

## **The Role of Internal Audit East Carolina University**

### **Introduction**

In the last decade, there has been sweeping changes made in the field of internal auditing. Once perceived as an adversary, internal audit is now seen as a core part of an organization that contributes value-added services. Internal audit's purview not only includes internal controls but also risk management and corporate governance.

Since the broad-based auditing of all activities within an organization is a relatively recent occurrence, Internal Audit at East Carolina University has gone through a re-engineering process. We have adopted internal audit best practices that fit within the University and the UNC System. Our role at the University is to furnish management with the information needed so they can effectively discharge their responsibilities. Internal Audit is an independent appraisal activity that reviews operations as a service to management by measuring and evaluating the adequacy of controls and the efficiency and effectiveness of operations. Further, Internal Audit is significantly involved in all matters that relate to the University's governance and risks.

The following sections will explain in further detail the best practices that Internal Audit has adopted with regard to its reporting relationship to management; the types of audits and services we provide; how we determine what to audit; how the audit process evolves; and our standards of practice. Our philosophy is one of "continuous improvement", which means that we strive to continuously review industry best practices as it relates to internal audit and determine if they are applicable to the University.

### **Reporting Relationship**

Internal Audit reports functionally to the East Carolina University Board of Trustees through the Executive and Audit Committee and administratively to the Chancellor. The details of this reporting relationship are explained in the Audit Committee Charter.

All audit reports are sent to the Executive and Audit Committee, Chancellor, and other members of management. Each quarter a report is issued to the Executive and Audit Committee and the Chancellor that details the activities of the Internal Audit function for that quarter. This report includes a summary of (1) audits issued during the quarter; (2) consultations conducted during the quarter; (3) other Internal Audit activities such as professional development, special projects,

external auditor assistance, and leave time; and (4) the status of the Internal Audit strategic plan.

The Director of Internal Audit meets quarterly with the Executive and Audit Committee and monthly with the Chancellor to provide feedback on current issues and trends. This reporting relationship facilitates transparent and candid communication and feedback between the Internal Audit function and senior management, as well as the ECU Board of Trustees.

Internal Audit has a very good rapport with the UNC Office of the President. Although we do not report directly to the UNC Office of the President, there is a liaison officer that we confer with regarding audit issues.

### **Types of Audits and Services**

In order to meet the responsibilities and objectives as set forth in the Internal Audit Charter, it is necessary for Internal Audit to perform reviews and audits of varying types and scopes depending on the circumstances and requests from management. The following types of audits and services are provided by Internal Audit:

#### **Audit Liaison Officer**

The Director of Internal Audit has been designated by the Chancellor to serve in the capacity of Audit Liaison Officer. The Audit Liaison Officer is responsible for overseeing that all findings and recommendations with regard to external audits and reviews are satisfactorily resolved, a requirement that is mandated by the UNC Office of the President. The Audit Liaison Officer is the initial contact point and attends all entrance and exit conferences.

Copies of all findings and recommendations issued to management by external auditors, consultants, and investigators along with University responses are forwarded to the Audit Liaison Officer in a timely manner. Upon implementation of the recommendations or other alternative action by management, the Audit Liaison Officer performs verification procedures to ensure that the stated plan of action has been implemented and issues a status report to the Chancellor and the Executive and Audit Committee of the ECU Board of Trustees.

#### **Financial Audits**

A financial audit is a review intended to serve as a basis for expressing an opinion regarding the fairness, consistency, and conformity to financial information with generally accepted accounting principles. Financial audits can be full or limited in scope, depending on the objectives.

A full scope financial audit consists of a review of the financial statements of an entity of sufficient extent to express an opinion on those statements. Such an audit is conducted in accordance with generally accepted auditing standards as adopted by the AICPA. The North Carolina Office of the State Auditor normally performs the University's financial audit. External accounting firms perform the Foundations' financial audits.

Financial audits that are limited in scope are normally performed by Internal Audit. These audits can include a transaction cycle review of administrative systems such as purchasing, payroll, and payables, or a special examination of the financial activities of a decentralized university department.

### **Operational Audits**

Operational audits are concerned with the effectiveness and efficiency of operational units within the University. Effectiveness measures how successfully an organization achieves its goals and objectives. Efficiency measures how well an entity uses its resources to achieve its goals.

### **Compliance Audits**

A compliance audit measures the compliance of the client with some established University, Federal, or State laws, regulations, and/or policies.

### **Information Technology Audits**

Information technology audits are conducted to evaluate the quality of the controls and safeguards over the information technology resources of the University. These audits normally consist of reviewing the effective use of information technology resources, adherence to management's policies, and to encourage the design and implementation of adequate controls over computer applications and the computing environments in which they are used.

### **Investigative Audits**

These audits are normally requested by management and/or anonymous tips and focus on alleged, irregular conduct. Reasons for investigative audits include: internal theft, misuse of State property, and/or conflicts of interest.

### **Consultations/Advisory Services**

Internal Audit also provides routine consultation and advisory services to University management. This may include but is not limited to interpreting policies and procedures, participation on standing committees, limited-life projects, ad-hoc meetings, and routine information exchange. Currently, Internal

Audit sits on the following key management committees: (1) Chancellor's Cabinet, (2) Information Resources Computing Committee, (3) HIPAA Compliance Committee, (4) Brody School of Medicine Risk Management and Compliance Committee, and (5) Banner Executive Steering Committee.

### **Year-end Work – State Auditors**

Internal Audit provides assistance to the NC State Auditors by conducting and/or compiling the following:

- Self Assessment of Internal Controls
- Petty Cash Counts and Bank Certifications
- Listing of Audit Engagements
- Listing of ECU Related Corporations
- Inventory for University Printing & Graphics, Brody School of Medicine Pharmacy, Warehouse, Central Store, Medical Storeroom, Student Bookstore, and Student Health Services' Pharmacy
- Fixed Assets Inventory

### **Special Projects**

Other special projects may be performed by Internal Audit as delegated by the UNC Office of the President, ECU Board of Trustees, the University Chancellor, or other University management. It should also be noted that when feasible, Internal Audit takes an integrated audit approach in performing audit services, which involves combining financial, operational, compliance, and information technology audits. This approach is a cost saving measure that results in a broader coverage of assurance.

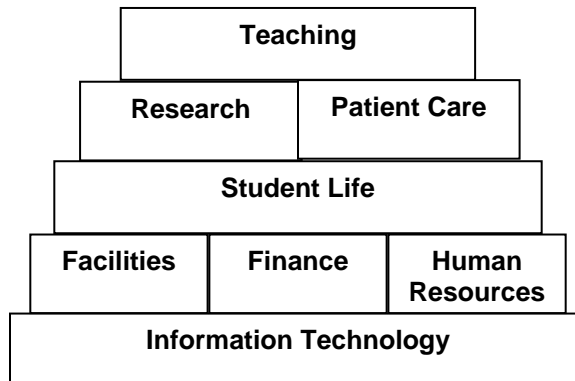
### **Audit Plan**

Universities have had to learn to do more with less. There are many drivers that are transforming today's higher education environment. Besides the academic mission, universities are also faced with corporate governance and accountability issues, which have been driven by current events and legislation. To effectively manage today's changing university environment, academic leaders must be cognizant of these drivers and the risks that accompany them and create a risk-conscious climate.

In the past, an annual audit plan was developed and submitted to the Executive and Audit Committee and the Chancellor for review and approval. This plan was subjective and included requests from senior management. In partnering with management to create a risk-conscious climate, Internal Audit is developing and implementing risk-based audit plans. This will ensure that our priorities are focused on those areas where risks and materiality of exposure is greatest.

The development of a risk-based audit plan includes defining an auditable unit, establishing the audit universe, establishing the risk criteria, constructing the risk model, and ranking the audit universe. We are basing the establishment of East Carolina University's audit universe and risk framework on the following models:

#### **Audit Universe Model:**



#### **Risk Framework Model:**

Higher Education Business Risks:
<b>Strategic</b> – Goals of the institution
<b>Financial</b> – Safeguarding assets
<b>Operational</b> – Processes that achieve goals
<b>Compliance</b> – Laws and regulations
<b>Reputation</b> – Public image

We plan to develop and implement a five year audit plan with the input of management. This audit plan will be approved by the Executive and Audit Committee and the Chancellor. Each year, the plan will be reviewed and adjusted accordingly as circumstances dictate. We will also coordinate our efforts with external auditors to ensure that we provide the maximum audit coverage and minimize any duplication of effort.

Besides determining the areas for review each year, Internal Audit is required to perform the following audits annually: (1) disaster recovery testing, (2) Special Responsibility Constituent Institution review, (3) misuse of State property, (4) Chancellor's discretionary account, and (5) follow-up on any State audit findings. These audits are required by either the UNC Office of the President, ECU Executive and Audit Committee, or the NC Office of the State Auditor.

## **Audit Process**

After the audit plan is approved, it is executed by the Director of Internal Audit. This involves assigning audits to members of the Internal Audit staff. The following is a description of the audit process.

**1. The engagement or review is announced through an engagement letter.**

Internal Audit notifies the client in writing when their area is selected for an audit. An engagement letter is sent to the client, which describes the general objectives of the engagement, the auditor in charge, the projected time frame of the engagement, and information the auditor may need the client to supply.

**2. An entrance conference is scheduled.**

An entrance conference is scheduled by the auditor in charge with the client to discuss the purpose, scope, and process of the engagement. The director and auditor in charge attend the entrance conference along with personnel deemed appropriate by the client. Clients are encouraged to present any questions or concerns they have about the engagement. Clients are also given the opportunity to request that a specific function or area of their office be examined during the engagement or in future work.

**3. A preliminary survey is performed.**

During this portion of the engagement, the auditor will gain an understanding of the client's operation or area being reviewed. The auditor may request written policies and procedures, organizational charts, job descriptions, and other information in order to become familiar with the client's operation. Internal controls may be reviewed and documented during this portion of the engagement through an internal control questionnaire and flowcharting. In keeping with industry best practices, the client is also asked if they know of or suspect any fraudulent activities in their area of responsibility. From this preliminary review, a work program is prepared.

**4. Fieldwork is conducted.**

This phase of the engagement includes testing the internal controls and performing other procedures necessary to accomplish the objectives of the engagement. The auditor will follow the work program when conducting this phase of the engagement. A work program lists the control objectives of the engagement and the necessary steps an auditor

must follow to collect and analyze the information. Numerous methodologies are utilized to collect and analyze information such as interviewing, sampling methods, observing, verifying, investigating, evaluating, flowcharting, and computer assisted auditing techniques.

This phase of the engagement is the most time-consuming part of the review for the client because personnel will need to be available to answer questions and provide information. Internal Audit realizes the value of each person's time and tries to arrange meetings in advance and work around scheduling conflicts when possible.

During this phase of the engagement, the auditor will strive to maintain an open communication with the client to ensure they are kept abreast of the initial observations and there are no surprises once the final report is issued.

**5. Draft report is prepared.**

After the fieldwork is completed, the auditor prepares a draft report, which will include the background of the area being audited, audit purpose, objectives, scope, methodology, reportable conditions, and recommendations. The draft report along with any non-reportable conditions is sent to the client via email for review before the exit conference.

**6. An exit conference is scheduled.**

An exit conference is scheduled by the auditor in charge with the client to discuss the draft audit report. The director and auditor in charge attend the exit conference along with client personnel. The conference is an opportunity to discuss the observations and clarify any ambiguities. Non-reportable conditions will also be discussed during the exit conference.

The client submits their responses to the audit findings and recommendations. After the exit conference, any changes deemed necessary are made to the draft report and submitted to the client via email. The client is normally given 30 days to respond to the draft report. The client includes a response to each of the observations and recommendations and sends the report to the auditor in charge via email. If circumstances arise that prohibit the client from responding to the report in the allotted time frame, the client should contact the director to request more time.

**7. The final report is issued.**

A final report is issued after the auditor in charge receives the draft report with the client's responses. The final report is distributed to the client, senior-level management, ECU Board of Trustees, and the Chancellor.

**8. Post-engagement survey.**

As part of a self-evaluation program, Internal Audit asks clients to comment on their performance. After the final report is distributed, Internal Audit will send client management a post-engagement survey to evaluate their performance concerning the review process. Clients need to be very honest when completing this survey because it will be used to evaluate procedures and make changes as a result of a client's suggestions.

**9. Follow-up review.**

A follow-up review is performed approximately 6 to 9 months after the final report is issued to verify the resolution of the observations. The review will conclude with a follow-up report, which lists the actions taken by the client to resolve the original observations. A discussion draft of the report will be circulated to the client before the report is issued. The follow-up report will be circulated to the original report recipients and other University officials as deemed appropriate.

**Standards of Practice**

Internal Audit has adopted the Institute of Internal Auditor's (IIA) professional standards and code of ethics. The IIA is the international professional association that is the recognized authority, principal educator, and acknowledged leader in certification, research, and technological guidance for the internal audit profession. The *International Standards for the Professional Practice of Internal Auditing (Standards)* represent the practice of internal auditing as it should be and is the criteria by which the operations of an internal audit department are evaluated and measured. The purpose of the code of ethics is to promote an ethical culture in the profession of internal auditing and consists of four core principle values: integrity, objectivity, confidentiality, and competency.

In keeping with the *Standards*, Internal Audit is committed to continuing education and quality assurance. The Internal Audit staff routinely evaluates their knowledge, skills, and competencies and attains the proper training to ensure audits are performed with proficiency and due professional care. By the



year 2007, we will also have gone through a quality assurance review conducted by an independent external review group that will provide feedback on the Internal Audit function at East Carolina University. The continuing education and quality assurance review will ensure that Internal Audit can provide the level of service expected by the University.

### **Conclusion**

Internal Audit at East Carolina University is committed to the mission of the University and assisting management in the effective discharge of their responsibilities and duties. By partnering with management to provide the proper feedback while utilizing internal audit best practices, Internal Audit can ensure the University has mitigated its strategic, financial, operational, compliance, and reputational risk.