



**The Institute of
Internal Auditors**

QUALITY ASSESSMENT OF

EAST CAROLINA UNIVERSITY

INTERNAL AUDIT ACTIVITY

May 2006



QUALITY
Ensuring Excellence

Final Report: June 22, 2006

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EXECUTIVE SUMMARY

As directed by The Institute of Internal Auditors (IIA), we conducted a quality assessment (QA) of the internal audit activity (IA activity) of the East Carolina University (ECU). The principal objectives of the QA were to assess IA activity's conformity to The IIA's *International Standards for the Professional Practice of Internal Auditing (Standards)*, evaluate IA activity's effectiveness in carrying out its mission (as set forth in its charter and expressed in the expectations of ECU's management), and identify opportunities to enhance its management and work processes, as well as its value to ECU.

As part of the preparation for the QA, IA activity prepared a self-assessment with detailed documentation and sent out surveys to its staff and a representative sample of ECU executives. A summary of the survey results and accompanying comments (without identifying the individual survey respondents) have been furnished to the IA activity. Prior to commencement of the onsite work by the QA team on June 15, 2006, the team leader made a preliminary visit by phone to gather additional background information, select executives for interviews during the onsite field work, and finalize planning and administrative arrangements for the QA. During the onsite field work, we interviewed the Audit Committee Chair (by phone); Vice Chancellor for Health Services; Vice Chancellor for Administration and Finance; Provost and Vice Chancellor for Academic Affairs; IT Manager; Auditor from the State Auditor's Office; the Chief Audit Executive (CAE); and IA activity staff. We did not interview the Chancellor, to whom the CAE reports, because he was on vacation. We also reviewed IA activity's risk assessment and audit planning processes, audit tools and methodologies, engagement and staff management processes, and a representative sample of IA activity's working papers and reports.

The IA activity environment where we performed our review is well-structured and progressive, where the IIA *Standards* are understood and management is endeavoring to provide useful audit tools and implement appropriate practices. Among these tools and practices are automated audit software; frequent professional training for IA activity staff development of self-assessment tools for operating and financial controls and facilitation of their use; concise reports with a focus on risk; and a good reputation and credibility with customers. Consequently, our comments and recommendations are intended to build on the foundation already in place in the IA activity.

Our recommendations are divided into two groups:

- Those that concern ECU as a whole and suggest actions by senior management. Some of these are matters outside the scope of the QA, 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 ECU management and because they impact the effectiveness of IA activity and the value it can add.
- Those that relate to IA activity's structure, staffing, deployment of resources, and similar matters that should be implemented within IA activity, with support from senior management.

Highlights of the more significant of our recommendations are set forth below, with details in the main body of our report.

PART I – MATTERS FOR CONSIDERATION OF ECU MANAGEMENT

1. Consider implementing a university-wide Enterprise Risk Management system and adopt a Management Control Policy. (PA 2110-1)
2. Approve significant interim changes to the approved annual audit plan. (*Standard 2060*)

PART II – ISSUES SPECIFIC TO THE INTERNAL AUDIT ACTIVITY

1. Coordinate activities with other internal and external providers of relevant assurance and consulting services. (*Standard 2050*)
2. Prepare quarterly and annual activity reports that compare actual performance with the IA Activity's annual plan, goals, audit work schedules, and financial budgets. (*Standard 2060*)
3. Continue to implement a risk based audit planning process and update the audit policies and procedures manual to document the program. (PA 2010-1 and Successful Practice)
4. Enhance the procedure for audit universe identification to ensure that all auditable entities are considered. (PA 2010-2)
5. Enhance the process of audit plan preparation. (PA 2010-1, PA 2010-2 and Successful Practice)
6. Issue audit reports in a timely manner. (Successful Practice)

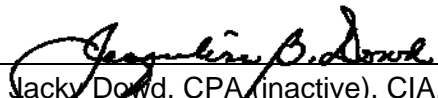
OPINION AS TO CONFORMITY TO THE STANDARDS

It is our opinion that the IA activity generally conforms to the following *Standards*:

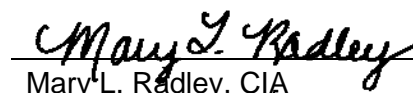
- 1000 – Purpose, Authority, and Responsibility (Charter)
- 1100 – Independence and Objectivity
- 1200 – Proficiency and Due Professional Care
- 1300 – Quality Assurance/Improvement Program
- 2000 – Managing the Internal Audit Activity
- 2100 – Nature of Work
- 2200 – Engagement Planning
- 2300 – Performing the Engagement
- 2400 – Communicating Results
- 2500 – Monitoring Progress
- 2600 – Resolution of Management’s Acceptance of Risks
- The IIA’s Code of Ethics, with opportunities for further improvement in such areas as Enterprise Risk Management; the audit universe and planning process and approval; coordinating with internal and external providers of relevant assurance and consulting services; and communicating results.

In our lexicon, “generally conforms” means that an internal audit activity has a charter, policies, and processes that are judged to be in accordance with the *Standards*, with some opportunities for improvement, as discussed in our recommendations. “Partially conforms” means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies did not preclude the internal audit 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 internal audit activity from performing adequately in all or in significant areas of its responsibilities.

We appreciate this opportunity to be of service to ECU. We will be pleased to respond to further questions concerning this report and to furnish any desired information.



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OBSERVATIONS AND RECOMMENDATIONS

PART I – MATTERS FOR CONSIDERATION OF ECU MANAGEMENT

These observations and recommendations originated principally from the comments received from the management survey, our interviews with selected executives, and follow-up of these matters. All are of direct importance to enhancing effectiveness and added value of the IA activity.

1. Consider Implementing a University-Wide Enterprise Risk Management System and Adopt a Management Control Policy.

East Carolina University has not taken steps to implement an Enterprise Risk Management (ERM) process. This type of initiative needs to emanate at the Board of Trustee level and be implemented at the top administrative executive level which would represent a significant step forward in setting the proper tone at the top of ECU.

Recommendations

We encourage the CAE to be a strong advocate for the development and implementation of an ERM process, while maintaining independence by not taking ownership or being responsible for the management of the risks identified. We believe that the CAE's knowledge and experience in the matter of risk management is significant, and can be communicated to the Audit Committee and top level management. The CAE can identify factors, such as the requirements placed on Boards of Directors by the Sarbanes-Oxley Act, and the guidance offered to business enterprises through COSO and participating organizations (i.e., the IIA) as a strong rationale for ERM at ECU. A preliminary inquiry shows that many prestigious institutions, such as the University of Pennsylvania, University of North Carolina at Chapel Hill, and the University of California System, have already implemented ERM, and are managing their risks in alignment, with their strategic plans, goals, and objectives.

Senior Management Response

The Chancellor's leadership team and the Executive Council will consider implementing an Enterprise Risk Management System as part of its current integrated planning process. In addition, it will discuss the implementation of an ERM with the Audit Committee of the ECU Board of Trustees.

2. Approve Significant Interim Changes to the Approved Annual Audit Plan.

The annual audit plan is approved by the Audit Committee but interim changes to the audit plan are not provided to the audit committee for review and approval.

Recommendation

The Audit Committee should approve significant interim changes to the approved annual audit plan.

Senior Management Response

The Chief Auditing Executive will ensure the Audit Committee approves any significant changes to the approved annual audit plan.

PART II – ISSUES SPECIFIC TO THE INTERNAL AUDIT ACTIVITY

1. Coordinate Activities with other Internal and External Providers of Relevant Assurance and Consulting Services.

Other oversight/monitoring units do not coordinate with Internal Audit in developing monitoring plans for assessing the identified risks, controls and processes in their areas of the University. These oversight/monitoring units at ECU, that require specific skill levels to fulfill their duties, include: Brody School of Medicine Compliance Officer, Brody School of Medicine Risk Manager, HIPAA Privacy Officer, NCAA Compliance Officer, Information Security Officer, Environmental Health and Safety Officer, and a proposed Research Officer. The Internal Audit Department does not have monitoring information from these units to use in developing their annual Audit Plan. The Chancellor has designated the Director of Internal Audit to be the Audit Liaison Officer for ECU and be responsible for overseeing that all findings and recommendations are resolved.

During our review of the IT function, it was noted that a significant portion of the issues which should be addressed by the IA activity's IT audit resource were being reviewed as part of the State Auditor's oversight of ECU's IT resource. Our review indicates that the IA activity is placing reliance on the State Auditor's work as satisfactory coverage of these audit issues. In order to properly place reliance on the State Auditor's work, the CAE must have access to the State Auditor's audit plans, audit programs, and workpapers.

The State Auditor conducts the annual financial audit of ECU. The IA activity does not rely on the State Auditor's work to cover any of its identified audit universe. If the CAE had access to the State Auditor's audit plans, programs, and workpapers, the IA activity might be able to avoid duplication of effort, and use their limited staff resources in other areas, which would increase the IA activity's flexibility in meeting the unscheduled demands of management and the Audit Committee.

Recommendation

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

Internal Audit Response

The Chief Auditing Executive will ensure that Internal Audit coordinates and shares information with other oversight/monitoring units. The Chief Auditing Executive will request that all pertinent units send any reports that contain findings and recommendations to Internal Audit. Further, the Chief Auditing Executive will request that Internal Audit have access to State Auditor audit plans, audit programs, and workpapers.

2. Prepare Quarterly and Annual Activity Reports that Compare Actual Performance with the IA Activity's Annual Plan, Goals, Audit Work Schedules, and Financial Budgets.

The quarterly reports provided to the Audit Committee and senior management do not provide metrics to reveal the effectiveness and quality of the IA activity. The CAE does not provide an annual activity report to the Audit committee, apprising them of the overall effectiveness of the IA activity, and providing them a final disposition of all audit work completed, in-process, deleted, added, or deferred.

Recommendation

The quarterly reports and the annual activity reports to senior management and the Audit Committee should include the following components:

- *The CAE should prepare activity reports that compare actual performance with the IA activity's annual plan, goals, audit work schedules, and financial budgets. The reports should explain the reason for major variances and indicate any action taken or needed (e.g., additions, deletions, or significant budget increases for a project should be discussed).*
- *The CAE should set, monitor and report on various metrics that reflect the value of the IA activity. Some metrics to consider are listed in the QA Manual 5th Edition, page 77.*

Internal Audit Response

The Chief Auditing Executive will ensure that quarterly reports and annual activity reports compare actual performance with the annual plan, goals, work schedules, and financial budgets to include reasons for any major variances. Further, the Chief Auditing Executive will consider the metrics listed in the QA Manual and include those metrics that have meaning to senior management and the Audit Committee in the activity reports.

3. Continue to Implement a Risk Based Audit Planning Process and Update the Audit Policies and Procedures Manual to Document the Program.

The CAE implemented a risk based audit planning process for the fiscal year 2005-06. This effort resulted in a well structured approach to risk assessment but the process did not include all operating units and functions of the University.

Recommendation

The risk based audit planning process should continue to be used for future audit cycles. In an effort to make this process more effective in future periods, a number of steps can be taken:

- *Request all operations to complete questionnaire for the subjective evaluation of risk in their areas of responsibility.*
- *The CAE should summarize the subjective evaluations completed by the operations and assess an objective rating for the element of subjective risk.*
- *Expand the use of the objective criteria to all operating units and functions.*
- *The audit universe worksheets should contain the risk scoring for both subjective and objective risk factors for each auditable operation.*
- *Develop method and presentation of risk measures to the ECU strategic plan, goals and objectives.*
- *Update the Audit Policies and Procedures Manual with the latest version of the program to conduct risk assessments.*
- *During the next planning process cycle, the CAE should consider expanding the role of the audit staff in risk assessment and plan preparation.*

Internal Audit Response

Internal Audit will implement all steps outlined in the recommendation.

4. Enhance the Procedure for Audit Universe Identification to Ensure that all Auditable Entities are Considered.

The audit entities identified in the 2005-06 audit universe appear to be too general and some audit entities appear to have been excluded from the universe (there were no operations identified within ECU Advancement group for inclusion in the audit plan).

Recommendation

Enhance the procedure for audit universe identification to ensure that all auditable entities are considered.

Internal Audit Response

Internal Audit will implement the recommendation with regard to the audit universe.

5. Enhance the Process of Audit Plan Preparation.

The annual audit planning process does not indicate risk rankings of the processes and operations of ECU. The Annual Plan does not provide staff hours for the performance of investigations, and for responses to ad hoc management requests.

Recommendation

The following issues should be incorporated into the plan preparation process for the next audit planning cycle:

- The risk calculation for each process or operation included in the audit universe should be presented on the audit universe schedule, and the annual audit plan.*
- All processes and operations should be ranked according to risk and listed in the audit universe in descending order of risk.*
- After the audit universe has been finalized, and risk calculated, the CAE should notify each manager in regard to the determinations. The CAE should request feedback from management, indicating their agreement with the determinations, or providing additional input for consideration of IA.*
- Two new categories of audit engagements should be added to the annual plan to provide for the performance of investigations, and the response to ad hoc management requests. The budgeted time for these categories should be based on past history and information gathered from management.*
- The CAE needs to develop an audit cycle which can be used to determine whether IA resources are adequate to cover the audit universe in a time frame which appropriately addresses risk and is acceptable to the Board of Trustees and Executive Management.*

Internal Audit Response

Internal Audit will implement all steps outlined in the recommendation.

6. Issue Audit Reports in a Timely Manner.

Our review of three audits revealed the reporting cycle time averages >72 days from the end of fieldwork to final report issuance. Peer organizations, as evidenced by the GAIN Report, averaged 39.8 days.

Recommendation

The timing of the presentation of engagement results should be set without undue delay and with a degree of urgency so as to enable prompt, effective actions.

Internal Audit Response

Internal Audit determined that our end of fieldwork date was the last day of testing. Instead, the end of fieldwork date should be the date of the exit conference. This should improve our reporting cycle time.