



NC Community Colleges System Office

External Quality Assurance Review

October 2024

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NC Community Colleges System Office Internal Audit

It is our overall opinion that the NC Community Colleges System Office “generally conforms” with the Institute of Internal Auditors (IIA) Standards and the IIA Code of Ethics

Generally conforming demonstrates 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 standards or elements of the Code of Ethics in all material respects.

Governance		Staff		Management		Process	
Standard	Rating	Standard	Rating	Standard	Rating	Standard	Rating
1000	PC	1200	PC	2000	GC	2200	GC
1100	GC			2100	GC	2300	GC
1300	GC			2600	GC	2400	GC
Code of Ethics	GC					2500	GC



Thank you for the opportunity to be of service to Internal Audit. We will be pleased to respond to further questions concerning this report.

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Standard and the IIA Code of Ethics Conformance Summary

It is our overall opinion that the NC Community Colleges System Office’s Internal Audit function is “**generally conforming**” with the Standards and the IIA code of Ethics. This level of conformance demonstrates a clear intent and commitment to achieving the Core Principles and the Definition for the Professional Practice of Internal Auditing. Consequently, comments and recommendations are intended to build on this foundation already in place.

Rating for each standard are below.

	GC	PC	DNC
Overall:	X		

IIA Code of Ethics	X		
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Attribute Standard (1000 – 1300)				
1000	Purpose, Authority, and Responsibility		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		
1112	Chief Audit Executive Roles Beyond Internal Auditing	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		X	
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		
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		GC	PC	DNC
Performance Standards				
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		
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		
2600	Communicating the Acceptance of Risks	X		

Key Observations

The independent assessment team identified key observations in the following areas:

- Successful internal audit practices,
- Gaps to conformance with the Standards, and
- Opportunities for improvement to enhance efficiency and effectiveness of the Internal Audit function process and Agency Governance.

Detailed observations, recommendations, and responses are included in the following section of this report.

Successful Internal Audit Practices

- Collaborator and Trusted Advisor
- Automation in Monitoring of Audit Findings
- Comprehensive Risk Assessment Process

Gaps to Conformance with the Standards or the Code of Ethics

- Lack of Supervisory Reviews
- Need for Additional Resources
- Internal Audit Charter and Audit Committee Charter Should Be Updated
- Strengthen Internal Audit Policies and Procedures for Managing Errors and Omissions
- Delay in Conducting Required External Assessment

Opportunities for Continuous Improvement Noted: Senior Management & Audit Committee

- Strengthen Organizational Independence

Opportunities for Continuous Improvement Noted: Internal Audit Management

- Improve Communications to Board on Impacts of Unaudited Risks

The International Standards for the Professional Practice of Internal Auditing (Standards) published by the Institute of Internal Auditors (IIA) requires that an external quality assessment of an internal audit activity must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization. The NC Community Colleges System Office's internal audit function selected the North Carolina Council of Internal Auditing's peer review program to accomplish this review.

Opinion as to conformance with the Standards and Code of Ethics

It is our overall opinion that the NC Community Colleges System Office's Internal Audit function **generally conforms** with the Standards and the IIA code of Ethics. This level of conformance demonstrates a clear intent and commitment to achieving the Core Principles and the Definition for the Professional Practice of Internal Auditing.

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 the assessor or assessment team 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 Standards and the IIA Code of Ethics in all material respects. Detailed definitions for rating criteria associated with "Generally Conforms", "Partially Conforms", and "Does Not Conform" are described in Attachment A of this report and are consistent with the guidance provided by the IIA in their Quality Assessment Manual.

Objectives

The principal objectives of the Quality Assessment (QA) were to:

- Assess IA's conformance with the *Standards* and the Code of Ethics.
- Evaluate IA's effectiveness in carrying out its mission.
- Identify successful internal audit practices demonstrated by the Internal Audit function.
- Assess the effectiveness of internal audit in providing assurance and advisory services to the Board and senior stakeholders.
- Identify opportunities for improvement to both senior management and internal audit to improve their performance and service and promote their image and credibility.

Scope and Methodology

The scope of this review includes the operations of the internal audit function as of March 1, 2023, as set forth in the approved audit charter which defines the purpose, authority, responsibility, and accountability of the internal audit function. To accomplish the objectives, the independent assessment team reviewed information prepared by the internal audit function; conducted interviews with key stakeholders and internal audit management and staff; reviewed a sample of internal audit projects and associated work papers and reports; reviewed survey data received from executives and management; and prepared diagnostic tools consistent with the methodology established by the IIA *Quality Assessment Manual*.

Successful Internal Audit Practices

1. Collaborator and Trusted Advisor

The Internal Audit Director (IAD) is seen as a trusted advisor rather than a punitive watchdog. Stakeholders value internal audit and view the IAD as a key resource. Through strong communication and accessible operations, the IAD has cultivated a reputation for helpfulness. Surveys and interviews reflect stakeholders' positive views, and it is common for them to seek the IAD's advice or services.

2. Automation in Monitoring and Follow-up of Audit Findings

The Internal Audit Director (IAD) developed an automated solution using existing systems to monitor prior engagement findings. This system provides real-time alerts to stakeholders and dashboards for management to track issue status. The scalable model can benefit smaller internal audit functions statewide.

3. Comprehensive Risk Assessment Process Implemented

The Internal Audit Director (IAD) developed a robust risk assessment process, incorporating extensive input from management through numerous interviews with executive leaders. Feedback has been highly positive, with leaders praising the thoroughness and efficiency. The process effectively identifies and prioritizes key risks, strengthening the organization's overall risk management.

Gaps in Conformance with the Standard or Code of Ethics

1. Lack of Supervisory Reviews

Observation: Our review indicated partial conformance with the 1220, 1311, and 2340 Standards as noted previously.

Standard 2340 Engagement Supervision requires engagements to be properly supervised, which generally involves supervisory review of the engagement workpapers, results, and conclusions to be reported. The engagement supervisor usually reviews the engagement workpapers that describe the audit procedures performed, the information identified, and the observations and preliminary conclusions made during the engagement. The supervisor evaluates whether the information, testing, and results are sufficient, reliable, relevant, and useful to achieve the engagement objectives and support the engagement results and conclusions, as required by Standard 2330 – Documenting Information.

Standard 1311 Internal Assessments require internal audit activities to conduct ongoing performance monitoring through a Quality Assurance and Improvement Program (QAIP). The Internal Audit Director has implemented internal monitoring and documented self-assessments; however, no supervisory reviews have been conducted on these assessments.

Standard 1220 Due Professional Care requires the internal auditor to exercise sound judgment and

diligence in performing their duties. The Internal Audit Director has ensured that audit work provides reasonable assurance by designing audits to assess key risks and controls, maintaining the necessary level of care and competence. However, supervisory reviews would enhance objectivity and help identify potential oversights or errors in engagement processes.

As the sole member of the internal audit team, the Internal Audit Director's work is not subject to additional supervisory reviews, leading to a gap in conformance with internal audit standards.

Recommendation: To ensure compliance with internal audit standards, it is recommended that an external or independent reviewer be engaged periodically to perform supervisory reviews of the Internal Audit Director's work. This could involve peer reviews from state agencies or external audit consultants to provide an objective assessment and maintain the quality and integrity of the audit process.

Response:

The System Office agrees with the recommendation and will work to establish a relationship with another Internal Audit Department to perform supervisory reviews.

2. Need for Additional Resources

Observation: Our review indicated partial conformance with the 1210 and 2030 Standards. The lack of resources leaves the NC Community Colleges System Office exposed to increased risk. Only 3 of the top 10 identified risks were included in the audit plan for 2024.

Standard 2030 highlights the need to have enough resources and an appropriate mix of knowledge, skills, and other competencies. Currently, NC Community Colleges System Office employs one internal auditor. During a recent internal audit staffing analysis, OSBM determined a minimum of three internal auditors were needed at NC Community Colleges System Office. The staffing analysis was to determine the minimal, not the optimum number of internal auditors needed to address the risk.

Standard 1210 Proficiency requires the internal auditor to demonstrate that they possess the necessary knowledge, skills, and competencies to carry out the internal audit function effectively. The Internal Audit Director is proficient in the practices of internal auditing and maintains broad knowledge of the operations of the NC Community Colleges System Office. With additional resources, Internal Audit could obtain deeper proficiencies across multiple disciplines (e.g., IT, Regulatory). This would lead to more thorough audits, especially in complex or high-risk areas.

Recommendation: To ensure a strong audit staff appropriately sized to provide adequate assurance and consultative services to cover the agency's risks, we recommend that agency senior management and the board increase the size of the internal audit office. We also encourage management to request more permanent, full-time staff to the General Assembly to ensure the continuity and quality of the

program may be sustained in the future.

Response:

The System Office agrees with the recommendation and will continue to pursue avenues for providing additional resources for the Internal Audit function. This may include, but is not limited to, expanding the practice of augmenting internal audit resources through contractors and interns.

3. Internal Audit Charter and Audit Committee Charter Should Be Updated to Align with Standards

Observation: Our review indicated that the Internal Audit Charter does not fully conform to the IIA standards, leading to partial conformance to Standard 1000. Standard 1000 indicates the specific internal audit elements to be documented in the Internal Audit Charter for organizations.

Specifically, the following issues were identified:

1. The "Purpose" of the internal audit activity was not formally defined. Standard 1000 states that the purpose "must be formally defined in an internal audit charter."
2. The nature of assurance services provided was not defined. Standard 1000.A1 states, the "nature of assurance services provided to the organization must be defined in the internal audit charter."
3. The nature of consulting services was not defined. Standard 1000.C1 states, the "nature of consulting services must be defined in the internal audit charter."

The Accountability and Audit Committee charter should also agree with the internal audit charter.

Recommendation: The Internal Audit Charter and the Accountability and Audit Committee Charter be revised to fully align with Internal Audit Standard 1000. For instance, the "purpose of internal audit" should be explicitly defined in the Internal Audit Charter, along with clear definitions of assurance and consulting services. These revisions will ensure greater clarity and compliance with the standard.

Response:

The System Office agrees with this recommendation. The Internal Audit Director will revise the charter to comply with the standards and will ensure that the Audit Charter and Audit Committee Charter are aligned to the standards.

4. Strengthen Internal Audit Policies and Procedures for Managing Errors and Omissions

Observation: Our review indicated partial conformance with the 2421 Standard. The Internal Audit Director maintains a policy and procedure manual to guide their day-to-day duties. At a minimum, the Internal Audit should add to procedures manual the process for errors and omissions. The Internal Audit Manual does not specify the office's procedures for communicating errors and omissions, as required by audit standards when applicable. Standard 2421 – Errors and Omissions states that if a final communication contains a significant error or omission, there must be established procedures to ensure that the corrected information is communicated to all parties who received the original report.

Incorporating these procedures into the manual would ensure compliance with the standard and enhance transparency in audit communications.

Recommendation: The Internal Audit Director should critically review current documentation and:

- Discuss situations with senior management and the board when “significant” errors and omissions occur and how those would be communicated.
- Update the Internal Audit manual to incorporate the developed process for any errors or omissions, ensuring that it is clearly written and easy to follow.

Response:

The System Office agrees with this recommendation. The recommended changes will be made to the Internal Audit Manual.

5. Delay in Conducting Required External Assessment

Observation: Our review identified partial conformance with Standard 1312, which requires that an external assessment be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization. The last external assessment was completed in April 2017, making it seven years since the previous review. Due to this overdue assessment, Internal Audit has been unable to confirm compliance with internal audit standards with its customers, management, or the board.

Recommendation: The Internal Audit Director should integrate the cost and scheduling of the external assessment into the internal audit’s long-term strategic plan and annual budget. This approach will ensure that the assessment is not overlooked and that adequate resources are available for its timely completion, as mandated by Internal Audit standards.

Response:

The System Office agrees with the recommendation. Appropriate audit processes have been documented and put into place. These audit practices and communications ensure that management and the Audit Committee are aware of the required external review timeline. Management is committed to ensuring that resources are available to support the external reviews.

Opportunities for Continuous Improvements – Senior Management and the Board

1. Strengthen Organizational Independence

Observation: The IIA Standard 1110 provides guidance on functional oversight to create the right working conditions to permit the operation of an independent and effective internal audit activity. Critical to this environment is the direct reporting line to the Accountability and Audit Committee.

The Accountability and Audit Committee’s Charter includes all the requirements outlined in Standard 1110 except for:

- Approving decisions regarding the appointment and removal of the chief audit executive.

-
- Approving the remuneration of the chief audit executive.

By law the Audit Committee cannot hire nor terminate State employees. However, there is no limitation to participating in the process with the ultimate responsibility and decision making remaining with the System President.

Recommendation: The System President should consider ways to involve the Accountability and Audit Committee or Audit Committee Chair in the process of hiring or terminating the Internal Audit Director. This could be as simple as informing the Audit Committee Chair of the top candidate prior to extending the offer and providing notice prior to termination of the Internal Audit Director. Additionally, involvement can be as complex as allowing an Audit Committee member to be part of the recruitment process.

Response:

The System Office agrees with the recommendation and will consider steps to ensure the Audit Committee is adequately informed regarding decisions regarding the Internal Audit Director position.

Opportunities for Continuous Improvements – Internal Audit Management

1. Improve Communications to Board on Impacts of Unaudited Risks

Observation: The review indicated that the current process of reporting unaudited risks to the Accountability and Audit Committee lacks detail on potential impacts. While the Internal Audit Director briefs the committee on key risks, the reports don't consistently address the consequences of not addressing these risks. This communication gap could limit the committee's understanding of overall risk exposure and hinder informed decisions on mitigation strategies, such as outsourcing.

Recommendation: The Internal Audit Director should enhance communication with the Board and Accountability and Audit Committee regarding unaudited risks by providing more detailed analysis of potential impacts. This should include an assessment of the likelihood and severity of unaudited risks, as well as any plans for future audits or risk management actions. A structured and transparent approach to reporting unaudited risks will enable the committee to better prioritize resources and make more informed decisions to safeguard the organization.

Response:

The System Office agrees with this recommendation. The Internal Audit Director will add more detail on the unaudited risks, their ratings, and management's handling of those risks when presenting the risk assessment results and annual audit plan to the Audit Committee.

Attachment A: Rating Definitions

Rating Definitions

GC – “Generally Conforms” means that the assessor or the assessment team 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 elements 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 Standard or element 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 and has not applied them effectively or achieved its stated objectives. As indicated above, general conformance does not require complete or perfect conformance, the ideal situation, or successful practice, etc.

PC – “Partially Conforms” means that the assessor or assessment team has concluded that the activity is making good-faith efforts to comply with the requirements of the individual standard or elements of the Code of Ethics or a 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 the Code of Ethics and/or achieving their objectives. Some deficiencies may be beyond the control of the internal audit activity and may result in recommendations to senior management or the board of the organization.

DNC – “Does Not Conform” means that the assessor or assessment team has concluded that the internal audit activity is not aware of, is not making good-faith efforts to comply with or is failing to achieve many or all of the objectives of the individual standard or element of the Code of Ethics or a section or major category. These deficiencies will usually have a significantly negative impact on the internal audit 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.