beginning an audit engagement. However, based on the above observation and recommendation, the Director will expand the planning process to include a more robust planning document containing greater detail relating to areas such as objective, scope, timing, and risk. Also, the Director will work on the development of audit programs to assist in the planning process.

5. **Observation:** Client Corrective Action Plans

Standard: Communications must include the engagement’s objectives and scope as well as applicable conclusions, recommendations, and action plans. (Standard 2400)

Final communication of engagement results must include applicable conclusions, as well as applicable recommendations and/or action plans. Where appropriate, the internal auditors’ opinion should be provided. An opinion must take into account the expectations of senior management, the board, and other stakeholders and must be supported by sufficient, reliable, relevant, and useful information. *Interpretation: Opinions at the engagement level may be ratings, conclusions, or other descriptions of the results. Such an engagement may be in relation to controls around a specific process, risk, or business unit. The formulation of such opinions requires consideration of the engagement results and their significance.* (Standard 2410.A1)

Condition: Internal Audit does not obtain the client’s agreement or disagreement related to the results communicated nor are corrective action plans requested. Client’s corrective action plans are beneficial to the System Office management and the Board to keep them abreast on risk within the agency. Requesting corrective action plan, assist Internal Audit with timing and extent of required follow-up.

Practice Advisory 2410-1, delineate best practice and state: “...The engagement client’s written comments may be included as an appendix to the engagement report, in the body of the report, or in a cover letter.”

Recommendation: To ensure the System Office management and the Board is apprised of existing risk; and allow the client the opportunity to agree or disagree with findings; the Director should require clients to respond to findings and incorporate those responses into the engagement report.

Response: Based on the above observation and recommendation, the Director will request, as part of communicating the audit results, a written response to any/all audit findings and/or recommendations. In applicable situations, the Director will request a written corrective action plan to assist the internal audit function with corrective action monitoring. Once received, the Director will present the audit report and the client’s response to the auditing findings and/or recommendations to the Accountability and Audit Committee of the State Board of Community Colleges as well as the full membership of the State Board of Community Colleges. Also, the Director will report the client’s corrective action plan to the Accountability and Audit Committee of

the State Board of Community Colleges as well as the full membership of the State Board of Community Colleges.

6. **Observation:** Monitoring Corrective Action

Standard: The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management. (Standard 2500)

The chief audit executive 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. (Standard 2500.A1)

The internal audit activity must monitor the disposition of results of consulting engagements to the extent agreed upon with the client. (Standard 2500.C1)

Condition: There is no system for monitoring corrective action related to audit or consulting findings. Internal Audit cannot keep the Committee apprised on status of corrective action if follow up work is not performed. Internal Audit recently developed a policy to require follow up within 12 months of issuance and results be provided to the Board. However, there is no evidence this process is being followed by Internal Audit.

Recommendation: To improve the Board's oversight and ensure risk is mitigated, the Director should develop and implement a system to ensure follow up work is performed in a timely manner and report status of corrective action to the Board.

Response: Currently, Internal Audit has a policy to follow up within 12 months of report issuance. However, the follow up is currently informal in many instances and the Director will work to ensure the follow up process is formalized. The Director will discuss the current policy of 12 months with the Accountability and Audit Committee of the State Board of Community Colleges to determine the Committee's thoughts on timing. Any changes requested by the Committee will be incorporated in the follow up policy. Also, the Director will ensure a written report is prepared delineating the results and/or status to the Accountability and Audit Committee of the State Board of Community Colleges as well as the full membership of the State Board of Community Colleges at its first scheduled meeting following the preparation of the follow up report.

7. **Observation:** Evaluate and Contribute to Improving the Governance Process

Standard: The internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the organization;
- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of the organization; and
- Coordinating the activities of and communicating information among the board, external and internal auditors, and management. (Standard 2110)

The internal audit activity must evaluate the design, implementation, and effectiveness of the organization's ethics-related objectives, programs, and activities. (Standard 2110.A1)

The internal audit activity must assess whether the information technology governance of the organization supports the organization's strategies and objectives. (Standard 2110.A2)

Condition: The internal audit plan does not include work related to the agency's governance process surrounding ethic and information technology governance. The focus of internal audit is to complete all aspects of the EAGLE process which relates to testing controls of financial statements.

Governance is "the combination of processes and structures implemented by management to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives." The information and technological components of an organization are among its most important assets. A lack of appropriate governance over information stored, processed, or produced by IT systems can have a significant negative impact on an organization, ranging from fines and penalties to damaged reputation that can take time, energy, and money to rebuild.

Internal auditors can act in several different capacities in assessing and contributing to the improvement of governance practices. Typically, internal auditors provide independent, objective assessments of the design and operating effectiveness of the organization's governance processes. They may also provide consulting services and advice on ways to improve those processes.

Recommendation: Evaluate and/or contribute to improving the Community College System Office governance process. There are a variety of potential projects that meet the scope and intent of the governance *Standard* including the following examples:

- Coordinating with management in administering an employee ethics survey;
- Participating as a presenter in employee ethics training;
- Providing information and training to management and staff members on the COSO model for Internal control;
- Reviewing executive management and Board members' conformance with state ethics filing requirements;
- Assess the involvement of IT leadership in the development and ongoing execution of the agency's strategic plan.
- Reviewing the processes and/or assess key controls used by the IT division to identify, assess, and monitor/mitigate risks within the IT environment.

Some IIA publication that can aid with improving the governance area are:

- 2012 IIA GTAG 17 – IT Auditing IT Governance
- 2011 IIA Practice Guide – Auditing the Control Environment
- 2012 IIA Practice Guide – Ethics-Related Programs and Activities
- Auditing Social Media: A Governance and Risk Guide
- Evaluating and Improving Organizational Governance
- Advancing Organizational Governance

Response: The Director currently works with the System Office Ethics Liaison to monitor State Board member conformance with the education and filing requirements of the North Carolina State Ethics Commission. The Director will expand the monitoring to include applicable members of System Office management. Also, the Director has informal conversations with members of executive management on occasion to discuss risk and governance. However, based on the above

observation and recommendation, the Director will formalize these discussions and have them on a more scheduled, regular basis and capture the content of the discussions. Also, the Director and the Chief Technology Officer discuss IT risks on occasion. The Director has similar conversations with members of the IT Security unit. Moving forward, the Director will formalize this process and capture the content of the conversations. As relating to internal controls education and discussion, the Director will formalize the process by which internal controls are discussed with and considered by members of the Executive Leadership Council. Lastly, as the State Board of Community College embarks upon the development of a new strategic plan, the Director will continue to participate in all aspects of the plan's development while also participating in the conversations and work surrounding the plan, offering guidance and input as needed.

PART IV— OBSERVATION OF PROCESS IMPROVEMENT OPPORTUNITIES

1. **Process improvement:** Guest or Contracted Auditor

There are other methods for increasing resources within internal auditing without adding permanent positions. This includes utilizing guest auditors and hiring contracted auditors. Observation discussed earlier in this report identified needed improvements and the root cause of most of the shortcomings are lack of resources. In addition, internal audit responsibilities are outline in the Internal Audit Charter and North Carolina General Statute Article 79 of Chapter 143. Both included: "Periodically audits the agency's major system and controls, including:

- Accounting systems and controls.
- Administrative Systems and Controls.
- Information technology systems and controls."

Internal audit has not performed any information technology systems audit due to the lack resources and limited skill set related to information system audits.

Utilizing guest auditors increases specialized skill set within internal auditing with no additional cost to the agency. Cost will be incurred if contractors are hired to increase specialized skill sets resources within internal audit.

Recommendation: To enhance audit coverage, including information technology audits; Internal Audit should consider implementing a Guest Auditor program to allow for leveraging the specialized skills and knowledge for better technical audits within an agency. If funds become available, Internal Audit should consider hiring contractors to increase the number of engagements being performed or assist with the development of a robust risk assessment.

Response: The System President has begun implementing a plan to reorganize the Internal Audit function by creating a new position having a 100% focus on internal audit. Adding another internal auditor will enhance audit coverage and increase resource availability for the internal audit function. Also, the Director will consider the use of contractors in situations deemed appropriate dependent upon the availability of funds.

2. **Process improvement:** Stakeholder Satisfaction

Internal audit functions are required by IIA Standards to maintain a quality assurance improvement to continually monitor and improve internal audit's efficiency and effectiveness. Seeking input from internal audit stakeholders can help internal audit functions determine if they are meeting stakeholder's expectations; how well they are achieving goals and objectives; identify process improvements; and improve communication.

Recommendation: To enhance the quality assurance improvement program, internal audit should consider developing a client satisfaction survey which can be used after each engagement to seek input from clients related to internal audit staff and processes. In addition, internal audit should consider developing a survey for the State Board members and senior management which should be used at least annually.

Response: The Director will develop a survey tool to be shared with clients at the conclusion of the engagement. The survey results will be reported to the Accountability and Audit Committee of the State Board of Community Colleges as well as the full membership of the State Board of Community Colleges at its first meeting following the receipt and compilation of the results. The Director will develop a different survey to be shared with members of the State Board of Community Colleges and members of the Executive Leadership Council. The survey will be shared on an annual basis with the results being reported as part of the internal audit annual update provided to the Accountability and Audit Committee of the State Board of Community Colleges as well as the full membership of the State Board of Community Colleges.

3. **Process improvement:** Accountability and Audit Committee Charter

Duties as defined in the Accountability and Audit Committee's and Internal Audit's charters should coincide with each other. The Internal Audit Charter identifies the duties related to the Accountability and Audit Committee (Committee). The Committee's charter does not include these duties. Missing from the Committee's charter is the review and approval of the internal audit charter and plan, and updates on the results for internal audit's work.

Recommendation: To ensure consistent understanding of roles and responsibility, the Committee should revise the Committee's audit charter to include all duties related to the internal audit function as stated in their charter.

Response: The System Office Internal Audit Charter is updated annually and shared with the Accountability and Audit Committee of the State Board of Community Colleges as well as the full membership of the State Board of Community Colleges. However, the charter of the Accountability and Audit Committee is not reviewed and updated annually. The Director will develop a process to ensure the charter of the Accountability and Audit Committee is reviewed and updated annually and presented to the full membership of the State Board of Community Colleges for review and approval

4. **Process improvement:** Fraud, Waste and Abuse Hotline

A hotline is a great mechanism that anyone may use to report allegations of fraud, waste and abuse. This is an important step toward minimizing losses due to fraud, waste, and abuse. The 2014 ACFE Report to the Nation stated that fraud was detected by tips 42 percent of the time, which made tips

the leading method for detecting fraud. The study also found that entities with fraud hotlines have smaller losses per scheme presumably because the fraud was discovered faster through the tips. Therefore, the greatest reduction in loss was associated with anonymous reporting mechanisms, such as a hotline.

Recommendation: Internal Audit Division should establish a hotline for fraud, waste, and abuse in which allegations can be reported anonymously via telephone and/or website.

Response: System Office management is support the Director's plan to move forward with the plan to establish an e-mail account to allow for anonymous reporting of fraud, waste and abuse concerns. A link to the e-mail account will be visible on the front page of our website. The account should be established no later than May 31, 2017.

5. **Process improvement:** Policy and Procedure Manual

Internal Audit has a limited policy and procedure manual. This may be adequate for a sole audit function, but if addition resources are obtained, the manual should be improved. Developing clearly written policies and procedures that are documented, updated, and followed allow employees to fully understand their roles and responsibilities. Policies and procedures serve as an internal control method to ensure consistent, predictable performance, however internal auditors must follow the policies and procedures otherwise they are meaningless.

Recommendation: To ensure consistent, predictable performance, Internal Audit should consider expanding the policy and procedure manual especially if there is an increase of resources within Internal Audit.

Response: As mentioned, Internal Audit currently has a limited policy and procedures manual. The Director will work to expand the manual and plans to have a more robust manual completed no later than June 30, 2018.

We appreciate this opportunity to be of service to North Carolina Community College System Office. We will be pleased to respond to further questions concerning this report and to furnish any desired information.

ATTACHMENT A: Standards Conformance Form – Overall Evaluation Summary

PART III: OVERALL EVALUATION		Standards			Major Standards		
		GC	PC	DNC	GC	PC	DNC
IIA Code of Ethics					X		
1000	Purpose, Authority, and Responsibility	X			X		
1010	Recognition of the Definition of Internal Auditing	X					
1100	Independence and Objectivity				X		
1110	Organizational Independence	X					
1111	Direct Interaction with the Board	X					
1120	Individual Objectivity	X					
1130	Impairments to Independence or Objectivity		X				
1200	Proficiency and Due Professional Care				X		
1210	Proficiency	X					
1220	Due Professional Care	X					
1230	Continuing Professional Development	X					
1300	Quality Assurance and Improvement Program					X	
1310	Requirements of the Quality Assurance and Improvement Program		X				
1311	Internal Assessments			X			
1312	External Assessments	N/A					
1320	Reporting on the Quality Assurance and Improvement Program		X				
1321	Use of “Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”	X					
1322	Disclosure of Nonconformance	X					
2000	Managing the Internal Audit Activity				X		
2010	Planning		X				
2020	Communication and Approval	X					
2030	Resource Management		X				
2040	Policies and Procedures		X				
2050	Coordination	X					
2060	Reporting to Senior Management and the Board	X					
2070	External Service Provider and Organizational Responsibility for IA	X					

PART III: OVERALL EVALUATION (continued)		Standards			Major Standards		
		GC	PC	DNC	GC	PC	DNC
2100	Nature of Work				X		
2110	Governance		X				
2120	Risk Management	X					
2130	Control	X					
2200	Engagement Planning					X	
2201	Planning Considerations		X				
2210	Engagement Objectives		X				
2220	Engagement Scope		X				
2230	Engagement Resource Allocation	X					
2240	Engagement Work Program		X				
2300	Performing the Engagement				X		
2310	Identifying Information	X					
2320	Analysis and Evaluation	X					
2330	Documenting Information	X					
2340	Engagement Supervision			X			
2400	Communicating Results				X		
2410	Criteria for Communicating		X				
2420	Quality of Communications	X					
2421	Errors and Omissions	X					
2430	Use of “Conducted in conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”	X					
2431	Engagement Disclosure of Nonconformance	X					
2440	Disseminating Results		X				
2450	Overall Opinions	X					
2500	Monitoring Progress			X			X
2600	Communicating the Acceptance of Risks	X			X		

Definitions

GC – “Generally Conforms” means the assessor has concluded that the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, comply with the requirements of the individual Standard or element of the Code of Ethics in all material respects. For the sections and major categories, this means that there is general conformity to a majority of the individual *Standards* or elements of the Code of Ethics, and at least partial conformity to the others, within the section/category. There may be significant opportunities for improvement, but these should not represent situations where the activity has not implemented the *Standards* or the Code of Ethics, has not applied them effectively, or has not achieved their stated objectives. As indicated above, general conformance does not require complete/perfect conformance, the ideal situation, “successful practice,” etc.

PC – “Partially Conforms” means the evaluator has concluded that the activity is making good-faith efforts to comply with the requirements of the individual Standard or element of the Code of Ethics, section, or major category, but falls short of achieving some major objectives. These will usually represent significant opportunities for improvement in effectively applying the *Standards* or Code of Ethics and/or achieving their objectives. Some deficiencies may be beyond the control of the activity and may result in recommendations to senior management or the board of the organization.

DNC – “Does Not Conform” means the evaluator has concluded that the activity is not aware of, is not making good-faith efforts to comply with, or is failing to achieve many/all of the objectives of the individual Standard or element of the Code of Ethics, section, or major category. These deficiencies will usually have a significant negative impact on the activity’s effectiveness and its potential to add value to the organization. These may also represent significant opportunities for improvement, including actions by senior management or the board.