



HONKAMP KRUEGER & CO, P.C.

CPAs & Business Consultants

Quality Assessment Report

For

East Carolina University

Office of Internal Audit and

Management Advisory

Services

March 30, 2011

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Executive Summary

Introduction

At the request of the East Carolina University's Executive Director Honkamp Krueger & Co. P.C. (HK) has completed a Quality Assessment of the Office of Internal Audit and Management Advisory Services group. We appreciate the opportunity to present the engagement results in the narrative which follows.

East Carolina University (ECU) is a public, coeducational, engaged doctoral/research university located in Greenville, North Carolina. The university is the largest institution of higher learning in eastern North Carolina and the third-largest university in the State. With a Fall 2010 enrollment of 27,816 students, it has been the fastest-growing campus in the University of North Carolina system for six consecutive years. Founded in 1907 it has grown from 43 acres to almost 1,600 acres today. The university's academic facilities are located on four properties: Main, Health Sciences, West Research facility, and the Field Station for Coastal Studies in New Holland. The nine undergraduate colleges, graduate school, and two professional schools are all located on these four properties. All of the non-health sciences majors are located on the main campus. The College of Nursing, College of Allied Health Sciences, The Brody School of Medicine and School of Dental Medicine are located on the health science campus.

ECU currently has an established internal audit activity lead by the organization's Chief Audit Executive (CAE), the Executive Director of the Office of Internal Audit and Management Advisory Services (OIAMAS). Reporting to the CAE are six professionals including an Associate Director who also functions as the IT Auditor.

The HK Solution

OIAMAS acted to confirm its compliance with the Institute of Internal Auditors (IIA) *Standard* 1312 by hiring HK to perform an External Quality Assessment (QA). Specifically, the *Standard* states that all internal audit activities are required to conduct an external assessment every five years in order to provide assurance that the activity is in conformity with the IIA *Standards* and the Code of Ethics.

HK utilized proven methodology to execute this QA. As a first step, OIAMAS prepared Self Study material and gathered other pertinent data which provided HK detailed information about the organization and the internal audit function. Also, surveys were sent to a representative sample of the ECU management team by OIAMAS. The HK team compared the survey results to historical data available from QAs conducted by the IIA. A summary of the results and accompanying comments (without identifying the individual survey respondents) have been furnished to OIAMAS.

While on-site, interviews were conducted with OIAMAS staff and the following ECU executives and the Audit Committee:

<u>Name</u>	<u>Title</u>
Joel Butler	Audit Committee Chair
Dr. Steve Ballard	Chancellor
Dr. Marilyn Sheerer	Provost
Dr. Rick Niswander	Interim Vice Chancellor Administration and Finance
Dr. Phyllis Horns	Vice Chancellor for Health Sciences
Donna Payne	University Attorney
Joe Norris	Chief Information Officer
Tim Wiseman	Assistant Vice Chancellor Enterprise Risk Management
Ray Whitby	External Auditor North Carolina Office of State Auditor
Jeff Henderson	University of North Carolina General Administration

In addition, the HK team reviewed the OIAMAS risk assessment and audit planning processes, audit tools and methodologies (including information technology), engagement management and staff development processes, and a sample of internal audit work papers and reports.

Comments

We found numerous positive aspects about the ECU OIAMAS group and the work it performs. As evidenced by interviews, surveys, document reviews, and observations, OIAMAS currently uses “Innovative Practices” in its audit operations and administration. Some of the more notable positive aspects and practices include:

- Being recognized as key advisor by senior management through the CAE participation on high level corporate leadership teams
- A closely coordinated working relationship with State auditors and other ECU assurance functions
- Establishing and maintaining a University Hotline
- Developing a report format in conjunction with their clients that has been widely accepted and appreciated
- A highly experienced staff seen as valued added by the organization
- Client survey results that demonstrate an above average overall satisfaction level with OIAMAS

Conformity Rating

The IIA QA framework provides a system for rating conformity to the *International Standards for the Professional Practice of Internal Auditing (Standards)*, which consists of three categories: generally conforms, partially conforms, and does not conform.

The framework describes these categories as follows:

- “Generally conforms” (GC) means that an internal audit activity has a charter, policies, and processes that are judged to be in accordance with the *Standards* in all material respects, but some opportunities for improvement may exist.
- “Partially conforms” (PC) means that practices were noted that are judged to deviate from the *Standards*, but they did not preclude the internal audit activity from performing its responsibilities in an acceptable manner.
- “Does not conform” (DNC) means that deficiencies in practices were judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

The *Standards* are divided into two primary subsets: Attribute Standards and Performance Standards. **The QA team rates the ECU Office of Internal Audit and Management Advisory Services function as “generally conforming” to the Attribute Standards, Performance Standards and the Code of Ethics. Overall, the Office of Internal Audit and Management Advisory Services “generally conforms” to the *International Standards for the Professional Practice of Internal Auditing*.**

Opportunities and Innovative Practice Suggestions - Summary

Opportunities and innovative practice suggestions that we believe will enhance conformity with the *Standards* and further improve the effectiveness of the Office of Internal Audit and Management Advisory Services are summarized below.

Innovative Practice Suggestions for Consideration by OIAMAS

1. **Enhance the current Quality Assurance and Improvement Program** by applying the concepts recommended in the new IIA Practice Guide which are focused on stakeholder satisfaction, key departmental processes, staff capabilities, and on-going technological innovations. (*Standards* 1310 & 1311 – Requirements for the QA&IP & Internal Assessment)
2. **Improve documentation of ongoing supervision** to assure appropriate evidence of its occurrence is consistently retained in individual work paper files. (*Standard* 2340 – Engagement Supervision)
3. **Re-evaluate the OIAMAS criteria for scheduling follow-up efforts on audit recommendation implementation** to better utilize limited internal audit resources. (*Standard* 2500.A1 – Monitoring Progress)

4. **Improve overall work paper communication record** by preparing and distributing the currently used “Fact Finding Forms” to audit clients on an on-going basis during fieldwork. (Innovative Practice)
5. **Consider increasing dedicated information technology audit resources** to a minimum of one full time equivalent auditor which would more closely align OIAMAS overall audit resource usage with other professional audit activities. (Innovative Practice)


Innovative Practice Suggestions for Audit Committee and Management Consideration

1. **Enhance OIAMAS functional reporting relationship to the Audit Committee** by obtaining specific and documented Audit Committee annual approval for the OIAMAS financial budget and resourcing plans and any significant changes to these plans. (*Standards 2020 – Communication and Approval*)
2. **Consider issuing a Management Control Policy** to help ensure that the all ECU staff and stakeholders are informed of the specific roles that management, OIAMAS and the Audit Committee have with regard to internal controls. (Innovative Practice)

Additional detail about the previously listed opportunities and innovative practices is provided in the Report Detail section that follows this Summary.

Thank you again for the opportunity to provide you with our quality assessment services.

Respectfully,



Brian E. Kruk
Senior Director Quality & Risk Services

Team Member:
David Walsh III – QA Consultant

Report Detail

Innovative Practice Suggestions for OIAMAS Consideration

Observations	Recommendations	OIAMAS Responses
<p>1. Enhance current Quality Assurance & Improvement Program (QA&IP) – Since its last full quality assessment OIAMAS has taken steps to establish some internal assessment processes that moved it into conformity with IIA <i>Standard</i> 1311. These steps include establishing and tracking periodic metrics, post periodic reviews of work paper file quality, and periodic self assessment of OIAMAS conformity with individual IIA <i>Standards</i>. These exercises are notable innovative best practices and should be continued going forward.</p> <p>OIAMAS has opportunities, however, to enhance and right-size its formalized internal QA&IP. These opportunities are discussed in a framework that is covered in the IIA’s recently issued <i>Practice Guide - Measuring Internal Audit Effectiveness and Efficiency</i>. This framework discusses the use of general concepts such as stakeholder satisfaction, key audit processes, audit staff capabilities, and technological innovation to create a robust, right-sized QA&IP program to meet the specific needs of an internal audit activity.</p>	<p>OIAMAS should enhance its current QA&IP by considering the techniques purported in the new IIA Practice Guide. The resulting program should be tailored to fit the situation, involve all members of the OIAMAS, and help provide assurance that OIAMAS is following its own policies and procedures, while meeting the expectations of senior management and the AC as well as assuring general conformity with the IIA <i>Standards</i> and Code of Ethics on a consistent basis.</p> <p>Components of the QA&IP should consider stakeholder satisfaction, key audit processes, staff capabilities, and technological innovation, while bringing focus on managing and improving all OIAMAS activities. (<i>Standard</i> 1311 – Internal Assessment)</p> <p>Periodic communication of the enhanced on-going internal QA&IP results to senior management and the AC should continue, as deemed appropriate. (<i>Standard</i> 1320 – Reporting on the QA&IP)</p>	<p>The CAE will meet with the internal audit staff to discuss how we as a team can further enhance our QA&IP program. Based on the outcome of this meeting, our QA&IP process will be updated in the OIAMAS audit manual.</p>
<p>2. Improve documentation of on-going engagement supervision - <i>Standard</i> 2340, states that “engagements should be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed.” Related Practice Advisories provide guidance emphasizing the need for on-going, complete, timely and thus effective work paper review. The intent here is to assure that adequate and appropriate documentation exist to clearly demonstrate and support all audit observations and recommendations.</p> <p>Our review of work papers and the processes used</p>	<p>The extent of supervision required will always depend on the proficiency and experience of the auditors performing the work and the complexity of an engagement. With this in mind, we suggest that OIAMAS develop an effective consistent method of documenting the on-going supervisory review in each work paper file to clearly show conformity with <i>Standard</i> 2340. This review should be accomplished and documented by OIAMAS management and/or an appropriate designee. (<i>Standard</i> 2340 – Engagement Supervision)</p>	<p>The CAE will ensure that ongoing supervision of engagements is formally documented in the workpapers.</p>



<p>by OIAMAS management pointed out that the role of conducting <u>on-going</u> supervision appears to be taking place informally, but the documentation of these efforts (sign-offs) is not being accomplished on a consistent basis.</p> <p>Supervisory sign-off of completed work papers prior to the issuance of the draft report was determined to be adequately documented.</p>		
<p>3. Re-evaluate criteria for scheduling follow-up effort on audit recommendation implementation – <i>Standard</i> 2500.A1 states that “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.” OIAMAS generally conforms to this <i>Standard</i>.</p> <p>During our review it was pointed out that OIAMAS currently budgets 10% of its direct audit time to follow-up and test 100% of its audit recommendation implementation efforts by management. In the last fiscal year the actual percentage of audit time attributed to follow-up was 12%. Additionally we were informed that senior management had asked OIAMAS to increase its follow-up efforts to provide added assurance that corrective actions had been taken as stated in management responses.</p> <p>The <i>Standards</i> emphasize that follow-up is an important internal audit responsibility. In our experience however, follow-up and implementation testing on 100% of internal audit’s recommendation is not the norm. GAIN benchmarking data supports this conclusion by showing that implementation testing is performed by other respondent less than 40% of the time. This is the result of the chief audit</p>	<p>Practice Advisory 2500.A1-1 Paragraph #5 states that “where the CAE judges that management’s oral or written response indicates that action taken is sufficient when weighed against the relative importance of the observation or recommendation, internal auditors may follow up as part of the next engagement.” This Advisory supports our belief that the level of follow-up activities should be determined at the discretion of the CAE. This approach combined with strong senior management and audit committee support that repeat audit observations will not be tolerated can be used as an extremely effective method to assure that implementation of corrective action has taken place. This approach will result in more audit time being available for additional risk coverage and better utilization of OIAMAS limited resources. (<i>Standard</i> 2500A.1 – Monitoring Progress)</p>	<p>OIAMAS will take this recommendation under advisement. The AC and Chancellor have established a “management corrective actions” process and this criterion will need to be approved by both the AC and Chancellor.</p>

<p>executive using their judgment to determine the level of follow-up necessary based on the risk and exposure involved on an observation by observation basis. Using this technique internal audit resources can be more effectively utilized.</p>		
<p>4. Improve overall work paper communication record – During our review of work paper files and the work paper preparation procedures described in the OIAMAS Audit Manual we determined that current procedure has the formal written communications of an audit issue taking place just prior to the drafting of the report with the completion of the OIAMAS “Fact Finding Form”. This form uses a recognized professional approach to recording the auditor’s observations and recommendations that, in most cases, were verbally discussed with the internal client during the audit fieldwork. Each form is reviewed and signed-off on by the CAE prior to its issuance.</p> <p>The more commonly seen approach to the communication of audit observations is to first verbally vet an observation with the audit client and second immediately document it for the work paper file. This written record detailing the observation and recommendation is then delivered to the audit client during fieldwork. This approach helps formalize and start the audit client’s response process usually leading to quicker resolutions that can be included in initial draft reports often leading to reduced cycle times for final report issuance.</p>	<p>We understand that current procedure has the CAE reviewing and approving draft “Fact Finding Forms” prior to their issuance and recognize that this is one of the primary reasons for the current timing of their preparation and distribution.</p> <p>We believe however, that the issue warrants revisiting the process to hopefully discover an alternative that would allow OIAMAS to consider adjusting its approach involving the timing of the “Fact Finding Forms” preparation and distribution. If these documents were simply prepared and distributed to audit clients on an on-going basis during fieldwork we believe it could result in reducing cycle time for final report issuance. (Innovative Practice)</p>	<p>OIAMAS communicates with the client either verbally or via email throughout the entire engagement so there will be no surprises once the engagement has concluded. A draft report of the observations and recommendations is normally sent out in advance of the exit conference so management can be prepared to discuss the issues during the exit conference or beforehand. OIAMAS feels that issuing fact finding forms in advance would not reduce the cycle time for final report issuance.</p>

<p>5. Consider increasing dedicated information technology audit resources – One of the highest categories of risk to any organization is the highly complex area of information technology. As a result internal audit activities always face the difficult challenge of identifying, assessing, and considering how to effectively allocate the correct amount of its limited resources to this very important area of their annual audit plan.</p> <p>The IIA Global Audit Information Network (GAIN) current benchmarking data provided to us by OIAMAS shows that most organizations structure their internal audit groups in a fashion that dedicates at least 17% of their audit staffing to IT audit work. Our experience in this area with other high performing internal audit shops supports this benchmarking conclusion.</p> <p>Our review of the internal audit hours being applied specifically to the ECU IT audit areas indicated that an estimate of direct time applied to IT audits is somewhere between 600 and 800 hours per year or approximately 1/3 of a full time equivalent employee (FTE). In addition, it was pointed out that the efforts of the State auditors add another 400 hours annually to specific IT audit coverage. With the inclusion of these hours the total hours applied to the university's IT audit areas is estimated to be 1000 to 1200 hours or approximately 2/3 of an FTE.</p>	<p>Based on the GAIN Benchmarking and our experiences with other internal audit activities, we suggest that OIAMAS should move towards applying a higher percentages of it limited audit resources specifically to IT audit coverage. Considering the size of the group, we recommend that at a minimum, one FTE dedicated to IT audit topics would more closely align overall resource usage to that of other professional internal audit activities. This can be accomplished either by assigning one individual specifically to the task, training additional internal resources to assist in handling these assignments, or the use of outsourcing. (Innovative Practice)</p>	<p>OIAMAS will discuss this observation with the AC and the Chancellor as any options explored will require resources. Currently, we have one position that is classified as an IT auditor. However, this position conducts fraud and abuse investigations as these reviews require the utilization of EnCase software, which entails a specific level of expertise.</p>
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Innovative Practice Suggestions for Audit Committee and Management Consideration

Observations	Recommendations	AC & Management Responses
<p>1. Enhance OIAMAS functional reporting relationship to the Audit Committee - The Audit Committee Charter was examined to understand and evaluate its content. Generally, it was found to be professionally prepared and robust in its content when compared with the IIA Model Audit Committee Charter.</p> <p>An issue was noted however, involving the specificity of the Committee responsibility to approve the financial budget, the associated resourcing plan and any subsequent significant changes to these plans. Final approval authority over these importance aspects of an internal audit activity are seen by the profession as a further strengthening of the document and consequently, the internal audit activity's functional reporting relationship.</p>	<p>The clear understanding of a functional reporting relationship between an IA activity and its Audit Committee is often difficult to communicate to all stakeholders of the department. To strengthen and make clear this functional reporting relationship, the Audit Committee should consider revising its Charter narrative which emphasizes and clarifies their defined responsibilities regarding the approval of the OIAMAS annual financial budget and the associated resourcing plan and any subsequent significant changes to these plans.</p> <p>These responsibilities are considered by the profession to be part of the cornerstones of a solid functional reporting relationship. They strengthen independence by providing the necessary functional oversight for the scope of proposed work and any limitations placed on that scope while being recognized as innovative governance practices. (Innovative Practice)</p>	<p>The CAE will present this observation to the AC and Chancellor during the April 14, 2011 audit committee meeting for their consideration.</p>
<p>2. Consider issuing a Management Control Policy – ECU has been proactive in enhancing internal control policy and promoting operating management's responsibility for internal controls. However, an entity level policy is not in place that links the responsibilities between the AC, senior management, and OIAMAS. As the demand for robust corporate governance processes grows, management is continuously charged with enhancing the governance structure by identifying all parties, their responsibilities and by issuing policy statements for controlling organization activities. With this in mind, a concise Management</p>	<p>The CEO and board should have the CAE draft a Management Control Policy Statement that clearly defines management's role in, and responsibility for, internal control and the associated roles of the AC and OIAMAS. This policy should be submitted to senior management for review and the board for approval. (Innovative Practice)</p>	<p>The CAE will present this observation to the AC and Chancellor during the April 14, 2011 audit committee meeting for their consideration.</p>

<p>Control Policy Statement, issued at the senior management and board level which clearly defines the responsibilities of these three parties has been recognized as a best practice by the IIA. An IIA model policy example was provided to the CAE.</p>		
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