

March 9, 2014

Ms. Phyllis C. Petree
Director of Internal Audit
University of North Carolina at Chapel Hill

Dear Phyllis:

On behalf of Stefanie Powell, Interim Director of Audit at UNC Wilmington, and myself, I am pleased to submit the 2014 Quality Assessment Review report for the UNC Internal Audit Program. We hope that the report's findings will help to instill confidence in the quality of the Program and the report's recommendations will be helpful to you in further enhancing the Program in service to the University.

If we can be of assistance in addressing any of the recommendations please feel free to call on us. Should the Chancellor or any Board member have an interest in further clarification of any report matter we would be happy to assist.

Thank you for the opportunity to serve UNC Chapel Hill, and best wishes for continued success.



Patrick V. Reed
Quality Assessment Team Leader
University Auditor (Retired)
University of California System



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

**Internal Audit
External Quality Assessment
January 2014**

Reviewers:

Patrick V. Reed

Stefanie Powell

UNCCH External Quality Assessment

*This External Quality Assessment of the UNCCH Internal Audit Program was performed in accordance with The Institute of Internal Auditors (IIA) Quality Assessment Manual. The primary purpose of a Quality Assessment is to determine the internal audit function's conformance to the International Standards for the Professional Practice of Internal Auditing. There are three possible outcomes of the QA: the internal audit program **generally conforms, partially conforms or does not conform** to the Standards.*

Ms. Phyllis Petree
Director for Internal Audit
University of North Carolina at Chapel Hill

January 31, 2014

Dear Ms. Petree:

We have completed an External Quality Assessment (QA) of the University of North Carolina at Chapel Hill (UNCCH) Internal Audit Program as required every five years by the International Standards for the Professional Practice of Internal Auditing (the *IIA Standards*). The objectives of the QA were:

1. To assess conformance to the *IIA Standards*;
2. To assess the effectiveness and efficiency of the Internal Audit activity in providing services to the Board of Trustees and management of UNCCH; and
3. To identify opportunities for improving the Internal Audit Program at UNCCH.

Overall, it is our opinion that the UNCCH Internal Audit Program Generally Conforms to the *IIA Standards*. Opportunities for improvement were noted that will enhance conformance to the Standards and improve the efficiency and effectiveness of the Internal Audit Program. These are described in following sections of this report.

Patrick V. Reed
Stefanie Powell

UNCCH External Quality Assessment

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UNCCH External Quality Assessment

Executive Summary

Introductory Comments

The UNCCH Internal Audit Program (Program) exists in particularly challenging circumstances. The Reviewers observed that the University is extraordinarily decentralized even as compared to other institutions with which we are familiar. In addition UNCCH is experiencing significant change in a number of key leadership positions, State budgetary constraints and changing performance expectations. Further, it is well recognized that the Program is and has historically been significantly understaffed (currently at approximately one-half the minimum desirable level based on industry measures and peer comparisons). Despite these challenging circumstances, the Program's leadership has managed to keep senior management and the Board highly satisfied with its services.

Overall Conclusion

The overall conclusion is that the Program Generally Conforms to the *IIA Standards*. This is the highest level of conclusion provided by the Standards for Quality Assessment. Evidence of awareness of the *IIA Standards* and efforts to conform to them are pervasive. There is strong support for the Program from the Finance and Infrastructure Committee (FIC) and senior management, the Program is well structured and positioned in the University and is well regarded by its customers.

Opportunities

The concept of general conformance recognizes that there can nevertheless be opportunities for improvement. This report contains a number of recommendations for improved conformance to the *IIA Standards* that should not be taken collectively to undermine the overall conclusion. In addition, there are recommendations that will improve the efficiency and effectiveness of the Program and can help to mitigate the impact of resource limitations.

UNCCH External Quality Assessment

Conformance to the IIA Standards

Generally Conforms means that IA has a charter, policies and processes that are judged to meet the spirit and intent of the *IIA Standards* with some potential opportunities for improvement.

Partially Conforms means deficiencies in practice are noted that are judged to deviate from the spirit and intent of the *IIA Standards*, but these deficiencies did not preclude IA 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 IA from performing adequately in all or in significant areas of its responsibilities

Overall, the UNCCH Internal Audit Program was judged to **Generally Conform** to the *IIA Standards*. While improvement opportunities exist in various areas, they did not preclude this assessment. The following individual standards were judged to **Generally Conform** to the *IIA Standards*.

1000--Purpose, Authority and Responsibility

1100--Independence and Objectivity

1200--Due Professional Care

2000--Managing the Internal Audit Program

2200--Engagement Planning

2300--Performance of the Engagement

2600--Resolution of Senior Management Acceptance of Risk

The following Standards were judged as **Partially Conforms** to the *IIA Standards*. See discussion under Opportunities for Continuous Improvement.

1300--Quality Assurance and Improvement Program

2100--Nature of Work

2400--Communication of Results

2500--Monitoring Progress

No Standards were judged as **Does Not Conform** to the *IIA Standards*.

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Positive Attributes of the UNCCH Internal Audit Program

- **Finance and Infrastructure Committee (Audit Committee or FIC) and Senior Management Support** – The interviews conveyed a high level of support from the Audit Committee and senior management. The Audit Committee Chairs have been active and engaged.
- **Position and Governance** – The Internal Audit Program is properly positioned within the University and is governed by generally appropriate Audit Committee and Internal Audit Charters. There are opportunities to further clarify the functional reporting relationship to the Audit Committee as discussed in the body of this report.
- **Customer Support** – The Program’s customers generally share very positive views of Internal Audit and it is clear that the auditors have been a valued resource when called upon in special circumstances.
- **Noteworthy Practices**--Several noteworthy practices exist including a robust risk assessment process and a well developed Audit Manual.
- **Staff Experience**--The Program benefits from a highly experienced staff of professionals with longevity in their positions and substantial institutional knowledge.

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Customer Perspectives of the UNCCH Internal Audit Program

A total of 21 customers were surveyed to solicit their input. The survey topics included structure and relationships with management, capabilities of the audit staff, planning and performance of internal audits, communication of audit results and other matters intended to probe the value added by the Internal Audit Program. Respondents were also encouraged to provide their views on opportunities for Internal Audit to better serve UNCCH. 18 surveys (86%) were returned. Rating options were Excellent (4), Good (3), Fair(2) or Poor (1), with an option to indicate N/A if the respondent did not have an adequate basis for evaluation of a particular area.

The overall customer rating was 3.16 (between Good and Excellent) which is positive in the reviewers' experience recognizing that the role of Internal Audit is frequently viewed as inherently adversarial. The highest score area related to the competence and professionalism of staff while the lowest score area related to the sufficiency of audit staff resources—a condition outside of the auditors' control. In narrative comments customers described the audit staff as responsive and providing valuable insight and expertise. Several constructive recommendations were offered by customers, such as participating with functional areas in their training programs to improve auditors' technical expertise and operational understanding.

Interviewed parties included the current and former Chair of the Finance and Infrastructure Committee, the Chancellor, selected additional senior administrators, the UNC Internal Audit Liaison, a representative of the Office of the State Auditor and all audit staff. Stakeholders generally characterize Internal Audit as hard working, helpful and more pragmatic than dogmatic, respected and accessible. Perhaps because they are viewed as very busy, several observed that they would benefit from improved visibility. They provided various recommendations including attending more departmental business officers' meetings, and sharing the higher level learnings from their audit work more broadly. A specific recommendation was made by one person that Internal Audit should consider performing transition audits when very senior positions turn over. There was also a request to more broadly share the Audit Plan once approved by the Audit Committee.

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Opportunities for Continuous Improvement—Conformance to the Standards

Standard 1000--Purpose, Authority and Responsibility--Generally Conforms

Because of the breadth of its responsibilities, the Audit Committee Charter could be read to understate the Committee's oversight role with respect to Internal Audit. The language would be strengthened if the Charter made specific reference to the Program's **functional** reporting relationship with the Board (through the Committee). Consideration should be given to adding clarity to certain specific aspects of functional reporting including involvement in performance evaluations and approval of compensation for the Director of Internal Audit. In addition, the current language says that the Committee will "consult with the appointing authority regarding the selection and removal of the Director of Internal Audit"; however, the Committee should be in an approval capacity rather than a consultative role. The language in the Internal Audit Charter more appropriate describes this element of functional reporting and there should be consistency between the charters.

Standard 1300--Quality Assurance and Improvement Program (QAIP)—Partially Conforms

This Standard essentially has three elements: ongoing monitoring (principally represented by supervision and other routine activities), periodic reviews performed through self-assessment, and external assessments, such as this Quality Assessment review. Our review found the first and third elements to be sufficient, but identified a need to establish a more formal and rigorous program for the periodic review element. While certain efforts to improve the Program were noted, they did not result from a documented, systematic and disciplined approach to the periodic self assessment as contemplated by the Standards. Furthermore, the results of the periodic self assessment should be reported to senior management and the board. An effective QAIP is the principal means of ensuring continuous improvement of the Internal Audit Program.

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Opportunities for Continuous Improvement—Conformance to the Standards

Standard 2100--Nature of Work—Partially Conforms

Standard 2100 requires that auditors “must evaluate and contribute to the improvement of governance, risk management and control processes using a systematic and disciplined approach”. The UNCCH Program has focused its evaluation (audit) efforts almost exclusively on the control process element. Historically, involvement in a number of committees and task forces in an advisory capacity has contributed somewhat to the performance of this Standard in regard to governance and risk management. However, the Standard requires a more thorough and active level of evaluation on an array of topics related to governance and risk management including ethics programs, organizational performance management and accountability, information technology governance, alignment of objectives with the mission as well as risk identification, assessment, communication and mitigation processes. Admittedly, governance is a somewhat nebulous concept but professional literature and peer experiences are creating fairly robust guidance in this area. The UNCCH Audit Director has established governance as an element of the audit universe but has not yet performed any audits targeted at specific governance elements or topics.

Risk management is entering a new era at UNCCH with the establishment of an Enterprise Risk Management Task Force. As a member of the Task Force, the Program can begin to fulfill its obligation under this Standard to evaluate and contribute to the improvement of risk management processes. However, sitting on the Task Force alone will not cause the evaluation of risk management processes to become an inherent part of the internal audit activity, incorporated in audit processes down to the engagement level.

The Program has acknowledged what they believe to be internal control issues in the IT environment including decentralized operations, challenges to enforcement of information security policy and practices given that environment, limited disaster recovery and business continuity validation or planning and the need to strengthen the IT governance structure. However, audit resources have not been available and/or allocated to audit these risks. Historically, substantial reliance has been placed on the State Auditor’s in-depth general controls review which has not

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Opportunities for Continuous Improvement—Conformance to the Standards

Standard 2100--Nature of Work—Partially Conforms

occurred since 2009. A substantial portion of the Program's IT capabilities have been devoted to supporting their internal IT administration which may not be the optimal use of this resource.

As the University's governance processes evolve and the Enterprise Risk Management program matures, we recommend that the planning of future activities carefully consider how this Standard can be more completely and explicitly addressed in the program of work.

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Opportunities for Continuous Improvement—Conformance to the Standards

Standard 2300--Performing the Engagement—Generally Conforms

This Standard requires internal auditors to identify sufficient, reliable, relevant, and useful information to achieve an engagement's objectives. In addition, this information should be factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the auditor. Conclusions and engagement results should be based on appropriate analyses and evaluations, and all relevant information should be documented. Finally, engagements should be supervised to ensure objectives are achieved, quality is assured, and staff is developed. Overall, we noted that information is factual and that conclusions and engagement results are based on analysis and evaluations. However, in some instances not all relevant information was documented, and discussions with audit staff members were needed in order to determine the adequacy and completeness of the work completed. For one engagement, there was no documented evidence of all related risks being considered, and after discussions with the relevant audit staff members it appears as though certain major risks attendant to a finding may have been overlooked. In general, engagements are supervised and workpapers are reviewed to help ensure quality and the achievement of engagement objectives. However, we did not note evidence of staff development and growth such as measurable goals for staff members.

Opportunities include:

- Expanding the planning process and test methodology where possible to ensure key risks are consistently addressed
- Increasing documentation to indicate why certain risks are not included in testing and why some identified audit findings are not included in the final report
- Updating workpaper methodology to ensure each workpaper indicates the purpose of testing, the summary of work completed, testing results, and that testing results agree to the purpose described
- Creating a methodology for ensuring staff development through documented training plans and goal setting.

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Opportunities for Continuous Improvement—Conformance to the Standards

Standard 2400--Communicating Results—Partially Conforms

The Standard on Communicating Results has a number of elements some of which describe the characteristics of *quality* in communications. Those characteristics include accuracy, completeness, clarity and timeliness, among others. We performed in-depth reviews on six audit or investigation projects performed over the past two years and read a number of additional audit and special project reports. Timeliness of communications was an issue with respect to all but one of the six projects we reviewed. The duration of the audit was inordinately long for the five projects other than an investigation taken on and completed under exigent circumstances. There are numerous reasons for the delays, and interruptions due to the dynamic nature of your environment are unavoidable. However, there appear to be additional factors at work here, including initial project planning to ensure completion within the budgeted time, subsequent scope expansion for circumstances encountered during the audit and project management deficiencies. As a result, project duration was excessive in part due to the large number of hours consumed by the projects. There is evidence of interim communications to management of the area under audit, and in the case of certain significant findings, elevation of the matter to senior management for attention. In addition, periodic reports to the FIC include brief status reports on open projects. While these interim reporting practices help to mitigate the impact of timeliness issues, they are not as comprehensive and effective as timely reporting of the full results of audits including planned management corrective actions.

We also concluded that the writing style employed in certain reports could be improved as to clarity in order for the reader of the report to have a better understanding of the situations reported. We observed phrases such as “some” of the transactions tested were in error or the appropriate reporting did “not always” occur per regulations. These and other broad generalizations led to a concern that the reader of the reports may not be sufficiently informed so as to make their own judgment about the sufficiency and appropriateness of management’s planned corrective actions.

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Opportunities for Continuous Improvement—Conformance to the Standards

Standard 2400--Communicating Results—Partially Conforms

One of the projects reviewed identified issues with what we believe to be significant tangential ramifications involving tax reporting and employee benefits. The financial magnitude of these issues would not be material to the University as a whole; however, the compliance and personnel ramifications could be fairly significant. In our judgment, the report, and to a lesser extent the workpapers, did not make clear how these issues were addressed leaving the reader of the report with unanswered questions.

We recommend that every effort be made to improve the timeliness of reporting, including consideration of issuance of more interim reports on sizeable projects. Timeliness would also be greatly aided by reducing the average project size and resulting duration. In addition we recommend that careful consideration be given to completeness, accuracy and clarity of findings and conclusions expressed in reports, with an effort toward ensuring that the reader is fully informed without sacrificing conciseness. One practice employed in public accounting which could be helpful is to utilize a “cold review” by an auditor not otherwise associated with the project to ensure that an uninformed reader finds the report to be clear and complete.

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Opportunities for Continuous Improvement—Conformance to the Standards

Standard 2500—Monitoring Progress—Partially Conforms

This Standard requires the Internal Audit Director to establish and maintain a system to monitor the disposition of results communicated to management. UNCCH Internal Audit maintains a database of all findings and recommendations included in audit reports. However at the time of this review a University-wide project to review open findings and recommendations dating to 2005 was in process and had been ongoing for over eighteen months. Follow up on selected matters has occurred, including follow up on State Auditor findings and one prior year audit is scheduled for follow up on the current year audit plan. The University-wide project was undoubtedly made more difficult than it would otherwise have been if follow up occurred on a more timely basis. Circumstances may have changed, responsible parties may no longer be in position and the planned action from an earlier time may be less appropriate or effective than when agreed upon. Attention to other more pressing matters was cited as the reasons for follow up becoming so delinquent. To the extent that open items from earlier years have been subject to validation of corrective action, periodic status reports to the Audit Committee have generally indicated that corrective action was taken or in process for the most part. One report on follow up matters did report uncompleted actions and reaffirmed the need for improvement. However, until all such open items are closed by validation of corrective action or otherwise closed by virtue of changed circumstances rendering the prior recommendations impractical, there is no assurance that the identified risks have been mitigated.

Once all open findings and recommendations from prior audits are addressed, and a manageable inventory of open items due to receive future attention is established, we recommend that a system and procedure be put in place to ensure that follow up on corrective actions occurs on a timely basis and the results of such actions are reported to the Audit Committee on a regular basis.

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Opportunities for Continuous Improvement—Effectiveness and Efficiency

The following observations and recommendations relate less directly to the *IIA Standards* but to best practices and other observations made by the reviewers based on customer surveys, interactions with Internal Audit staff and UNCCH officials, and the reviewers' own experiences as peer practitioners.

Audit Planning--The annual risk assessment and audit planning process is extensive but could be improved in several respects as discussed below.

Audit Universe—The audit planning process could be improved by additional evidence of consideration of the universe of audits that *could* be undertaken, and a historical perspective of audit coverage across the audit universe over time. The current processes do a good job of informing its readers about what *is* planned to be audited—but less to advise its readers about what *is not* planned to be audited or has not been audited in recent history, if ever. IIA guidance states that “the definition of the audit universe, and how to ensure that it is complete, is important in effective risk assessment. You must have a good process to not only define what gets in your audit universe, but also a way to challenge it to ensure it is complete.” Resource limitations make it impossible to ensure audit coverage of the entire audit universe on a cyclical basis, however a broad perspective of risks and audit coverage of those risks over time would further inform the annual planning process. Without this broader perspective, attention tends to be driven towards only the most contemporary risks, potentially ignoring major activities for unreasonable periods.

We noted that affiliated entities are excluded from the audit universe on the basis of their separate legal status and because they receive independent audits. However, we are aware that some UNC institutions include them in their audit universe. We recommend resolution of this matter on a system basis. Further we recommend that, greater consideration be given to potential audits of the overlapping and intersecting activities between UNCCH and the affiliated entities—e.g. employees serving both organizations, flow of funds between the organizations and affiliated entities acting on behalf of UNCCH.

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Opportunities for Continuous Improvement—Effectiveness and Efficiency

Management Communications—Several survey respondents or interview subjects commented that the Annual Audit Plan would benefit from greater input and transparency. While individual conversations occur with management regarding risks, the planning process would be enhanced by also seeking input from the audit staff, and by sharing the draft plan with senior management and the audit staff. In addition, the approved Audit Plan is not made as public as some would suggest, and management is not broadly made aware of areas under their responsibility that are planned for audit. Some programs, including some within the UNC system, publish the audit plan, timeline and status on their web sites.

Audit Processes

Electronic Workpapers—The Program has developed a number of standard working papers and checklists, and in addition there is a well developed audit manual that helps to ensure consistency in the audit process. Use of electronic workpapers can further ensure that quality controls are fully utilized and adhered to, that supervision occurs and is documented, that sufficient evidential matter is captured, and working paper storage, retention and destruction standards are met.

Use of CAATs--The use of Computer Assisted Audit Techniques (CAATs) can be a highly effective audit technique that can leverage limited audit resources and provide a more effective basis for audit conclusions. The Program has a tool called ACL but has not widely developed the skills to utilize this tool. We encourage the use of CAATs on most, if not all, audit engagements. We understand that use of ACL for potential continuous monitoring is also under consideration. We encourage the development of continuous monitoring capabilities designed to revert to management use after assisting in their development.

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Opportunities for Continuous Improvement—Effectiveness and Efficiency

Communications/Visibility—The surveys and interviews identified several opportunities as follows:

Use of Customer Surveys—75% of peer survey respondents utilize customer surveys to get feedback on their performance. Some even use customer satisfaction scores as a performance metric. In addition to customer surveys sent out at project completion, consideration could be given to an annual survey of senior management satisfaction.

Interaction With Existing Groups—There are groups, such as the Business Officers in the School of Medicine (and likely elsewhere), who meet regularly and would likely welcome Internal Auditors into their meetings, providing a forum for discussion of current control topics, University policy issues and other matters of mutual interest. Group and departmental training opportunities tend to follow these interactions and they can be a very good use of time while engaging with customers in their environment and outside the setting of an audit.

Specialized Training—Two people from the research community suggested that auditors could take part in their in-house training thereby expanding the auditors' technical skills in research regulations and compliance. Similar opportunities likely exist elsewhere.

A survey of selected peer institutions outside the UNC System revealed that one-half of the surveyed Audit Directors sit on the Chancellor's/President's cabinet or senior manager's counsel, which is an avenue to consider to improve visibility at the highest levels.

Productivity/Efficiency—As referenced under Communicating Results, a number of projects suffered from being very large and drawn out. This causes the Audit Plan to suffer and completion of planned audits has not been at the desired level. Risk-based audits have been deferred or dropped not only because more pressing projects (such as investigations) arise but also because overruns on other projects consume the resources intended for their completion. There are a number of opportunities for your consideration including the following:

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Opportunities for Continuous Improvement—Effectiveness and Efficiency

Project Management Practices—The time keeping system can produce more timely and simple reports for open projects that can be used in conjunction with status report meetings. Budgets can be more closely monitored and a more formal protocol established for requesting budget augmentation. The Program’s administrative staff can easily create additional reports from the timekeeping system that will better inform the auditors and Director without taking time away from their audit activities.

Status Reporting—Bi-weekly status reporting sessions should pay closer attention to budget and completion estimates as well as audit processes and findings. The plan for completion of the audit should be discussed not only in terms of work to be completed but also the time required. The estimate of time to complete should be reconciled with the remaining hours in the budget. Any discrepancies should be identified and planned around at the earliest possible time.

Project Planning, Scoping and Budgeting—The Audit Plan appropriately assigns initial budgets that appear reasonable in size and are in line with what most audit programs would consider to be a manageable size—300-500 hours per project. Increased emphasis needs to be placed on keeping to a scope that will allow adherence to this budget level. With a staff of experienced auditors it should be possible to meet original targets most of the time and recognize when unusual circumstances require alternative approaches.

Team Assignments—Consideration should be given to assigning more than one auditor to a project in order to reduce project duration. In addition, such assignment practices build relationships, allow for skill building and sharing, and provide a natural avenue for splitting someone off the engagement should the need arise to take on a special project while keeping the original project moving forward.

Performance Metrics/Accountability—Expectations need to be clearly articulated and measured by establishing productivity measures, timeliness measures, deadlines and project milestones with interim percentage of completion/budget targets.

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Opportunities for Continuous Improvement—Effectiveness and Efficiency

Audit Committee Reporting—The reports to the Audit Committee are factual, concise and the current and former Chairs indicate that they are satisfied with the information provided. However, we believe there are opportunities to make the reports more informative and demonstrate greater accountability.

Audit Schedule Status Report—This standard report is simply a list of projects under generic status headings, such as Routine Audits, Annual Projects, Audit Related and further characterized as complete, in process, scheduled etc. We noted that the classification of matters as Routine Audits sometimes included projects first taken up as a management request and the caption “Routine Audits” does not help the reader understand what was in the original approved Audit Plan. Some improvement in structure and captioning could improve the status report. In addition, associating projects with hours incurred and comparison to the budget would better convey the stage of the audit and allow for improved accountability.

Annual Report—The materials presented to the Audit Committee at year end provide a final status report of all projects worked on during the year. There is a comparison of budget to actual audit hours, but only at the highest summary level. There is little analysis of the data and no summary of the most significant audit finding of the year or overview of the high level observations derived from the body of work as a whole. Some good examples exist among peers that could help guide the creation of a more comprehensive and informative annual report.

Performance Metrics—There are no performance metrics reported to the Audit Committee to demonstrate performance and accountability. There are a number of fairly common, though not universal, performance measures in use in internal auditing. One of these is percentage completion of the audit plan. The use of this measure could assist in promoting attention to audit plan completion—a need previously discussed. Productivity measures could also help address the need for improved efficiency. Benchmarks and metrics can be highly useful in driving desired outcomes but they can also drive undesirable behavior or even inefficiencies if there are too many measures or the wrong ones.

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Opportunities for Continuous Improvement—Effectiveness and Efficiency

Audit Committee Reporting-Continued

Performance Metrics, Continued--Accordingly we recommend establishing just a few key measures that are the most important to the Audit Committee in order to assess the effectiveness of the Audit Program.

Department Staffing and Structure

As previously stated, the UNCCH Internal Audit Program is and has historically been significantly understaffed. By any benchmark comparison, the minimal staffing level should be at least two times the current staffing level. Due to the small size of the department, the structure is simple—with six experienced auditors each reporting to the Director and typically working on distinct, individual projects. As growth or turnover allows, we recommend consideration be given to establishing a position of Audit Manager or Assistant Director. An intermediate tier of management could allow for better leveraging of the Director's time, assistance in administrative duties and closer supervision of the staff.

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Appendix I Engagement Methodology

Review Procedures Included:

- Review of audit charter, mission and other background/organizational materials regarding UNCCH and the Internal Audit Program
- Review of Finance and Infrastructure Committee Materials
- Review of QA advance preparation materials providing background on the IA Program and practices
- Review of Annual Audit Plan and risk assessment process
- Review of selected internal audit project work papers and reports
- Review of qualifications and training histories for staff
- Review of UNCCH Internal Audit Manual
- Interviews with 19 UNCCH individuals, including the Audit Committee Chair, the Chancellor, selected senior administrators, IA staff and the UNC Audit Liaison
- Interview with a representative of the Office of the State Auditor
- Review of audit follow-up practices and reporting on follow-up activities
- Review of Quality Improvement Initiatives
- Survey of 21 audit customers
- Comparison to select “Best Practices”
- Survey of twelve identified peer institutions and certain institutions within the UNC System regarding select practices, staffing, and reporting

UNCCH External Quality Assessment

Appendix II List of Stakeholders Interviewed

Board of Trustees Finance and Infrastructure Committee Current and Immediate Past Chair

Steven Lerner
Sallie Shuping-Russell

UNCCH Officials

Carol L. Folt, Chancellor
James W. Dean, Jr., Executive Vice Chancellor and
Provost
Erin Schuettpelz, Chief of Staff
Barbara Entwisle, Vice Chancellor for Research
Chris Kielt, Vice Chancellor for Information
Technology and Chief Information Officer
Kevin Seitz, Interim Vice Chancellor for Finance and
Administration
Leslie Chambers Strohm, Vice Chancellor and
General Counsel
James Beck, Executive Associate Dean, School of
Dentistry
Walter Miller, Interim Associate Dean for Financial
Affairs, School of Dentistry
Patricia Oliver, Associate Dean and Chief Financial
Office, School of Medicine

UNC

Lynne Sanders, Associate Vice President for University
Financial and Compliance Operations

UNCCH Internal Audit

All Audit Staff Members

Other

Office of the State Auditor, Katie Thigpin

UNCCH External Quality Assessment

Appendix IV Biography of Reviewers

Patrick Reed is the retired University Auditor for the University of California System. Mr. Reed served UC from 1994 to 2009 after a twenty-two year career in public accounting with KPMG. The UC System Internal Audit Program was comprised of over 110 auditors in 11 audit departments, all of which reported to The Regents of the University through Mr. Reed. He also served on the Audit Committees of the LLCs responsible for managing Los Alamos and Lawrence Livermore National Laboratories for the Department Of Energy. Mr. Reed is a Past President of the Association of College and University Auditors and has performed numerous Quality Assessments in the industry at both private and public institutions. He is a graduate of Rockhurst University and a Certified Public Accountant.

Stefanie Powell joined the Office of Internal Audit at UNC Wilmington in 2007 and has served as the Interim Director since December 2012. Stefanie began her career at Deloitte and Touche where she interned in their audit practice and worked full time in the tax practice. After several years with Deloitte, she accepted a position at Ohio University where she served first as the coordinator of an afterschool program and summer camp for at-risk youth and later as the university's first tax compliance manager. Stefanie holds a Bachelor of Business Administration degree in accounting and management information systems from Ohio University and is a Certified Public Accountant and a Certified Information Systems Auditor.

The reviewers would also like to acknowledge the assistance of Carolyn Fulk, Director of University Audits, University of Virginia, who assisted in certain aspects of the Quality Assessment.



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

INTERNAL AUDIT
DEPARTMENT

HILL COMMERCIAL BUILDING
CAMPUS BOX 1050
CHAPEL HILL, NC 27599-1050

T 919.962.5524
F 919.962.2659

March 24, 2014

Members of the Finance and Infrastructure Committee
Campus Box 9100
South Building

Dear Sirs and Madam:

In January 2014, the Internal Audit function at UNC-Chapel underwent an external Quality Assessment Review (QAR). The *International Standards for the Professional Practice of Internal Auditing* (Standards) requires internal audit functions to have an external QAR done at least once every five years.

We are pleased that the overall opinion of our activities is Generally Conforms and thank the QAR team members for their work.

The QAR report identifies that the Program is and has historically been significantly understaffed. Staff limitations directly affect the audit coverage that we can provide and the assistance we can provide to management in improving governance and risk management. In response to this concern, we will determine the optimal staffing levels to address the ever changing needs and risk areas of the university. In the interim, we will continue to apply our resources in a way that best assists management.

Attachments A and B contain our responses to the specific comments, conclusions, and recommendations in the report and, where appropriate, our corrective action plans. Attachment A relates to report items related to conformity with the Standards. Attachment B relates to continuous improvement report items.

If you have questions about the QAR or our responses and corrective action plan, please call me at (919) 962-7883.

Sincerely,

Phyllis C. Petree
Director of Internal Audit

c: Chancellor Carol Folt
Kevin R. Seitz

Attachment A
Conformance to the “International Standards for the Professional Practice of Internal Auditing” (Standards)

QAR Report Comment	Audit Response
<i>Standard 1000--Purpose, Authority and Responsibility</i>	
<p>The language would be strengthened if the [Finance and Infrastructure Committee (Committee)] Charter made specific reference to the Program’s <i>functional</i> reporting relationship with the Board (through the Committee). Consideration should be given to adding clarity to certain specific aspects of functional reporting including involvement in performance evaluations and approval of compensation for the Director of Internal Audit. In addition, the current language says that the Committee will “consult with the appointing authority regarding the selection and removal of the Director of Internal Audit”; however, the Committee should be in an approval capacity rather than a consultative role.</p>	<p>We defer to the Committee and the Chancellor for decisions about the suggested changes.</p> <p>The audit committee’s role in personnel decisions related to the Internal Audit Director (IAD) varies among institutions in the University of North Carolina System. Eight institutions responded to my inquiries about their audit committee’s role in this area. Most committees have only an advisory role in the selection or removal of the IAD or no role at all. One audit committee also has an advisory role in compensation decisions for the IAD.</p> <p>Only one audit committee reviews and approves appointment, removal, and compensation decisions of the IAD.</p> <p>One audit committee provides input for the IAD’s performance evaluations. Most have no role in this activity.</p>
<i>Standard 1300--Quality Assurance and Improvement Program</i>	
<p>Our review found...a need to establish a more formal and rigorous program for the periodic review element. While certain efforts to improve the Program were noted, they did not result from a documented, systematic and disciplined approach to the periodic (self-assessment) as contemplated by the Standards.</p>	<p>We will continue to monitor, on an on-going basis, our audit activities for opportunities to improve the quality of our work and services we provide to the University. By the end of the 2013/14 fiscal year, we will have an Internal Quality Review policy. The nature and frequency of our internal quality assessment reviews will evolve over time.</p>
<i>Standard 2100--Nature of Work</i>	
<p>Standard 2100 requires that auditors “must evaluate and contribute to the improvement of governance, risk management and control processes using a systematic and disciplined approach”. The UNCCH Program has focused its evaluation (audit) efforts almost exclusively on the control process element.</p> <p>Historically, involvement in a number of committees and task forces in an advisory capacity has contributed somewhat to the performance of this</p>	<p>Governance and risk management processes at UNC-CH are decentralized and evolving. Therefore, our role in these areas has been primarily a consulting and advisory one. This approach is allowed under Institute of Internal Auditors (IIA) practice advisories.</p> <p>We will continue our advisory approach and, as governance processes evolve, add formal assessments.</p>

Attachment A
Conformance to the “International Standards for the Professional Practice of Internal Auditing” (Standards)

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<p>Standard in regard to governance and risk management. However, the Standard requires a more thorough and active level of evaluation on an array of topics related to governance and risk management including ethics programs, organizational performance management and accountability, information technology governance, alignment of objectives with the mission as well as risk identification, assessment, communication and mitigation processes.</p>	<p>We are in the process of developing a departmental audit process. This process will include evaluations of:</p> <ul style="list-style-type: none"> • Knowledge of and alignment with relevant strategic plans; • Risk identification and assessment; • Monitoring of activities and results; and • Communications. <p>Due to the PeopleSoft conversion scheduled for October 2014 and the impact the conversion will have on departments and their operations we anticipate full implementation of departmental audits beginning in fiscal year 2015/16.</p>
<p>The Program has acknowledged what they believe to be internal control issues in the IT environment including decentralized operations, challenges to enforcement of information security policy and practices given that environment, limited disaster recovery and business continuity validation or planning and the need to strengthen the IT governance structure. However, audit resources have not been available and/or allocated to audit these risks. Historically, substantial reliance has been placed on the State Auditor’s in-depth general controls review.....</p>	<p>We have focused our limited resources on working with management to develop good IT governance, policies, and practices and on the Enterprise Resource Planning (ERP) project as these are the most significant risk areas. Our activities in these areas provide value; therefore we will continue our advisory and ERP work. After PeopleSoft goes live, we will expand into other types of IT audit work such as a post-implementation review, data security, more extensive reviews of general controls, etc.</p> <p>We participated in the initial table-top test of the disaster recovery and business continuity plans (after the end of the QAR review period). We will be part of work done in response to the initial test of the disaster recovery plan and future tests and related exercises.</p> <p>In fiscal year 2013/14, we added a limited review of IT general controls issues to the procedures we perform in each audit. In the future, we will periodically evaluate these procedures for ways to enhance our IT assessments.</p>
<p><u>Standard 2300—Performing the Engagement</u></p>	
<p>Opportunities include: Expanding the planning process and test methodology where possible to ensure key risks are consistently addressed;</p>	<p>We will incorporate these suggestions where possible and continue to perform ongoing assessments to identify ways we can improve the quality of our audit work. Any changes will be made in fiscal year 2014/15.</p>

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<p>Increasing documentation to indicate why certain risks are not included in testing and why some identified audit findings are not included in the final report;</p> <p>Updating workpaper methodology to ensure each workpaper indicates the purpose of testing, the summary of work completed, testing results, and that testing results agree to the purpose described;</p> <p>Creating a methodology for ensuring staff development through documented training plans and goal setting.</p>	
<p><u>Standard 2400—Communicating Results</u></p>	
<p>The Standard on Communicating Results has a number of elements some of which describe the characteristics of <i>quality</i> in communications. Those characteristics include accuracy, completeness, clarity and timeliness, among others...Timeliness of communications was an issue for all but one of the six projects we reviewed.</p>	<p>We have made project management techniques and practices a priority. As new projects are started, auditors will be held to due dates set for phases of projects and will be required to request and justify any extension needed for a due date or an increase in hours budgeted. Streamlining our audit processes and expanding our use of audit tools, such as Computer Assisted Audit Techniques (CAATs), will improve, over time, the efficiency and effectiveness of our work.</p> <p>We will continue our practice of discussing audit issues, as we find them, with auditee management. This practice is specifically designed to ensure that we have all relevant information about the issue and to give management an opportunity to begin corrective action. If the issues found are significant, we will continue to notify senior management and the Board of the issues and what is being done to address the issues. When appropriate, we will issue written interim audit reports.</p>
<p>We also concluded that the writing style employed in certain reports could be improved as to clarity in order for the reader of the report to have a better understanding of the situations reported. We observed phrases such as “some” of the transactions tested were in error or the appropriate reporting did “not always” occur per regulations. These and other broad generaliza-</p>	<p>We chose the style of our reports to provide a broad view of issues reported and to be concise. We believe that the nature, cause, and impact of issues noted are the most important items to communicate. However, we will quantify information in our findings when doing so adds to the clarity and completeness of our reports.</p>

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<p>tions led to a concern that the reader of the reports may not be sufficiently informed so as to make their own judgment about the sufficiency and appropriateness of management’s planned corrective actions.</p>	
<p><i>Standard 2500—Monitoring Progress</i></p>	
<p>This Standard requires the Internal Audit Director to establish and maintain a system to monitor the disposition of results communicated to management. UNCCH Internal Audit maintains a database of all findings and recommendations included in audit reports. However at the time of this review a University –wide project to review open findings and recommendations dating to 2005 was in process and had been ongoing for over eighteen months. Follow up on selected matters has occurred, including follow up on State Auditor findings and one prior year audit is scheduled for follow up on the current year audit plan.</p> <p>However, until all such open items are closed by validation of corrective action or otherwise closed by virtue of changed circumstances rendering the prior recommendations impractical, there is no assurance that the identified risks have been mitigated.</p>	<p>Completing the university-wide follow-up review is currently our top priority. The follow-up report will clearly identify any items that have not been corrected and the risk level of each finding.</p> <p>In addition to formal follow-up work and testing, we also monitor progress toward correcting previously reported findings through our work on task forces and committees empaneled to develop solutions to issues reported. We are also able to monitor the status of findings through discussions with individuals responsible for resolving prior findings.</p> <p>In the future, we will base the timing of follow-up work on the projected correction date provided by management. Focusing on an individual audit or small group of findings will simplify and shorten the follow-up process and provide more timely feedback. We can produce reports of all uncorrected findings when needed.</p>

Attachment B
Opportunities for Continuous Improvement – Effectiveness and Efficiency

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<p><u>Audit Universe</u>—The audit planning process could be improved by additional evidence of consideration of the universe of audits that <i>could</i> be undertaken, and a historical perspective of audit coverage across the audit universe over time. The current processes do a good job of informing its readers about what <i>is</i> planned to be audited—but less to advise its readers about what <i>is not</i> planned to be audited or has not been audited in recent history, if ever.</p> <p>We noted that affiliated entities are excluded from the audit universe on the basis of their separate legal status and because they receive independent audits. However, we are aware that some UNC institutions include them in their audit universe. We recommend resolution of this matter on a system basis. Further we recommend that, greater consideration be given to potential audits of the overlapping and intersecting activities between UNCCH and the affiliated entities—e.g. employees serving both organizations, flow of funds between the organizations and affiliated entities acting on behalf of UNCCH.</p>	<p>We will develop a meaningful way to include this information with our 2014/15 audit plan.</p> <p>Our decision not to audit affiliated entities is based on relative risk considerations as well as the fact they are legally separate entities that received audit coverage that we can rely on. In the past, we have audited controls related to intersecting activities such as the flow of funds between the organizations and whether funds transferred are used in keeping with donor restrictions.</p> <p>We defer to the Committee and the Chancellor for decisions about the inclusion of affiliated entities in our audit universe.</p>
<p><u>Management Communications</u>—Several survey respondents or interview subjects commented that the Annual Audit Plan would benefit from greater input and transparency. While individual conversations occur with management regarding risks, the planning process would be enhanced by also seeking input from the audit staff, and by sharing the draft plan with senior management and the audit staff</p>	<p>In the future, we will share a draft copy of our audit plan for each fiscal year with key members of management including those responsible for any are scheduled for an audit. The audit staff will provide input before the annual audit plan is finalized. Each year, we will post a copy of the audit plan to our web page.</p>
<p><u>Electronic Workpapers</u>—The Program has developed a number of standard working papers and checklists, and in addition there is a well-developed audit manual that helps to ensure consistency in the audit process. Use of electronic workpapers can further ensure that quality controls are fully utilized and adhered to, that supervision occurs and is documented, that sufficient evidential matter is captured, and working paper storage, retention and destruction standards are met.</p>	<p>We are evaluating electronic working paper packages. If a suitable package is identified, it will be purchased and implemented.</p>
<p><u>Use of CAATs</u>—The use of Computer Assisted Audit Techniques (CAATs) can be a highly effective audit technique that can leverage limited audit re-</p>	<p>We have used ACL for analytical reviews in some of our audits and will continue to look for ways we can use ACL to enhance our work in individual projects. As noted</p>

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<p>sources and provide a more effective basis for audit conclusions. The Program has a tool called ACL but has not widely developed the skills to utilize this tool. We encourage the use of CAATs on most, if not all, audit engagements. We understand that use of ACL for potential continuous monitoring is also under consideration. We encourage the development of continuous monitoring capabilities designed to revert to management use after assisting in their development.</p>	<p>above, we are considering developing continuous auditing routines but, due to the complexity of programming these routines, we will need outside assistance to develop them.</p>
<p><u>Audit Committee Reporting</u>—The reports to the...Committee are factual, concise and the current and former Chairs indicate that they are satisfied with the information provided. However, we believe there are opportunities to make the reports more informative and demonstrate greater accountability.</p> <p><u>Audit Schedule Status Report</u>—This standard report is simply a list of projects under generic status headings, such as Routine Audits, Annual Projects, Audit Related and further characterized as complete, in process, scheduled etc. We noted that the classification of matters as Routine Audits sometimes included projects first taken up as a management request and the caption “Routine Audits” does not help the reader understand what was in the original approved Audit Plan. Some improvement in structure and captioning could improve the status report. In addition, associating projects with hours incurred and comparison to the budget would better convey the stage of the audit and allow for improved accountability.</p> <p><u>Annual Report</u>—The materials presented to the Audit Committee at year end provide a final status report of all projects worked on during the year. There is a comparison of budget to actual audit hours, but only at the highest summary level. There is little analysis of the data and no summary of the most significant audit finding of the year or overview of the high level observations derived from the body of work as a whole. Some good examples exist among peers that could help guide the creation of a more comprehensive and informative annual report.</p> <p><u>Performance Metrics</u>—There are no performance metrics reported to the... Committee to demonstrate performance and accountability. There are a number of fairly common, though not universal, performance measures in</p>	<p>We will evaluate these suggestions for items that we can use to improve the quality of and clarity of our periodic reports to the Committee. In addition, we will seek input from Committee members regarding additional or different information they would like to see in our status reports. Improvements to status reports will evolve over time.</p>

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<p>use in internal auditing. One of these is percentage completion of the audit plan. The use of this measure could assist in promoting attention to audit plan completion—a need previously discussed. Productivity measures could also help address the need for improved efficiency. Benchmarks and metrics can be highly useful in driving desired outcomes but they can also drive undesirable behavior or even inefficiencies if there are too many measures or the wrong ones.</p>	
<p><u>Other Opportunities for Continuous Improvement</u></p> <p>A survey of selected peer institutions outside the UNC System revealed that one-half of the surveyed Audit Directors sit on the Chancellor’s/President’s cabinet or senior manager’s counsel, which is an avenue to consider to improve visibility at the highest levels.</p> <p><u>Productivity/Efficiency</u>—As referenced under Communicating Results, a number of projects suffered from being very large and drawn out. This causes the Audit Plan to suffer and completion of planned audits has not been at the desired level. Risk-based audits have been deferred or dropped not only because more pressing projects (such as investigations) arise but also because overruns on other projects consume the resources intended for their completion. There are a number of opportunities for your consideration including the following:</p> <p><u>Project Management Practices</u>—The time keeping system can produce more timely and simple reports for open projects that can be used in conjunction with status report meetings. Budgets can be more closely monitored and a more formal protocol established for requesting budget augmentation. The Program’s administrative staff can easily create additional reports from the timekeeping system that will better inform the auditors and Director without taking time away from their audit activities.</p> <p><u>Status Reporting</u>—Bi-weekly status reporting sessions should pay closer attention to budget and completion estimates as well as audit processes and findings. The plan for completion of the audit should be discussed not only in terms of work to be completed but also the time required. The estimate of time to complete should be reconciled with the remaining hours in the</p>	<p>We agree that having the Internal Audit Director be part of the Chancellor’s cabinet will be beneficial as the Director can bring valuable insight to discussions at cabinet meetings.</p> <p>As mentioned our responses in Attachment A, improving project management and the efficiency of audits is one of our highest priorities. Auditors will be held to established due dates unless they request and justify an extension. Discussions at bi-weekly status meeting will focus more heavily on keeping projects on target for completion and performance measures such as comparing the percentage of work complete with the percentage of hours used.</p>

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<p>budget. Any discrepancies should be identified and planned around at the earliest possible time.</p> <p><u>Project Planning, Scoping and Budgeting</u>—The Audit Plan appropriately assigns initial budgets that appear reasonable in size and are in line with what most audit programs would consider to be a manageable size—300-500 hours per project. Increased emphasis needs to be placed on keeping to a scope that will allow adherence to this budget level. With a staff of experienced auditors it should be possible to meet original targets most of the time and recognize when unusual circumstances require alternative approaches.</p> <p><u>Performance Metrics/Accountability</u>—Expectations need to be clearly articulated and measured by establishing productivity measures, timeliness measures, deadlines and project milestones with interim percentage of completion/budget targets.</p> <p><u>Team Assignments</u>—Consideration should be given to assigning more than one auditor to a project in order to reduce project duration. In addition, such assignment practices build relationships, allow for skill building and sharing, and provide a natural avenue for splitting someone off the engagement should the need arise to take on a special project while keeping the original project moving forward.</p> <p><u>Specialized Training</u>—Two people from the research community suggested that auditors could take part in their in-house training thereby expanding the auditors’ technical skills in research regulations and compliance. Similar opportunities likely exist elsewhere.</p> <p><u>Use of Customer Surveys</u>—75% of peer survey respondents utilize customer surveys to get feedback on their performance. Some even use customer satisfaction scores as a performance metric. In addition to customer surveys sent out at project completion, consideration could be given to an annual survey of senior management satisfaction.</p>	<p>We will begin to use team assignments, particularly for large, complex projects.</p> <p>We will address this recommendation as part of training plans for each auditor. In addition, we increase our routine interaction with campus managers by attending business officer meetings and similar activities and, on occasion, sharing general information from our audits is beneficial to campus managers.</p> <p>We will consider the use of audit surveys, the target audiences, the types of question these surveys should include, and the frequency with which they should be used.</p>