



STATE OF NORTH CAROLINA

PERFORMANCE AUDIT

INTERNAL AUDITING IN NORTH CAROLINA AGENCIES AND INSTITUTIONS

SEPTEMBER 2006

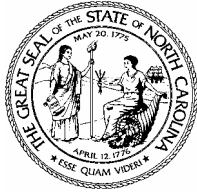
OFFICE OF THE STATE AUDITOR
LESLIE W. MERRITT, JR., CPA, CFP
STATE AUDITOR

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September 28, 2006

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Members of Council of State
Chief Justice Sarah Parker
Members of Governor's Cabinet
President Erskine B. Bowles, University of North Carolina General Administration
President H. Martin Lancaster, North Carolina Community College System
Chancellors of the North Carolina University System
Presidents of North Carolina's community colleges

Ladies and Gentlemen:

We are pleased to submit this performance audit entitled *Internal Auditing in North Carolina Agencies and Institutions*. The objectives of the audit were to determine whether North Carolina state agencies, universities, and community colleges had sufficient internal audit resources and to assess the level of compliance that existing internal audit functions have achieved with generally recognized internal audit principles and best practices. Interested state officials have reviewed a draft copy of this report. Their written comments are included in the appendices to the report.

We wish to express our appreciation to the various officials and staffs of universities, state agencies, and community colleges for the courtesy, cooperation, and assistance provided us during the audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Leslie W. Merritt, Jr.".

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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Summary

This report contains the results of a performance audit of the internal audit function at state agencies, universities and community colleges. The objectives of this audit were to determine whether North Carolina state agencies, universities, and community colleges had sufficient internal audit resources and to assess the level of compliance that existing internal audit functions have achieved with generally recognized internal audit principles and best practices.

Our audit universe encompassed the university system and its 16 campuses, the community college system including the 58 separate community colleges, and 31 major general government state departments and component units. During the course of our audit, we surveyed all state entities and visited several universities, state agencies, and community colleges including some that did not have an internal audit function. Currently, internal audit functions exist at all 16 universities, one community college, and 13 state agencies (see the appendices to this report).

The presence of a functioning internal audit operation is a key component of a good system of internal control. Internal auditors evaluate systems within an organization, help to prevent and detect errors and irregularities, help to ensure the reliability and integrity of financial and operational information and compliance with laws and regulations, and help to safeguard assets. They also function as management consultants by identifying problems and recommending methods to improve the effectiveness and efficiency of an organization's operations.

RESULTS IN BRIEF

The internal audit function in North Carolina is inadequately staffed and is in need of more direct guidance from the General Assembly. Many state entities have no internal audit function; others are inadequately staffed; still others lack the mix of expertise needed to meet the challenges presented by their organizations. No universal state criteria or minimum standards exist regarding the establishment of an internal audit activity that addresses the authority and responsibilities of the internal audit function or how the function should be organized and staffed.

The level of compliance that existing internal audit functions have achieved with generally recognized internal audit principles and best practices is varied. In general, the universities have achieved a greater level of compliance largely due to a structure that has been in existence for some time, support of senior administrations at both the University of North Carolina General Administration and individual university levels, and a strong sense of awareness and commitment that the internal audit staffs of the various universities have to the potential of internal audit and its importance to the university. General government is not as far along in achieving a more structured and working internal audit environment, largely, we believe, because of a lack of funding and a need for increased awareness of the value that internal audit can bring to the organization. In the case of community colleges, the function is largely non-existent; however, we believe there is an increased awareness of its need,

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especially at the community college system level.

We found the following conditions that need to be addressed:

- Several internal audit sections do not follow any professional auditing standards. Only three internal audit sections have obtained quality assurance (peer) reviews by outside parties.
- Some internal audit sections do not report to the highest management level within the organization thus creating the potential for loss of audit independence.
- Two audit sections did not execute annual audit plans. Others did not execute annual audit plans based on risk assessments. Internal auditors were often assigned tasks in addition to their primary job responsibilities. We found several instances where the internal audit section's ability to meet its scheduled audit plan was hampered due to the need to complete other responsibilities.
- Several internal audit sections did not have an audit charter or had inadequate policies and procedures.
- The Office of Information Technology Services shifted the focus of its internal audit function from internal audit responsibilities to new priorities. A recent reorganization redirected the internal audit function to testing compliance with statewide information technology policies.
- The Department of Transportation's internal audit section has experienced significant issues impairing its ability to complete audits and produce audit reports. We identified problems with failure to complete audits and release reports of results, lack of auditor productivity, failure to correct deficiencies identified by outside consultants, problems with the reporting structure and failure by management to focus on and remedy these conditions.

Responses From State Entities

The responses to the findings by each entity audited are included in the appendices to this report.

Introduction

BACKGROUND

Internal auditing, as defined by the Institute of Internal Auditors, “is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

Internal auditing is established to assist management with improving the effectiveness and efficiency of operations, ensuring the reliability and integrity of financial and operational information, preventing and detecting errors or irregularities, safeguarding of assets, and complying with laws and regulations. While management is responsible for establishing internal controls, internal auditors evaluate the effectiveness of these controls.

The Department of Health and Human Services is the only entity required by legislation to have an internal audit function. All universities, several state agencies, and one community college have established internal auditing functions at their own initiation. Various position classifications exist for internal auditors within the state personnel system. Auditors are classified as governmental accounts auditors, internal auditors, internal auditing managers, and information system auditors. The appendices to this report contain tables that show the internal audit functions currently existing within state agencies, universities, and community colleges.

As the tables depict, the size of the internal audit functions vary without much correlation as to the size or operating expenditures of the organization. Many entities have no internal audit function at all.

Funding for each of these internal audit sections is provided through the normal budgeting process. Most of the internal audit functions are independent sections reporting to the chief executive of the entity while some of the internal audit functions are contained in the fiscal operations or elsewhere within the entity. Internal auditors conduct examinations of various types, including reviews of internal controls, operational audits, internal investigations, information system audits, and compliance reviews.

Internal Auditing Vs. Monitoring

Internal auditing should not be confused with the monitoring activity that many state entities have. The term monitoring can be used in many contexts. Monitoring, as is commonly used among state entities, is a separate function whose focus is on other organizations. Monitors typically watch over funds granted to local governments and non-profits or contractors to ensure that the subrecipients and contractors comply with rules, regulations, and terms of contracts. Internal auditing, unlike monitoring, is focused on operations and systems within the organization in which the internal auditing function resides.

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OBJECTIVES, SCOPE, AND METHODOLOGY

The State Auditor initiated this audit to assess the internal auditing function in state agencies, universities, and community colleges. The audit stemmed from increasing public awareness and concern over fraudulent activities in governmental entities and large organizations in the private sector. We had two objectives on this audit: first, to determine whether North Carolina state agencies, universities, and community colleges had sufficient internal audit resources; second, to assess the level of compliance that existing internal audit functions have achieved with generally recognized internal audit principles and best practices.

To accomplish these objectives, we identified which state agencies, universities, and community colleges had an internal audit function. We selected a sample of these organizations to evaluate their operations. In addition, we visited some organizations that did not have an internal audit function to determine whether a definable need to establish such a function existed.

The scope of the audit focused on the operations of 14 state entities that have established internal audit sections as follows:

- Appalachian State University
- East Carolina University
- Elizabeth City State University
- North Carolina State University
- University of North Carolina at Asheville
- University of North Carolina at Chapel Hill
- University of North Carolina Wilmington
- Central Piedmont Community College
- Department of Correction
- Department of Environment and Natural Resources
- Department of Health and Human Services
- Department of Public Instruction
- Department of Transportation
- Office of Information Technology Services

To accomplish our objectives, we interviewed senior management and internal audit staff at each entity visited. We reviewed laws, rules, regulations, policies, and procedures related to the internal audit function. We examined reports and studies, both internal and external, regarding internal audit operations. We reviewed each entity's organizational structure, audit plans, and operating standards and identified whether audit risk assessments were conducted. Additionally, we reviewed personnel files, job descriptions, training records, time sheets, and a sample of audit reports. The audit period covered the three-year period July 2002 through June 2005.

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This report contains the results of the audit including conclusions and recommendations. Specific recommendations related to our audit objectives are reported. Because of the test nature and other inherent limitations of an audit, together with the limitations of any system of internal and management controls, this audit would not necessarily disclose all weaknesses in the systems or lack of compliance.

We performed the audit fieldwork from October 2005 to March 2006. We conducted this audit under the authority vested in the State Auditor by North Carolina General Statute §147-64.6 and according to generally accepted government auditing standards.

Findings and Recommendations

1. NORTH CAROLINA STATE GOVERNMENT AND ITS INSTITUTIONS LACK SUFFICIENT INTERNAL AUDIT RESOURCES

The internal audit function in North Carolina is inadequately staffed and is in need of more direct guidance from the General Assembly. Many state entities have no internal audit function; others are inadequately staffed; still others lack the mix of expertise needed to meet the challenges presented by their organizations. The high-tech environment is increasingly presenting new challenges for better safeguards; requirements by funding agencies continue to put state entities at risk for paybacks due to non-compliance with regulations; the public's demand of agencies to be better stewards of taxpayer dollars is increasing the burden on management to do a better job of managing resources and risks. An integral player in this regard is an adequately staffed and functioning internal audit activity. Some recent major financial scandals in the private sector are warnings of what can happen when proper oversight is not in place. As demonstrated from time to time, the public sector is not immune to becoming a victim from a failure to adequately respond to these challenges.

Agencies With No Internal Audit Function - North Carolina has addressed the internal audit function in the past, but only to a very limited degree. North Carolina does not have minimum uniform internal audit requirements that would apply to all state entities. North Carolina has general statutes establishing an internal audit function specific to the Department of Health and Human Services, but none exists pertaining to the remaining entities in the State. State entities other than the Department of Health and Human Services have internal audit functions, but they were created at the discretion of their management with no guidance from the General Assembly. The absence of legislation allows those state entities to disband their internal audit function at any time and does not establish minimum standards.

Most state entities have no internal audit function. Those not having an internal audit function include many small entities but also include several large organizations, which generally would be indicative of large, varied, and/or complex operations. Eighteen of the 31 general government agencies reviewed for this audit have no internal auditors on their staff. Only one of the 58 community colleges has an internal audit function. The Administrative Office of the Courts, comprising all clerks of courts in the State, has 5,700 employees and expenditures of \$556 million, but no internal audit function. Tables in the appendix to this report display all those entities with no internal audit function accompanied with data on number of employees and expenditures. The entities without internal audit functions had total expenditures of about \$5.9 billion and had about 25,000 employees.

Entities Without Internal Audit Function			
	Number of Entities	Number of Employees	Operating Expenditures
General Government	18	11,962	\$ 4.54 billion
Community Colleges	57	12,833	\$ 1.31 billion
Total	75	24,795	\$ 5.85 billion

During the past few years, we have witnessed a number of corporate accounting improprieties at organizations such as Enron, WorldCom and Tyco. These financial

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scandals resulted in a decline of public trust in accounting and reporting practices. In response, the United States Congress enacted the Sarbanes-Oxley Act of 2002. The Act is wide-ranging and addresses accounting, management responsibilities, and auditing requirements of publicly traded companies. Sarbanes-Oxley also served as an impetus for the federal government to reevaluate its policies regarding internal controls over financial reporting and related management responsibilities. Although most provisions of Sarbanes-Oxley apply only to publicly traded entities, there are movements to extend provisions of the act, at least in some respects, to the government sector.

Accountability, ethics and transparency are words we hear more often as it relates to state government, and they should be more than simply buzz words for organizations that must meet the expectations of the public. The concept of accountability for public resources is vital in the governing process. Legislators and the public need to know that (1) government resources are properly managed and used in compliance with laws and regulations, (2) government programs are achieving their objectives and desired outcomes, and (3) government services are being provided efficiently, economically, and effectively.

Authoritative bodies have without exception recognized the internal audit function as a vital ingredient in an organization's effort to achieve these objectives. The Government Finance Officers Association (GFOA), a professional association of state and local finance officers in the United States and Canada, dedicated to the sound management of government financial resources, encourages every government organization to consider an internal audit function. The GFOA has indicated the vital importance of internal auditing, not only to prevent fraud and abuse and to monitor the design and proper functioning of internal controls, but also to be an integral part of the organization's goal to achieve its objectives. It recognizes the internal auditor's valuable role in conducting performance audits and special investigations and studies.

Government Finance Officers Association

"Every government should consider the feasibility of establishing a formal internal audit function because such a function can play an important role in helping management to maintain a comprehensive framework of internal controls. If it is not feasible to establish a separate internal audit function, a government is encouraged to consider either 1) assigning internal audit responsibilities to its regular employees or 2) obtaining the services of an accounting firm (other than the independent auditor) for this purpose."

The United States Government Accountability Office (GAO) in an exposure draft to *Government Auditing Standards* recognizes internal auditing as "an important part of overall governance, accountability, and internal control. A key role of many internal audit organizations is to provide assurance that internal controls are adequate to mitigate risks and achieve program goals and objectives."

Institute of Internal Auditors

"A cornerstone of strong governance, internal auditing bridges the gap between management and the board, assesses the ethical climate and the effectiveness and efficiency of operations, and serves as an organization's safety net for compliance with rules, regulations, and overall best business practices."

At present, the State of North Carolina has not sufficiently reacted to the corporate scandals in an effort to prevent similar situations from arising within our state government. No universal state criteria or minimum standards exist

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regarding the establishment of an internal audit activity that addresses the authority and responsibilities of the internal audit function or how the function should be organized and staffed.

Agencies With Inadequately Staffed Internal Audit Functions - Having an internal audit function does not necessarily mean that all is well with internal audit. Some agencies with the function do not have adequate staff in its internal audit section. This includes state entities that have large budgets or a large number of employees.

Take, for example, the Department of Health and Human Services (DHHS). DHHS is the largest agency in North Carolina state government. DHHS consists of an assortment of 33 divisions and administrative offices with many federally mandated programs within those divisions and offices. For the fiscal year ending June 30, 2005, it had in excess of 17,000 funded positions and its revenues and appropriations exceeded \$13 billion.

The DHHS internal audit office has only seven funded positions, including a director and six auditors. Two of the auditors are devoted to the \$7 billion Medicaid program, itself a highly complex program whose expenditures are of ever increasing concern to the State. One auditor is primarily responsible for investigations within the Women, Infants, and Children program. That leaves only three auditors (two internal auditors and one information system auditor) dedicated to the remaining activities throughout the Department.

In addition to the existing audit workload, the internal audit office also provides technical assistance on numerous projects.

Selected Agencies With Inadequate Internal Audit Staffs			
	DHHS	DENR	DPI
Number of employees	17,131	3,580	538
Expenditures	\$13 billion	\$569 million	\$7.7 billion
Number of Divisions/Departments	33	20	23
Number of federal programs	119	62	39
Federal programs funding	\$8.4 billion	\$128 million	\$1.1 billion
Internal Audit Staff			
Number of internal auditors:	7 including director	1	1
• Devoted to Medicaid	2		
• Devoted to Women, Infants, and Children program	1		
• Devoted to all other programs/activities	3	1	1

Other examples include the Department of Environment and Natural Resources (DENR) and the Department of Public Instruction (DPI). DENR has many high-risk activities affecting the public health and safety of the State's citizens such as pollution control, water quality, hazardous waste, among others, and has in excess of 3,500 employees - but only one internal auditor. DPI spends billions of dollars of the State's funds on programs that are of ever-increasing concern to parents and taxpayers that they are administered both effectively and efficiently, and yet, its one internal auditor position was created just last year and has \$7.7 billion to watch over. Furthermore, DPI readily admits that its internal audit function is not a true internal audit function as it is obligated to perform many duties unrelated to internal audit.

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Skill Set of Internal Audit Staffs Not Adequate - Some state entities have internal audit staffs, but even some of them are inadequately staffed because they don't have the mix of expertise needed to meet the challenge of an increasingly more complex operational environment. For example, information system auditors are viewed as vitally important in the audit of computer, communication transmission, and security systems. The very systems that make it possible for today's organizations to conduct business have made the organizations themselves vulnerable to a whole host of risks. Because such systems are an integral part of every organization's operation, they present a substantial risk to an organization's operation and therefore should be monitored by the organization's internal audit function.

Yet we found information system resources in the internal audit function were lacking. Of the general government agencies with internal audit functions, few have information system auditors. For example, DOT, confronted with a relatively new and complex accounting system unique within North Carolina state government, has no information system auditor on its internal audit staff. Community colleges, with one exception, lack internal auditors altogether. And while some of the larger universities have information system auditors, most universities lack this expertise on their internal audit staff.

The call for more information system resources was the most common concern expressed by the agencies and universities we visited. There was also some concern expressed for other internal audit skills needed for specialized programs or to meet the challenges presented by work requiring special skills. According to the Institute of Internal Auditors *International Standards for the Professional Practice of Internal Auditing (Standards)*, "internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities."

The absence of an effective internal audit function increases the risk that irregularities may occur. Internal audits provide oversight to strengthen internal controls and to prevent problems from occurring. Further, internal audits help management achieve its objectives. They help to ensure scarce state funds are used effectively and efficiently and in accordance with laws and regulations.

Recommendations: The General Assembly should enact legislation clearly defining the internal audit expectations for each agency. Internal audit functions should be established in accordance with generally recognized internal audit principles and best practices. These recommendations are discussed in more detail below.

- A. Legislation Is Needed: The General Assembly should establish minimum requirements for the development of an internal audit function at the agency level, should specify the minimum staffing criteria and qualifications, and should mandate the internal auditing standards the State's internal audit functions are to comply with. The legislation should incorporate the recommendations that follow.

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B. Adequate Funding Should Be Provided: Adequate funding to establish the internal audit offices should be provided. Pay grades should be competitive with the private sector and sufficient to attract and retain staff.

C. Staffing Should Be Increased: Every entity should have an internal audit effort of some form and extent. The function will vary from the bare minimum for small agencies to a full-time audit staff for larger agencies. Some agencies are too small to have a full-time audit staff and others may be assessed of such low risk that a separate internal audit office is not warranted. In circumstances as this, management should have its regular staff perform on an as-needed basis internal audit functions to address special areas of concern.

Every organization should assess the extent of its internal audit needs using the following guidelines:

- Every agency, regardless of size, should first assess the size, type, and skills needs of its internal audit effort.

Factors to consider should include the size of the agency staff and its facilities; its budgets and whether they are changing; the number, complexity, sensitivity, and variety of its programs; the affected populations; the presence of activities that may pose a high risk to the State, such as health and safety issues or critical and sensitive financial data; the expectations of audit committees and management.

- After this initial assessment, a decision should be made as to the type and size of the internal audit function. The choice is between having internal audit activities conducted by an agency's own staff on an as-needed basis (for very small low risk agencies) or establishing a separate internal audit office. Any one factor considered in the assessment may be sufficient to require a separate fully staffed internal audit function.
- We believe agencies with 500 or more employees should have a separate fully staffed and functioning internal audit office. An agency with as many employees as this would generally indicate one of sufficient size in terms

Other States

Texas enacted legislation establishing guidelines for a program of internal auditing. The legislation requires state agencies that (1) have an annual operating budget exceeding \$10 million, (2) have more than 100 full-time equivalent employees or (3) receive and process more than \$10 million in cash in a fiscal year to implement an internal auditing function. Further, the legislation sets requirements for establishing an annual audit plan to be prepared using risk assessment techniques to assess major systems and controls including accounting systems, administrative systems, and electronic data processing systems. Finally, the legislation sets forth the internal audit professional standards to be followed as well as the minimum job qualification requirements for internal auditor staffing.

Florida requires each state agency to establish an Inspector General's office. The office serves as the central point for coordinating activities that promote accountability, integrity, and efficiency in government. Like Texas, it also sets forth professional standards and staff qualifications.

Mississippi requires each state agency, university, and community college to implement an effective internal audit program. The internal audit function may be outsourced if it is determined that it is more efficient than establishing the function internally. It also set forth the professional standards and the qualifications of the internal audit director.

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of expenditures and number of programs and activities as to indicate sufficient risks to warrant an internal audit office.

Centralized Audit Efforts Should Be Considered: Some entities might better lend themselves to having one central internal audit organization or one in which certain specialized audit skills are leveraged across entity boundaries. For instance:

- The 58 community colleges, with only two internal auditors employed by just one community college, should consider establishing a central system of internal auditors to serve community colleges not having their own internal audit staff. The internal audit staff could be housed at the Community College System, at regional offices, or under some other arrangement that guarantees each community college access to internal audit resources.
- The Administrative Office of the Courts, with no auditors for the 100 county courts system and employing 5,700 staff, should also consider a centralized internal audit function, similar to the one suggested for community colleges.¹
- The university system should consider supplementing the internal audit offices of some of its smaller institutions by employing and housing them at University of North Carolina General Administration. They could be made available to smaller institutions as needed and even to a larger institution if needed in specialized circumstances, for instance, where independence issues might bring into question resolution of a matter needing investigation.
- Centralizing internal audit resources could also work well when there is a need for specialized skills. For instance, due to the size of some of its institutions, it might not be warranted for each university to have an information systems auditor, in which case, University of North Carolina General Administration could acquire such skills and make them available to any institution in need.

Organizations should make its decision on whether to employ centralized internal audit services on many factors, including cost benefits, effectiveness, access to resources when needed, among others. Under a centralized internal audit arrangement, reporting authority should be made clear. An acceptable arrangement could be one in which the internal audit staff reports administratively to the central organization but functionally to the constituent organizations, or to a designated audit committee. The use of centralized internal audit resources could

¹ The Administrative Office of the Courts (AOC) includes Clerk of Court of Appeals and Clerk of Superior Court. Eight financial management analysts are currently on staff. These positions are not identified as auditors, but AOC may be reclassifying them in the future.

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provide benefits to the constituent organizations by reducing the overall costs of the internal audit, fostering cross training and contacts among agencies, improving communication, providing a broad base of experience to the specialized internal audit staff.

Size of Internal Audit Office Matters: Many agencies with internal audit functions have a staff of only one auditor. Agencies should carefully weight the reality of an internal audit office composed of very few internal auditors. An internal audit office that is too small places the agency in a vulnerable position. Any turnover could cripple the internal audit function or greatly delay needed benefits. Continuity could be lost. Maintaining independence in a small office may prove difficult. An audit of an area may be impossible because there is no one on the internal audit staff who is independent with regard to that area. It is more likely the internal auditor will not be able to devote sufficient time to risk assessments, systems reviews, audits of program results and efficiency and effectiveness of operations –internal audit activities that are more apt to prevent problems for the entity.

Internal Audit Should Be Staffed With Appropriate Skills: Internal audit offices should ensure that they possess the knowledge and skills needed to perform their duties, or be able to acquire specialized skills when needed. The internal audit staff should have the skills to enable the performance of a broad range of audits, including program results and efficiency and effectiveness audits.

- D. Scope of Internal Auditing Should Be Broad: Internal auditing has a broader purpose than preventing fraud and the safeguarding of assets. Ensuring adequate internal controls and compliance with laws, regulations, and contracts are other objectives that are commonly recognized within the scope of internal auditing. However, not always recognized as being within the scope of an internal auditing function are performance audit objectives such as program effectiveness and results, economy and efficiency of operations, improving procedures, finding ways to reduce costs.

The Institute of Internal Auditors *Standards* defines the internal auditing activity as a function “that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations.” The *Standards* state, “Internal auditors should review operations and programs to ascertain the extent to which results are consistent with established goals and objectives to determine whether operations and programs are being implemented or performed as intended.” The scope of internal auditing should encompass all aspects of internal auditing, including how well the entity’s operations are run in support of management’s objectives. By so doing, the internal auditing activity helps an organization accomplish its objectives.

- E. Standards Should Be Followed: Most of the entities with internal auditing functions responding to our survey indicated that they followed Institute of Internal Auditors *International Standards for the Professional Practice of Internal*

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Auditing (Standards), with some stating that they also followed other standards. We believe internal auditing offices should adhere to an authoritative body of internal audit standards and because the Institute of Internal Auditors *Standards* have acquired a wide acceptance with the State's internal auditing offices, we believe all audit offices should adopt them.

- F. Quality Control Should Be Maintained: In addition to an internal quality control program, each internal audit office should have a peer review in accordance with the Institute of Internal Auditors *Standards*. Quality control can be enhanced by a good flow of information among internal audit offices within the state community. We believe general government agencies should establish an interagency organization of internal auditors, the purpose of which is to share ideas, information, methodology, and other mutually beneficial information, similar to the North Carolina University Auditors Association, the internal audit organization created by the university community. As a means to hold down costs, the membership of these interagency audit organizations could serve as the resource providers of the peer review and supplemented, if needed, by others from outside the state community.
- G. Internal Audit Charter Is Needed: Each internal audit office should have a charter or mission statement. According to the Institute of Internal Auditors, "the purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the *Standards*, and approved by the board." Clarity of mission and support of senior management will serve to make a more effective internal audit function.
- H. Independence of the Internal Audit Function Should Be Assured: For the internal audit activity to effectively function it must be independent and, according to the Institute of Internal Auditors, it "should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities." We believe the internal auditor should report to the agency head, community college president, or university chancellor and to the audit committee of any oversight board.
- I. Annual Audit Plan Should Be Formulated: Each entity should prepare an annual audit plan based on an entity-wide risk assessment. A risk assessment helps management to identify, manage, and minimize risks to the entity. It will help to focus internal audit efforts on areas with the greatest payback to management towards achieving its goals and objectives.

Findings and Recommendations

2. SOME INTERNAL AUDIT ORGANIZATIONS DO NOT FOLLOW ANY PROFESSIONAL AUDITING STANDARDS

We identified through our survey or fieldwork that most of the entities that had an existing internal audit function reported that their internal audit sections followed standards promulgated by the Institute of Internal Auditors or the Government Accountability Office. However, internal audit sections at the following entities reported that they did not follow any professional auditing standards.

- Department of Environment and Natural Resources
- Department of Public Instruction
- Office of Information Technology Services
- University of North Carolina at Asheville
- University of North Carolina Wilmington

In November 2005, the Board of Governors of the University of North Carolina adopted best financial practices, effective July 2006, which required each institution's internal audit function to be carried out in a way that meets professional standards.

The absence of professional internal auditing standards compromises the quality of the internal audit function. Professional auditing standards provide the basis by which the operations of an internal audit unit are evaluated and measured. The Institute of Internal Auditors defines the purpose of professional standards are to:

- Delineate basic principles that represent the practice of internal auditing as it should be;
- Provide a framework for performing and promoting a broad range of value-added internal audit activities; and
- Foster improved organizational processes and operations.

Recommendation: Internal audit organizations should adopt and follow recognized professional auditing standards. We believe, at a minimum, the Institute of Internal Auditors *International Standards for the Professional Practice of Internal Auditing* should be adopted.

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3. INTERNAL AUDIT ORGANIZATIONS ARE NOT OBTAINING QUALITY ASSURANCE REVIEWS BY OUTSIDE PARTIES

With the exception of the departments of Health and Human Services and Transportation, no internal audit section in general government, the university system, or the community college system has obtained a peer review from an independent group. However, the Department of Transportation's peer review is out of date, given that it was last obtained on December 30, 2002. At the time of our fieldwork, East Carolina University had planned and budgeted for a peer review to be completed before the end of 2006. An external review helps to improve internal audit operations and provides assurance that the internal audit activity conforms to standards.

Every internal audit section should have internal quality assurance measures. In addition, an external quality assessment (peer review) performed by an independent party should serve to enhance the quality of the internal audit function. Institute of Internal Auditors *Standards* require that a peer review be conducted by a qualified independent reviewer or by a review team from outside the internal audit organization at least every five years.

Recommendation: Internal audit organizations should obtain as part of their quality assurance program an external quality assessment review at regular intervals. State universities currently have their North Carolina University Auditors Association that might be utilized to coordinate reviews of the universities. State agencies should consider establishing a similar mechanism as a means to greatly reduce the cost of an external assessment.

Subsequent Events: Subsequent to completion of fieldwork, East Carolina University obtained a peer review on June 22, 2006, ensuring compliance with Institute of Internal Auditors' peer review standards.

Findings and Recommendations

4. SOME INTERNAL AUDIT SECTIONS DID NOT REPORT TO THE HIGHEST MANAGEMENT LEVEL WITHIN THE ORGANIZATION

During the course of our audit fieldwork we identified six entities in our sample where the internal audit section did not report to the highest management level within the organization, thus creating the potential for loss of audit independence. Table 1 shows the reporting level at those entities.

Reasons provided by agencies for their internal audit functions reporting to lower levels included management decision (Department of Transportation), avoidance of excessive reporting to the chief executive officer (Central Piedmont Community College and UNC-Chapel Hill), reorganization (Information Technology Services), and the internal audit function not acting as a true internal audit operation (Department of Public Instruction and Department of Environment and Natural Resources).

Table 1	
State Entity	Reporting Level
Department of Transportation	Deputy Secretary-Administration & Business Development
Central Piedmont Community College	Executive Vice President
University of North Carolina at Chapel Hill	Vice Chancellor-Finance and Administration
Information Technology Services	Information Technology Manager-Strategic Initiatives Office
Department of Public Instruction	Financial Services Director
Department of Environment and Natural Resources	Controller

In November 2005, the Board of Governors of the University of North Carolina adopted best financial practices, effective July 2006, which required each institution's internal audit function to report to the chancellor and to have a reporting relationship with the chair of the audit committee.

The General Accountability Office (GAO), the Institute of Internal Auditors, and the American Institute of Certified Public Accountants all stress the importance of auditor independence. Where the internal audit function reports is a fundamental consideration of its independence and degree of authority it will possess.

GAO's *Government Auditing Standards* states that government internal audit organizations can be presumed to be free from organizational impairments to independence when reporting internally to management if the head of the internal audit section meets the following criteria:

- Is accountable to the head or deputy head of the government entity,
- Is required to report the results of the audit section's work to the head or deputy head of the government entity, and
- Is located organizationally outside the staff or line management function of the unit under audit.

The Institute of Internal Auditors *Standards* require the chief audit executive to report to a level within the organization that allows the internal audit activity to fulfill its responsibilities and to be free from interference in determining the scope of internal

Findings and Recommendations

auditing, performing work, and communicating results. The American Institute of Certified Public Accountants recommends that the director of internal auditing report to an individual in the organization with sufficient authority to promote independence, ensure broad audit coverage, ensure adequate consideration of audit reports, and ensure appropriate action on audit recommendations. Reporting to the highest level of management ensures auditor independence and signals the importance of the function to all members of the organization.

Recommendation: The state entities noted in table 1 should revise their internal audit reporting structures so that the internal audit function reports to the highest level within the organization. As such, we believe the internal auditor should report to the agency head, community college president, or university chancellor and to the audit committee of any oversight board.

Findings and Recommendations

5. SOME INTERNAL AUDIT ORGANIZATIONS DID NOT EXECUTE AN ANNUAL AUDIT PLAN WHILE OTHERS DID NOT PERFORM RISK ASSESSMENTS TO DEVELOP AN AUDIT PLAN

The University of North Carolina at Asheville and the Department of Public Instruction did not execute annual audit plans. The Department of Environment and Natural Resources, Department of Transportation, and UNC-Chapel Hill had audit plans, but the plans were not based on risk assessments. The lack of an effective audit plan based on risk assessments increases the chances of not focusing on higher risk areas where errors and irregularities are more likely to occur.

The Institute of Internal Auditors *Standards* require that the chief audit executive establish risk-based plans to determine the priorities of the internal audit activity that are consistent with the organization's goals. State entities have certain risks involved in meeting their objectives and providing services to the taxpayer. A risk assessment is the process utilized to identify, analyze, and manage those potential risks that could have a negative impact on achieving those objectives. The input of senior management and board, if applicable, should be considered in the process.

Recommendation: All internal audit organizations should comply with internal auditing standards by establishing an annual audit plan based on an effective risk assessment.

Findings and Recommendations

6. INTERNAL AUDITORS WERE OFTEN ASSIGNED TASKS UNRELATED TO THEIR PRIMARY JOB RESPONSIBILITIES

We found several instances where the internal audit section's ability to meet its scheduled audit plan was hampered due to the need to complete other responsibilities as requested by management. Specifically, the internal auditors at the University of North Carolina at Asheville (UNC-Asheville), Central Piedmont Community College (CPCC), the Department of Environment and Natural Resources (DENR), and the Department of Public Instruction (DPI) all cited examples of performing duties unrelated to those considered the proper role of an internal auditor. Time spent on tasks other than internal audit duties hampers the internal audit function from fulfilling its role to strengthen internal controls and conduct internal audit activities. In addition, these unrelated tasks could impair the independence of the internal audit section as auditors should not review work in which they had participated.

At UNC-Asheville, the internal auditor worked closely with the controller. The internal auditor completed schedules for the university's financial statements, assisted with bank reconciliations and inventories, and was the university's custodian of internal policies and procedures. The internal auditors at CPCC spent a majority of their time working on non-internal audit related activities. For example, the associate vice-president overseeing the internal audit function at CPCC was also responsible for health and safety, equal employment opportunity, and full-time equivalent (FTE) compliance. The internal auditor estimated that over half of her work time was devoted to ensuring compliance with Community College System Office FTE requirements.

At DENR and DPI, the function was not operating as a true internal audit function as defined by the Institute of Internal Auditing. As noted in a prior finding, the internal audit position was located organizationally within the Controller's Office at DENR and within the Financial Services Division at DPI. At DENR, the internal auditor acted as a "special projects" resource for the controller. In the special projects role, the internal auditor developed and updated policies and procedures, acted as a point-person for credit card use, updated the agency's cash management plan, and reviewed procurement card purchases. At DPI, the position was referred to as an "internal financial analyst" because management utilized the position to perform analysis of the Financial Services Division.

In many organizations, the internal auditors are viewed as a key management resource to provide analysis and expertise in addition to their focus on conducting internal audits and strengthening internal controls. As such, management often relies upon the internal auditor to complete additional tasks. However, the Institute of Internal Auditors *Standards* states that "internal auditors should refrain from assessing specific operations for which they were previously responsible."

Recommendation: Management should ensure that internal auditors focus their efforts on conducting audits and strengthening internal controls. To avoid interference with internal audit's workload or compromising the function's independence, management should refrain from assigning unrelated functions to the internal audit section.

Findings and Recommendations

7. SOME INTERNAL AUDIT SECTIONS DID NOT HAVE AN AUDIT CHARTER

Most entities having an internal audit function had an audit charter. However, the internal audit sections at the following entities had not established an audit charter.

- Department of Environment and Natural Resources
- Office of Information Technology Services
- Department of Public Instruction

The audit charter is the written instrument that serves as the foundation for the creation of the internal audit function. The document establishes the organizational authority, defines the function's mission and responsibilities, sets forth the scope of activities, institutes reporting structure, and establishes operating principles and standards. The audit charter should also clearly express senior management's support of the function as part of its operational policy.

Recommendation: All entities should have an internal audit charter consistent with the Institute of Internal Auditors *Standards*. The charter should clearly define the purpose, authority, and responsibility of the internal audit activity within the entity.

Findings and Recommendations

8. SOME INTERNAL AUDIT SECTIONS LACKED ADEQUATE POLICIES AND PROCEDURES

Several state entities did not have adequate policies and procedures governing the internal audit function. The lack of policies and procedures can hamper an organization's ability to conduct its operations. Without established standards, employees may not perform their job responsibilities consistently and in accordance with management expectations.²

- The Department of Correction's policies and procedures manual was out-dated and disorganized;
- The internal auditor at the Department of Public Instruction indicated that since the creation of the internal audit section in August 2005 there has not been time to formulate a policies and procedures manual;
- The Department of Environment and Natural Resources has not created a policies and procedures manual for its internal audit section. The Department's internal auditor said other job requirements interfered with having time to establish policies and procedures; and
- The University of North Carolina at Asheville did not have any written policies and procedures other than the internal audit charter. The university's internal auditor cited other job responsibilities preventing the auditor from writing these procedures.

Policies and procedures manuals provide continuity for an organization should employee turnover occur. The Institute of Internal Auditors *Standards* point out that internal audit shops should establish policies and procedures.

Recommendation: Policies and procedures governing the internal audit function should be established and maintained.

² See also finding 10 for a discussion of policies and procedures at the Department of Transportation.

Findings and Recommendations

9. THE OFFICE OF INFORMATION TECHNOLOGY SERVICES NO LONGER HAS A FULLY DEDICATED INFORMATION SYSTEMS INTERNAL AUDITOR POSITION

The Office of Information Technology Services (ITS) has changed its internal audit function by substantially reconstituting its duties to include duties unrelated to internal auditing. The diminishing of an internal auditing focus increases the likelihood that internal controls will weaken and that errors or irregularities may occur.

In a performance audit of ITS released in 1998, the State Auditor recommended that ITS establish an internal information systems auditor position. Soon thereafter, ITS implemented the recommendation by creating an information systems auditor position, obtaining funding for the position from the General Assembly, and filling the position. This position functioned as an internal auditor and reported to the State's Chief Information Officer, the agency head of ITS.

During 2005, ITS undertook a re-organization. As part of the re-organization effort, the internal information systems auditor position was moved into the newly established Strategic Initiatives Office. The position's responsibilities were changed to focus on statewide information technology compliance auditing for ITS and on the agencies under the purview of ITS for information system statewide policies. Despite the additional responsibilities and focus on statewide information technology compliance, this position retained responsibility for conducting internal audits within ITS. However, due to the workload of the new responsibilities, internal auditing is no longer the emphasis of this position.

Recommendation: ITS should re-establish an internal information systems auditor position separate from the statewide information technology compliance responsibilities. Its key and highly sensitive position in information technology mandates that it employ all reasonable controls to protect the integrity of information in state government. As with the prior existence of the position, the function should report directly to the Chief Information Officer.

Findings and Recommendations

10. THE DEPARTMENT OF TRANSPORTATION'S INTERNAL AUDIT SECTION HAS EXPERIENCED SIGNIFICANT DIFFICULTIES WITH COMPLETING AUDITS AND PRODUCING AUDIT REPORTS

Our review of the operations of the internal audit section at the Department of Transportation (DOT) revealed significant issues. We identified problems with failure to complete audits and release reports of results, lack of auditor productivity, failure to correct deficiencies identified by outside consultants, problems with the reporting structure and failure by management to focus on and remedy these conditions. As a result, DOT has failed to fully realize the benefits normally provided by an internal audit operation to help an organization accomplish its objectives and improve operations.

Lack of Productivity: We analyzed employee work logs for the three-year audit period ending June 30, 2005. Our analysis identified time charged on 45 internal audit projects totaling 10,033 work hours. Review of audit work plans for the same period identified 31 of the 45 projects as carryover projects from multiple years dating as far back as fiscal year 1999-2000.

We determined the status of each project and identified any reports, memos, or other documentation identifying the results of the project. We found only one audit report and eight memos/letters identifying any such results over this three-year period. The audit report was notated as a draft copy and covered the period from July 1, 2000 through June 30, 2002. We were told that perhaps the report only lacked the Chief Internal Auditor's signature to enable its release. The Chief Internal Auditor further explained that for most of 2003 the section spent its time on training and was unable to conduct any audits. He stated that for years subsequent to 2003, the reason for no audit reports was that his office decided to wait until this year (2006) and start anew.

Of the 45 projects for the three fiscal years, 36 (80%) are still pending closure. Audit work plans identified the status of these 36 projects with notations such as "issue report or cancel," "started-incomplete," "in-progress," "on hold/delayed," "on hold SAP issues," or no status was provided.

As illustrated in table 2, auditors charged a total of 9,006 hours to "miscellaneous" during the three-year period. The DOT Internal Audit Manual states that charges to this classification should be for "time spent on audits after the audit has been completed." In short, time devoted to miscellaneous tasks nearly equals the total direct hours (10,033) charged to audit projects for the same three-year period. Given that 36 of the 45 projects remain incomplete, we were not provided with an adequate explanation for the large number of hours charged to miscellaneous, particularly since very few projects appear to have come to fruition during this three-year period.

Fiscal Year	Total Miscellaneous Hours	Equivalent Person Years
2002-2003	2,862	1.38
2003-2004	2,879	1.38
2004-2005	3,265	1.57
Total	9,006	4.33

Source: Internal audit work-logs

Findings and Recommendations

The Chief Internal Auditor stated that much of the section's time in the prior years was spent on special projects. However, he was unable to provide any documentation on the special projects.

Policies and Procedures: A peer review report issued December 30, 2002, by the American Association of State Highway and Transportation Officials (AASHTO) cited the internal audit section for not addressing all significant standards in its audit manual. AASHTO identified 10 specific audit standards that needed to be addressed and recommended the internal audit section make the necessary updates to the manual.

We found no evidence those revisions had been made, nor did we find any indication that any of the policies and procedures had undergone a review. However, employee time sheets showed 422 hours was charged to revisions to the manual.

Reporting Structure (Independence): The Chief Internal Auditor currently reports to the Deputy Secretary-Administration & Business Development, who along with seven other senior managers, reports directly to the Secretary of DOT. The internal audit section could conduct audits of functions for which the Deputy Secretary-Administration & Business Development has responsibility, thus impeding or compromising internal audit independence. The peer review performed by AASHTO also identified the reporting structure within the DOT internal audit section as a deficiency. Generally accepted government auditing standards, to which the internal audit section subscribes, states that "to help achieve organizational independence, audit organizations should report the results of their audits and be accountable to the head or deputy head of the government entity and should be organizationally located outside the staff or line management function of the unit under audit."

Conclusion: Given its size, the DOT internal audit section needs to be far more productive than is currently evident. We believe the primary cause for the issues we identified stem from the lack of effective management within the internal audit section and insufficient senior Department management oversight. With effective leadership and oversight, the function could become a valuable resource to DOT management.

Recommendation: To achieve organizational independence and ensure proper oversight of operations, the Chief Internal Auditor should report directly to the Secretary and/or to the audit committee of the Board of Transportation. The Secretary of Transportation should take steps to improve the performance of the internal audit section that could include organizational and functional restructuring.

Comparative Data Related to the Number of Internal Auditors

The following tables display comparative information related to the number of authorized internal auditor positions for the University of North Carolina System, general government, and community colleges. The number of employees, approximate operating expenses, and average operating expenses and average number of employees per internal auditor are also reported. The source of the information is:

- Number of internal auditors and employees: data obtained from the Office of State Personnel, University of North Carolina General Administration, or the Community College System as of various dates from 2005 through 2006.
- Operating expenses:
 - For general government and universities: North Carolina Accounting System data as of June 30, 2005, as provided by Office of the State Controller.
 - For community colleges: year-end data as of June 30, 2005, as submitted by community colleges to Office of the State Controller.

University of North Carolina System					
Institution	Number of Internal Auditors	Number of Employees (Excludes Temps)	Approximate Operating Expenses	Average Operating Expense Dollars Per Auditor	Average Number of Employees Per Internal Auditor
UNC - Chapel Hill	5	11,107	\$ 1,677,965,280	\$ 335,593,056	2,221
UNC – Pembroke	½	698	68,955,814	137,911,628	1,396
UNC – Greensboro	2	2,307	242,595,753	121,297,877	1,154
North Carolina School of the Arts	½	482	38,061,086	76,122,172	964
UNC General Administration	½	481	88,718,351	177,436,702	962
North Carolina State	8	7,043	887,443,109	110,930,389	880
East Carolina	6	4,786	523,114,421	87,185,737	798
UNC - Asheville	1	662	64,475,567	64,475,567	662
UNC – Charlotte	3 ¾	2,440	251,293,548	67,011,613	651
Western Carolina	2	1,284	127,222,046	63,611,023	642
Appalachian State	3 ¾	2,223	224,699,175	59,919,780	593
Elizabeth City State	1	493	50,418,296	50,418,296	493
UNC – Wilmington	3 ¾	1,603	163,846,214	43,692,324	427
North Carolina A&T	4	1,571	192,324,733	48,081,183	393
Fayetteville State	2	733	80,097,177	40,048,589	367
Winston-Salem State	3	799	84,003,309	28,001,103	266
North Carolina Central	3 ¾	962	128,660,015	34,309,337	257
Totals for University of North Carolina System	50 1/2	39,674	\$ 4,893,893,894	\$ 96,908,790	786

Comparative Data Related to the Number of Internal Auditors

General Government Agencies					
Agency	Number of Internal Auditors	Number of Employees (Excludes Temps)	Approximate Operating Expenses	Average Operating Expense Dollars Per Auditor	Average Number of Employees Per Internal Auditor
Environment & Natural Resources	1	3,580	\$ 568,581,539	\$ 568,581,539	3,580
Crime Control & Public Safety	1	2,718	377,673,391	377,673,391	2,718
Health & Human Services	7	17,131	13,020,367,216	1,860,052,459	2,447
UNC Hospitals	2	4,352	653,612,116	326,806,058	2,176
Juvenile Justice & Delinquency Prevention	1	1,637	147,989,063	147,989,063	1,637
Transportation	9	12,429	3,538,609,879	393,178,875	1,381
Revenue	1	1,367	95,996,545	95,996,545	1,367
Agriculture	1	1,235	98,986,549	98,986,549	1,235
Correction	18	18,913	1,243,553,230	69,086,291	1,051
Employment Security Commission	2	1,564	1,042,117,124	521,058,562	782
Public Instruction	1	538	7,701,464,551	7,701,464,551	538
Information Technology Services	1	427	189,883,465	189,883,465	427
State Treasurer	2	330	5,077,794,258	2,538,897,129	165
Totals for Agencies With Internal Auditors	47	66,221	\$ 33,756,628,926	\$ 718,226,147	1,409
Administrative Office of the Courts	0	5,746	555,803,186		
Justice	0	1,207	93,515,304		
Administration	0	844	185,356,884		
Cultural Resources	0	745	85,274,946		
Commerce	0	734	333,806,754		
Wildlife Resources	0	603	79,979,536		
Labor	0	403	26,899,320		
Insurance	0	388	70,641,699		
General Assembly	0	339	49,770,655		
Governor's Office	0	220	62,983,944		
Community College System	0	179	893,982,200		
State Auditor	0	179	10,186,861		
Secretary of State	0	158	8,863,929		
State Controller	³ 0	97	11,085,583		
Board of Elections	0	45	9,907,008		
Administrative Hearings	0	38	2,802,709		
Comprehensive Major Medical Plan	0	25	2,056,109,905		
Lt. Governor's Office	0	12	685,551		
Totals for Agencies With No Internal Auditors	0	11,962	\$ 4,537,655,974		
Totals for General Government	47	78,183	\$ 38,294,284,900	\$ 814,772,019	1,663

³Please refer to the response from the State Controller, which can be found in the next appendix.

Comparative Data Related to the Number of Internal Auditors

Community Colleges					
Community College	Number of Internal Auditors	Number of Employees (Excludes Temps)	Approximate Operating Expenses	Average Operating Expense Dollars Per Auditor	Average Number of Employees Per Internal Auditor
Central Piedmont	2	923	\$ 97,487,066	\$ 48,743,533	462
Totals for Community Colleges With Internal Auditors	2	923	\$ 97,487,066	\$ 48,743,533	462
Alamance	0	198	23,311,504		
Asheville-Buncombe	0	341	37,254,286		
Beaufort County	0	155	14,670,778		
Bladen	0	107	12,430,812		
Blue Ridge	0	170	17,994,438		
Brunswick	0	117	11,238,419		
Caldwell	0	275	27,206,466		
Cape Fear	0	425	46,527,047		
Carteret	0	148	16,042,131		
Catawba Valley	0	315	31,652,022		
Central Carolina	0	343	33,456,265		
Cleveland	0	150	17,762,057		
Coastal Carolina	0	270	27,192,008		
College of the Albemarle	0	166	17,153,855		
Craven	0	178	21,990,712		
Davidson County	0	213	23,948,436		
Durham	0	266	29,060,893		
Edgecombe	0	193	19,120,923		
Fayetteville	0	695	67,161,063		
Forsyth	0	408	45,449,063		
Gaston College	0	338	32,213,417		
Guilford	0	581	58,477,274		
Halifax	0	167	14,923,917		
Haywood	0	143	16,150,329		
Isothermal	0	188	18,833,412		
James Sprunt	0	154	13,083,813		
Johnston	0	265	25,005,317		
Lenoir	0	217	21,760,386		
Martin	0	69	8,889,524		
Mayland	0	129	13,427,231		
McDowell	0	110	10,965,775		
Mitchell	0	171	16,750,968		
Montgomery	0	85	7,450,466		
Nash	0	167	16,287,733		
Pamlico	0	57	4,753,001		
Piedmont	0	192	16,389,943		
Pitt	0	342	35,591,223		
Randolph	0	175	16,721,441		
Richmond	0	153	14,536,778		

Comparative Data Related to the Number of Internal Auditors

Community Colleges					
Community College	Number of Internal Auditors	Number of Employees (Excludes Temps)	Approximate Operating Expenses	Average Operating Expense Dollars Per Auditor	Average Number of Employees Per Internal Auditor
Roanoke-Chowan	0	90	9,334,026		
Robeson	0	182	22,032,651		
Rockingham	0	187	17,443,731		
Rowan-Cabarrus	0	309	32,865,798		
Sampson	0	136	14,254,742		
Sandhills	0	263	27,795,377		
Southeastern	0	191	19,976,728		
South Piedmont	0	163	15,224,283		
Southwestern	0	169	16,470,248		
Stanly	0	156	15,943,870		
Surry	0	217	25,225,088		
Tri-County	0	84	8,137,747		
Vance-Granville	0	313	31,540,543		
Wake	0	698	66,750,209		
Wayne	0	263	25,073,484		
Western Piedmont	0	212	21,216,044		
Wilkes	0	218	25,297,167		
Wilson	0	146	17,062,493		
Totals for Community Colleges With No Internal Auditors	0	12,833	\$ 1,314,479,355		
Totals for Community Colleges	2	13,756	\$ 1,411,966,421	\$ 705,983,211	6,878

Individual Agency Responses

Responses were received from the following entities and are included herein in the following order:

1. Administrative Office of the Courts
2. Central Piedmont Community College
3. Community College System
4. Department of Correction
5. Department of Environment and Natural Resources
6. Department of Health and Human Services
7. Department of Transportation
8. Office of Information Technology Services
9. Office of the State Controller
10. University of North Carolina General Administration
11. University of North Carolina at Asheville
12. University of North Carolina at Chapel Hill
13. University of North Carolina Wilmington



**ADMINISTRATIVE OFFICE OF THE COURTS
FINANCIAL SERVICES DIVISION**

JUDGE RALPH WALKER
DIRECTOR

PO BOX 2448
RALEIGH, NC 27602

PHONE: (919) 789-3600 / FAX (919) 788-5320

REX WHALEY
Financial Services Officer

MARVIN MERVIN
Accounting Manager

KESHA HOWELL
Budget Manager

October 5, 2006

Mr. Leslie W. Merritt, Jr., CPA, CFP
State Auditor
Office of the State Auditor
2 S. Salisbury Street
Raleigh, NC 27699-0601

Dear Mr. Merritt:

Thank you for the opportunity to respond to the recently completed performance audit of the internal audit function at state agencies, universities and community colleges. The Administrative Office of the Courts generally agrees with the overall findings, conclusions, and recommendations of the report and offers the following comments.

As noted in meetings with your staff during the course of your fieldwork, the Administrative Office of the Courts (AOC) had previously recognized the need for internal audit capabilities and began development of a plan to address this function. This report supports our efforts in this area and our overall commitment to improving operations in terms of accountability, risk assessment, risk mitigation, economy, efficiency, and effectiveness.

One area that needs clarification in your report involves amounts shown for employees and operating expenses for the AOC (pages 6 and 24). These amounts reflect totals for the entire Judicial Branch, not just the AOC. Based on our records, Judicial Branch expenditures total \$555,883,887. These expenses are categorized as follows; the AOC's general and special funds total \$348,829,199; the Clerks of Superior Court's expenditures at the local level total \$117,774,872; Indigent Defense Services expenses total \$89,279,816. Should the AOC be shown as a separate entity, a corresponding break out of employees would be required.

October 5, 2006

Page 2

Also, the footnote on page 11 needs to be amended or removed. As stated in the paragraph above, the information presented for the AOC is reflective of the entire Judicial Branch. The Clerk of the Court of Appeals and Clerks of Superior Court are specifically identified in the footnote but not any of the other areas within the Judicial Branch. This may give some readers the impression that the information presented in the report only reflects the three areas noted. However our audit function would include all areas of the Judicial Branch.

The footnote also mentions the possible reclassification of eight Financial Management Analysts (FMA). A final decision on the future role of these positions and their function has not been determined. This disclosure may create speculation among the employees in these positions and the Clerks of Superior Court that the FMA function will no longer be provided.

Thank you again for the opportunity to respond to your findings and recommendations and for the professionalism and courtesy of your staff. We believe the modifications detailed above more accurately reflect the operations of the Judicial Branch and should be incorporated in the final report. If you have any questions or want to discuss any of the issues noted above, please contact us.

Sincerely,



Judge Ralph A. Walker
Director AOC

Cc: Honorable Chief Justice, Sarah Parker
Gregg Stahl, Senior Deputy Director
Rex A. Whaley, Chief Financial Officer



October 2, 2006

Mr. Stan Wesner, CPA
Office of the State Auditor
2 S. Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

*Equal Opportunity
Institution*

Dear Mr. Wesner:

Central Piedmont Community College's response to your internal audit function report dated September 29, 2006 is attached.

Let us know if you need additional information. Thank you for your close review of our responses.

Best regards,

P. Anthony Zeiss
President

PAZ/bl

Attachment

Central Piedmont Community College Responses to Performance Audit Report

Finding (3): INTERNAL AUDIT ORGANIZATIONS ARE NOT OBTAINING QUALITY ASSURANCE REVIEWS BY OUTSIDE PARTIES

Every internal audit section should have internal quality assurance measures. In addition, an external quality assessment (peer review) performed by an independent party should serve to enhance the quality of the internal audit function. Institute of Internal Auditors *Standards* require that a peer review be conducted by a qualified independent reviewer or by a review team from outside the internal audit organization at least every 5 years.

Recommendation: Internal audit organizations should obtain as part of their quality assurance program an external quality assessment review at regular intervals. State universities currently have their North Carolina University Auditors Association that might be utilized to coordinate reviews of the universities. State agencies should consider establishing a similar mechanism as a means to greatly reduce the cost of an external assessment.

Response: While there are no mandatory requirements for obtaining external quality assessment reviews in accordance with the Institute of Internal Auditors (IIA) standards, Central Piedmont recognizes the value of quality assurance measures and best practices. During the performance review, the College's Internal Auditor reported that she was currently in the process of completing the self-assessment and obtaining independent validation by an external organization or peer review. Following this initial review, Central Piedmont plans to undertake external reviews at regular intervals of approximately five years.

Finding (4): SOME INTERNAL AUDIT SECTIONS DID NOT REPORT TO THE HIGHEST MANAGEMENT LEVEL WITHIN THE ORGANIZATION

During the course of our audit fieldwork we identified six entities in our sample where the internal audit section did not report to the highest management level within the organization, thus creating the potential for loss of audit independence.

Recommendation: The state entities noted in table 1 should revise their internal audit reporting structures so that the internal audit function reports to the highest level within the organization. As such, we believe the internal auditor should report to the agency head, community college president, or university chancellor and to the audit committee of any oversight board.

Response:

Central Piedmont Community College is proud to be the vanguard in establishing an internal audit function ahead of other NC Community Colleges, the System Office, and other state agencies. The College believes it is important to maintain its own competent and independent internal audit function as a major component of managerial effectiveness. The College also believes its current reporting structure complies with the spirit and intent of professional guidance on this subject. For ease of day-to-day activity and routine tasks such as leave accounting, the Internal Auditor reports functionally to the Executive Vice President, who is the deputy head of the College per the Government Auditing Standards' guidance for reporting to management of an organization. The College's Internal Auditor also reports administratively to the President with periodic updates to the Board of Trustees. The College's Internal Audit Plan is reviewed annually by the President's Cabinet and the subcommittee of the Board of Trustees. The Internal Auditor provided an update to the Instructional Program and Institutional Support Committee of the Board of Trustees on April 5, 2006. The College will update College Policy 6.19 –Internal Audit to clearly delineate the reporting level of the Internal Audit Office.

Finding: (6) INTERNAL AUDITORS WERE OFTEN ASSIGNED TASK UNRELATED TO THEIR PRIMARY JOB RESPONSIBILITIES

We found several instances where the internal audit section's ability to meet its scheduled audit plan was hampered due to the need to complete to other responsibilities as requested by management. Time spent on tasks other than internal audit duties hampers the internal audit function from fulfilling its role to strengthen internal controls and conduct internally audit activities.

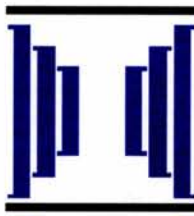
Recommendation: Management should ensure that internal auditors focus their efforts on conducting audits and strengthening internal controls. To avoid interference with internal audit's workload or compromising the function's independence, management should refrain from assigning unrelated functions to the internal audit section.

Response:

The internal audit function is vital to Central Piedmont Community College. Since its inception in 1992, staff has been effective in helping to promote and review the adequacy of internal controls as well ensure compliance with regulations and reduce financial penalties. Compliance with regulations is a major component of the internal audit function. In the face of limited human resources, Central Piedmont has assigned duties to the Internal Audit Office dealing with a myriad of complex federal and state regulations such as the following:

- Occupational Safety Health Administration
- Environmental Protection Agency
- State and Federal enforcement agencies
- International Fire Code
- Center for Disease Control
- Title VII of the Civil Rights Act
- American Disability Act
- Age Discrimination in Employment
- Title 23 of the North Carolina Administrative Code
- Community College Laws of North Carolina (Chapter 115D General Statutes)

Central Piedmont has aligned its limited human resources to report out to senior management on this important compliance related issues. We believe these duties are related to achieving good internal controls and compliance with regulations. The current reporting structure allows these compliance units to have greater independence in carrying out their assigned duties. The College will explore other alternatives and whether these duties should be assigned to other organizational departments to protect the independence of the Internal Audit Office in reviewing the work of these important functions.



NORTH CAROLINA COMMUNITY COLLEGE SYSTEM

October 5, 2006

H. MARTIN LANCASTER
PRESIDENT

ALAMANCE COMMUNITY COLLEGE
ASHEVILLE-BUNCOMBE TECHNICAL COMMUNITY COLLEGE
BEAUFORT COUNTY COMMUNITY COLLEGE
BLADEN COMMUNITY COLLEGE
BLUE RIDGE COMMUNITY COLLEGE
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CALDWELL COMMUNITY COLLEGE & TECHNICAL INSTITUTE
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CLEVELAND COMMUNITY COLLEGE
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SOUTHEASTERN COMMUNITY COLLEGE
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STANLY COMMUNITY COLLEGE
SURRY COMMUNITY COLLEGE
TRI-COUNTY COMMUNITY COLLEGE
VANCE-GRANVILLE COMMUNITY COLLEGE
WAKE TECHNICAL COMMUNITY COLLEGE
WAYNE COMMUNITY COLLEGE
WESTERN PIEDMONT COMMUNITY COLLEGE
WILKES COMMUNITY COLLEGE
WILSON TECHNICAL COMMUNITY COLLEGE

The Honorable Leslie W. Merritt, Jr.
North Carolina State Auditor
20601 Mail Service Center
Raleigh, NC 27699-0601

Dear Mr. State Auditor:

Thank you for allowing our Community College System Office to respond to your draft report on the performance audit entitled Internal Auditing in North Carolina Agencies and Institutions. Effectively and efficiently delivering workforce training at all levels, adult literacy training, and adult education programs to the citizenry of the State is the mission of our Community College System.

To ensure the efficiency of the System, program delivery, Chapter §115D-5(m) of the General Statutes of North Carolina provides the following:

The State Board of Community Colleges shall maintain an education program auditing function that conducts an annual audit of each community college operating under the provisions of this Chapter. The purpose of the annual audit shall be to ensure that college programs and related fiscal operations comply with State law, State regulations, State Board policies, and System Office guidance. The State Board of Community Colleges shall require auditors of community college programs to use a statistically valid sample size in performing program audits of community colleges. All education program audit findings shall be forwarded to the college president, local college board of trustees, the State Board of Community Colleges, and the State Auditor. The State Board shall assess a twenty-five percent (25%) fiscal penalty in addition to the audit exception on all audits of both dollars and student membership hours excepted when the audit exceptions result from nonprocessing errors.

MAILING ADDRESS: 5001 MAIL SERVICE CENTER ~ RALEIGH, NC 27699-5001
Street Address: 200 West Jones Street ~ Raleigh, NC 27603 ~ 919-807-7100 ~ Fax 919-807-7164
www.nccommunitycolleges.edu
AN EQUAL OPPORTUNITY EMPLOYER

This oversight is lead by a director and staff of regional program auditors that report directly to the Office of the President. The division of Program Audit Services audits annually all 58 community colleges and publishes a final audit report with findings to the General Assembly.

Also, the Community College Laws in §115-31.3 Performance Budgeting provide further accountability measures as outlined:

- (a) Creation of Accountability Measures and Performance Standards. – The State Board of Community Colleges shall create new accountability measures and performance standards to be used for performance budgeting for the Community College System. Survey results shall be used as a performance standard only if the survey is statistically valid. The State Board of Community Colleges shall review annually the accountability measures and performance standards to ensure that they are appropriate for use in performance budgeting.
- (b) to (d) Repealed by S.L. 2000-67 , §9.7, eff. July 1, 2000.
- (e) Mandatory Performance Measures. – The State Board of Community Colleges shall evaluate each college on the following 12 performance standards:
 - (1) Progress of basic skills students,
 - (2) Passing rate for licensure and certification examinations,
 - (3) The proportion of those who complete their goal,
 - (4) Employment status of graduates,
 - (5) Performance of students who transfer to the university system,
 - (6) Passing rates in developmental courses,
 - (7) Success rates of developmental students in subsequent college-level courses,
 - (8) The level of satisfaction of students who complete programs and those who do not complete programs,
 - (9) Curriculum student retention and graduation,
 - (10) Employer satisfaction with graduates,
 - (11) Client satisfaction with customized training, and
 - (12) Program enrollment.
- (f) Publication of Performance Ratings. – Each college shall publish its performance on the 12 measures set out in subsection (e) of this section (i) annually in its electronic catalog or on the Internet and (ii) in its printed catalog each time the catalog is reprinted.

The Community Colleges System Office shall publish the performance of all colleges on all 12 measures in its annual Critical Success Factors Report.

In action to monitor and continuously improve the System effectiveness, the State Board requires each college to comply with reporting annually, plans that consist of 60 annual reports and 9 daily and monthly reports. These reports support the compliance necessary to meet Federal and State guidelines, performance of work to General Assembly, along with meeting numerous other agency requirements. (*Attachment 1*)

The North Carolina Administrative Code, Title 23 Department of Community Colleges, Chapter 2D .0305(c) Continuing Education Program Management.

(c) Each college's local board of trustees must adopt a policy which requires the development and implementation of an internal audit plan. Each college is required to publish, maintain and utilize an internal audit plan. The college presidents shall periodically report to the board of trustees on the findings of the internal audit. The internal plan must be submitted to the Department for compliance review.

Attachment 2 outlines the State Board of Community College Policy on Criteria for Accountability and Credibility for Continuing Education. (*Attachment 2*)

Further, in the Community College Laws and the North Carolina Administrative Code, Chapter 2C .0603, all colleges shall obtain and maintain regional accreditation by the Southern Association of Colleges and Schools. Accreditation of an institution by the Commission on Colleges signifies that an institution has a purpose appropriate to higher education and has resources, programs, and services sufficient to accomplish its purpose on a continuing basis. Accreditation is concerned principally with the improvement of educational quality throughout a college and ensure to the public that the college meets established standards.

Finally, we question the comparative data related to the number of internal auditors in your report. You reported the data as submitted by our Community College System Office to the State Controller. We would like to update that report as attached and will seek solution to update the reporting to the State Controllers Office. (*Attachment 3*)

Based on a previous audit, the State Board of Community Colleges approved a process in consultation with the State Auditor by which the North Carolina Community College System will address the need for internal auditors through an expansion of its Program Audit Function, by giving those program auditors internal audit functions and authorities. To further expand the scope of internal auditing will certainly require resources. Individually, State agencies assessing the need and, in our case, extending what we presently are charged and having justification for adding staff and additional expenditures is of key consideration.

We are ever mindful of the important roles we play in the lives of those we serve and we use all of the processes we have highlighted along with other measures to strengthen our work performance. Providing a framework for improving accountability is utmost on the minds of all State Board Members. We will continue to monitor our work performance in order to establish the highest level of reliance possible.

The Honorable Leslie W. Merritt, Jr.

Page Four

October 5, 2006

We appreciate the opportunity to work with you and your staff to enhance the services we provide to our State. If you have questions or concerns and I can be of assistance with these issues, please call.

Sincerely,

A handwritten signature in black ink that reads "Fred G. Williams". The signature is written in a cursive style with a large, stylized initial "F".

Fred G. Williams
Executive Vice President

FGW/sth

Attachments: 3

NORTH CAROLINA COMMUNITY COLLEGE SYSTEM (NCCCS)

ANNUAL REPORTING PLAN 2006-2007

PERIODIC REPORTS

	DUE DATE	TITLE OF REPORT OR FILE	FREQUENCY	CONTACT(S)	REQUIRED BY	USES OF INFO	SUBMITTED BY	ENTERS STATUS
1	7/18/2006	Customized Industrial Training*	Annually	Larry Keen	Joint Legislative Education Oversight Committee GS115D5(i)	Annual Report to the State Board.	Economic and Workforce Development	Lynda Wilkins
2	7/18/2006	New and Expanding Industry Training Program Expenditure Report	Annually	Lynda Wilkins	Joint Legislative Education Oversight Committee GS115D5(i)	Annual Report to the State Board.	Economic and Workforce Development	Lynda Wilkins
3	7/28/2006	NCHED College Calendar Survey (NCHED A9)	Annually	Xiaoyun Yang, UNC GA	UNC-General Admin. & General Assembly	Annual NC Higher Education Statistical Abstract	UNC-GA	Terrence Shelwood
4	7/28/2006	Small Business Center (SBC) Annual Progress Report	Annually	Willa Dickens Rick Bundy	General Assembly	Report to the State Board	Economic and Workforce Development	Donna Miller
5	8/1/2006	Capital Improvement Data (DCC 3-5)	Annually	Sharon Rosado Dee Burns	General Assembly GS115D-31	Determine capital improvement non-state overmatch funds	Business and Finance	Marlene Hocutt
6	8/1/2006	Fixed Assets Reconciliation*	Annually	Sharon Rosado Wade Quinn	State Auditor	Ensure fixed assets reports are balanced.	Business and Finance	Karen Kelly
7	8/1/2006	Program Report—Internal Equipment Audit (DCC 4-13) - Annual Inventory Audit	Annually	Sharon Rosado Wade Quinn	State Auditor	Account for equipment expenditures	Business and Finance	Karen Kelly
8	8/1/2006	Program Report—Internal Equipment Audit (DCC 4-13) - Deletions Report	Annually	Sharon Rosado Wade Quinn	State Auditor	Account for equipment expenditures	Business and Finance	Karen Kelly
9	8/1/2006	Program Report—Internal Equipment Audit (DCC 4-13) - Fund Source Report	Annually	Sharon Rosado Wade Quinn	State Auditor	Account for equipment expenditures	Business and Finance	Karen Kelly
10	8/1/2006	Purchasing Flexibility Report	Semiannually	Sharon Rosado Wade Quinn	General Assembly GS115D-58.14	Data will be used by P&C for future changes to purchasing system.	Business and Finance	Karen Kelly
11	8/2/2006	Diplomas Awarded, Adult High School Diploma Program (DCC 9-10)	Annually	Randy Whitfield	NCCCS Finance Division	Determine funding	Academic and Student Services	Karen O'Neal
12	8/4/2006	North Carolina Community College Loan Program	Annually	Wanda White	SBCC	Prepare annual funding report for the State Board	Academic and Student Services	Karen Yerby
13	8/4/2006	Targeted Assistance Program	Annually	Wanda White	SBCC	Prepare annual report for the State Board	Academic and Student Services	Karen Yerby
14	8/7/2006	Literacy Education Information System Report	Annually	Terry Shelwood Jonathan McDougald	US Dept of Education	Literacy statistical analyses, Federal Literacy Education Report	Planning, Accountability, Research & Evaluation (PARE)	Terrence Shelwood
15	8/15/2006	NCHED Tuition, Fees, and Charges (NCHED A3)	Annually	Xiaoyun Yang, UNC GA	UNC-General Admin. & General Assembly	Annual NC Higher Education Statistical Abstract	UNC-GA	Terrence Shelwood

* New Report

Source: Planning Accountability, Research and Evaluation, NCCCS, 08/16/06.

ATTACHMENT 1

	DUE DATE	TITLE OF REPORT OR FILE	FREQUENCY	CONTACT(S)	REQUIRED BY	USES OF INFO	SUBMITTED BY	ENTERS STATUS
16	8/15/2006	Quarterly Certification Request (DCC 2-40)	Quarterly	Joy Wright Tangi Crotts	Office of State Budget & Management (OSBM)	Predicts cash needs	Business and Finance	Linda Wilson
17	8/16/2006	Focused Industrial Training (FIT) Annual Evaluation and Summary of Activities	Annually	Donna Miller	SBCC	Prepare annual report for the State Board	Economic and Workforce Development	Donna Miller
18	9/1/2006	Cont. Ed. Institution Class Report—Summer (DCC 7-3E)	Semester	Jung Fan	23NCAC	FTE computations, statistical analysis	PARE	Jung Fan
19	9/1/2006	Curriculum Institution Class Report—Summer (DCC 7-3C)	Semester	Jung Fan	23NCAC	FTE computations, statistical analysis	PARE	Jung Fan
20	9/6/2006	Basic Skills in the Workplace	Annually	Randy Whitfield	NCCCS Academic & Student Services Division	Share data with colleges on workplace programs	Academic and Student Services	Karen O'Neal
21	9/6/2006	Cont. Ed. Registration Report—Summer (DCC 7-2)	Semester	Barbara Boyce Rick Newsome Jung Fan	NCCCS Administration Div.	Statistical reporting and analysis	PARE	Jung Fan
22	9/8/2006	College Budget Summary of Revenues and Expenses (DCC 2-1)	Annually	Annette Dishner	General Assembly GS 115D-54	Approved by SBCC	Business and Finance	Linda Wilson
23	9/15/2006	Curriculum Registration, Completion & Financial Aid Report—Summer (DCC 7-1)	Semester	Jung Fan	23NCAC	Statistical reporting and analysis	PARE	Jung Fan
24	9/18/2006	Tuition & Fee Remission Report—Summer	Semester	Tangi Crotts	NCCCS Finance Division	Used to monitor remissions in system	Business and Finance	Linda Wilson
25	10/10/2006	Estimated FTE and Headcount—Fall (DCC 2-41)	Semester	Sheila Hohnsbehn	NCCCS Finance Division	Computer estimates of FTE for budget projections	Administration	Terrence Shelwood
26	10/10/2006	IPEDS Fall Survey Collection	Annually	J. Keith Brown	US Dept of Education	National Survey	PARE	Vivian Barrett
27	10/31/2006	Longevity Eligibility Determination	Annually	Annette Dishner	Office of State Personnel	Generates special allotments	Business and Finance	Linda Wilson
28	11/1/2006	NCHED New Undergraduate Transfer Students (NCHED A1.2)	Annually	Xiaoyun Yang, UNC GA	US Dept of Education	Annual NC Higher Education Statistical Abstract	UNC-GA	Terrence Shelwood
29	11/6/2006	Literacy Education Information System Report - Summer	Semester	Terry Shelwood Jonathan McDougald	US Dept of Education	Literacy statistical analyses, Federal Literacy Education Report	PARE	Terrence Shelwood
30	11/15/2006	NCHED Student Financial Aid Summary (For the twelve-month period ending June 30, 2006)	Annually	Xiaoyun Yang, UNC GA	US Dept of Education	Annual NC Higher Education Statistical Abstract	UNC-GA	Terrence Shelwood
31	11/17/2006	Budget Resolution	Annually	Annette Dishner	General Assembly GS115D-56	Audit purposes	Business and Finance	Linda Wilson
32	11/20/2006	Institutional Staff Information Report (DCC 7-8)	Annually	Rick Bundy Rick Newsome Mei-Hsin Ju	General Assembly, US Dept. of Education & Southern Regional Education Board (SREB)	Annual salary studies, IPEDS Survey, staffing analyses, SREB	PARE	Mei-Hsin Ju
33	12/1/2006	Developmental Student Report - Percent Passing	Annually	Edith Lang	General Assembly	Needed to respond to legislative mandate	Academic and Student Services	Edith Lang
34	12/1/2006	Developmental Student Report - Subsequent Course(s)	Annually	Edith Lang	General Assembly	Needed to respond to legislative mandate	Academic and Student Services	Edith Lang

* New Report

Source: Planning Accountability, Research and Evaluation, NCCCS, 08/16/06.

ATTACHMENT 1

	DUE DATE	TITLE OF REPORT OR FILE	FREQUENCY	CONTACT(S)	REQUIRED BY	USES OF INFO	SUBMITTED BY	ENTERS STATUS
35	12/1/2006	Quarterly Certification Request (DCC 2-40)	Quarterly	JoyWright Tangi Crotts	OSBM	Predicts cash needs	Business and Finance	Linda Wilson
36	1/17/2007	IPEDS Winter Survey Collection	Annually	J. Keith Brown	US Dept of Education	National Survey	PARE	Vivian Barrett
37	1/19/2007	Building Inventory (5 HEFC)	Annually	Jeff Hill, UNC GA	Higher Education Facilities Commission (HEFC)	Annual Facilities Inventory Report	UNC-GA	Jeff Hill
38	1/19/2007	Room Inventory Update (5 HEFC)	Annually	Jeff Hill, UNC GA	HEFC	Annual Facilities Inventory Report	UNC-GA	Jeff Hill
39	1/23/2007	Cont. Ed. Institution Class Report—Fall (DCC 7-3E)	Semester	Jung Fan	23NCAC	FTE computations, statistical analysis	PARE	Jung Fan
40	1/23/2007	Curriculum Institution Class Report—Fall (DCC 7-3C)	Semester	Jung Fan	23NCAC	FTE computations, statistical analysis	PARE	Jung Fan
41	1/24/2007	Cont. Ed. Registration Report—Fall (DCC 7-2)	Semester	Barbara Boyce Rick Newsome Jung Fan	NCCCS Administration Div.	Statistical reporting and analysis	PARE	Jung Fan
42	1/31/2007	Academic Library Survey	Biennial	Ruth Bryan	NCHEDS, ALA, NCES	Statistical reporting and analysis	Administration	Ruth Bryan
43	2/1/2007	Purchasing Flexibility Report	Semiannually	Wade Quinn	General Assembly GS115D-58.14	Data will be used by P&C for future changes to purchasing system.	Business and Finance	Karen Kelly
44	2/2/2007	Performance Measures - Completer/Non-Completer Survey Data	Annually	J. Keith Brown	General Assembly	Needed to respond to legislative mandate	PARE	Vivian Barrett
45	2/7/2007	Curriculum Registration, Completion & Financial Aid Report—Fall (DCC 7-1)	Semester	Jung Fan	NCCCS Administration Div.	Statistical reporting and analysis	PARE	Jung Fan
46	2/16/2007	Instructional Space Utilization (5 HEFC)	Annually	Jeff Hill, UNC GA Vicki Strayer Sharon Rosado	HEFC	Annual Facilities Utilization Report	UNC-GA	Jeff Hill
47	2/16/2007	Tuition & Fee Remission Report—Fall	Semester	Dorrine Fokes	NCCCS Finance Division	Used to monitor remissions in system	Business and Finance	Linda Wilson
48	3/1/2007	Quarterly Certification Request (DCC 2-40)	Quarterly	Joy Wright Tangi Crotts	OSBM	Predicts cash needs	Business and Finance	Linda Wilson
49	3/5/2007	On-Campus/Out-of-County Enrollment Report	Annually	Mei-Hsin Ju	General Assembly GS115D-31.2	Determine colleges eligible for state support of campus facilities	PARE	Mei-Hsin Ju
50	3/14/2007	Estimated FTE and Headcount—Spring (DCC 2-41)	Semester	Sheila Hohnsbehn	NCCCS Finance Division	Computer estimates of FTE for budget projections	Administration	Terrence Shelwood
51	3/27/2007	Literacy Education Information System Report-Su & F	Semester	Terry Shelwood Jonathan McDougald	US Dept of Education	Literacy statistical analyses, Federal Literacy Education Report	PARE	Terrence Shelwood
52	4/11/2007	IPEDS Spring Survey Collection	Annually	J. Keith Brown	US Dept of Education	National Survey	PARE	Vivian Barrett
53	4/17/2007	Basic Skills Program Plan and Application	Annually	Randy Whitfield	US Dept of Education	Monitor programs and determine funding	Academic and Student Services	Karen O'Neal
54	6/1/2007	Quarterly Certification Request (DCC 2-40)	Quarterly	Joy Wright Tangi Crotts	OSBM	Predicts cash needs	Business and Finance	Linda Wilson

* New Report
Source: Planning Accountability, Research and Evaluation, NCCCS, 08/16/06.

	DUE DATE	TITLE OF REPORT OR FILE	FREQUENCY	CONTACT(S)	REQUIRED BY	USES OF INFO	SUBMITTED BY	ENTERS STATUS
55	6/1/2007	Tier A Annual Report	Annually	Ken Whitehurst	General Assembly	Evaluate the diversity and accountability of professional development funds	Academic and Student Services	Pauline Kury
56	6/5/2007	Cont. Ed. Institution Class Report—Spring (DCC 7-3E)	Semester	Jung Fan	23NCAC	FTE computations, statistical analysis	PARE	Jung Fan
57	6/5/2007	Curriculum Institution Class Report—Spring (DCC 7-3C)	Semester	Jung Fan	23NCAC	FTE computations, statistical analysis	PARE	Jung Fan
58	6/8/2007	Cont. Ed. Registration Report—Spring (DCC 7-2)	Semester	Barbara Boyce Rick Newsome Jung Fan	NCCCS Administration Div.	Statistical reporting and analysis	PARE	Jung Fan
59	6/14/2007	Tuition & Fee Remission Report—Spring	Semester	Dorrine Fokes	NCCCS Finance Division	Used to monitor remissions in system	Business and Finance	Linda Wilson
60	6/19/2007	Curriculum Registration, Completion & Financial Aid Report—Spring (DCC 7-1)	Semester	Jung Fan	NCCCS Administration Div.	Statistical reporting and analysis	PARE	Jung Fan
DAILY AND MONTHLY REPORTS								
1	Daily by 10 a.m.	Certification State Deposit (10-4)	Daily	Joy Wright	State Treasurer	Record daily deposits; Cash consolidation and investment	Business and Finance	
2	5th Working Day of Month	General Expense Check Register & Summary (DCC 2-10)	Monthly	Joy Wright	NCCCS Finance Division	Cash/Budget Control	Business and Finance	
3	5th Working Day of Month	Personal Service Check Register & Summary (DCC 2-11)	Monthly	Joy Wright	NCCCS Finance Division	Cash/Budget Control	Business and Finance	
4	5th Working Day of Month	Current Expense & Capital Outlay Summary (DCC 2-12)	Monthly	Joy Wright	NCCCS Finance Division	Cash/Budget Control	Business and Finance	
5	5th Working Day of Month	Summary of Expenses for Federal Matching—Schedule A (DCC 2-7)	Monthly	Joy Wright	NCCCS Finance Division	Report to US Office of Education	Business and Finance	
6	5th Working Day of Month	Voucher Register—Special Projects (DCC 2 -32)	Monthly	Gina Sampson Linda Wilson	NCCCS Finance Division	Supports DCC 2-33	Business and Finance	
7	5th Working Day of Month	Request for Reimbursement—Special Projects (DCC 2-33)	Monthly	Linda Wilson Gina Sampson	NCCCS Finance Division	Request reimbursement by college	Business and Finance	
8	5th Day of Each Month	College Fire Fighting Certification Report (NCFC)	Monthly	Barbara Boyce Rick Bundy	Department of Insurance and NCCCS	Report students completing certification courses to DOI	Economic and Workforce Development	
9	15th Day of Each Month	Monthly Transaction Report (Fixed Assets)	Monthly	Wade Quinn	State Auditor	Ensure that each college is balancing their reports to the DCC 2-12 (G/L Summary File).	Business and Finance	

* New Report
Source: Planning Accountability, Research and Evaluation, NCCCS, 08/16/06.

State Board of Community Colleges

Internal Audit Plan for Continuing Education

Plan Compliance Review Checklist

STATE BOARD OF COMMUNITY COLLEGES**Criteria for Accountability and Credibility
Continuing Education**

The Community College System's credibility is based solely on the performance of the colleges, individually and collectively. Accountability and credibility are two of the most important elements of the Community College System's ability to achieve quality in teaching and learning and to provide effectiveness and efficiency in System management.

One of the primary ways this is accomplished is through a system of checks and balances designed to assure proper use of public funds. Each college shall continue to review existing provisions for maintaining and protecting accountability and credibility. This review should include all existing safeguards designed to maintain the public trust.

An internal audit plan shall be maintained at each college. The local board of trustees will adopt a policy which requires the development and maintenance of an internal audit plan for its continuing education program. The internal audit plan developed by the college and any subsequent modification of the plan must be submitted to the local board of trustees for approval. Annual reports on the implementation of the auditing plan must be made to the local board of trustees. The plan approved by the local board of trustees will be subject to compliance review by the System education program auditors. The plan must address specific actions for implementation of all the criteria outlined below:

1. On-site visits to each class

- A. The instructor's supervisor, or a designated representative as approved in writing by the senior continuing education administrator, will make at least one visit each quarter to fifty (50) percent of all off-campus and distance education (defined in C below) continuing education classes (excluding self-supported and community service classes) and will maintain written documentation for such visits.
 - (1) Classes which meet 12 hours or less may be excluded from a visit by the college representative.
 - (2) Twenty-five (25) percent of the on-campus classes require visitation and documentation as noted above.

State Board of Community Colleges

Internal Audit Plan for Continuing Education

Plan Compliance Review Checklist

- B. The senior continuing education administrator will visit a ten (10) percent sample of randomly selected off-campus and distance education continuing education classes each quarter with no prenotification of these visits and will maintain written documentation of such visits. The senior continuing education administrator may delegate this visitation requirement to an appropriate upper level administrator/supervisor, provided the delegation is approved in writing by the college president. Registration periods may not be considered as one of the senior continuing education administrator's unannounced class visits.
- C. An off-campus class is defined as any class not held in college owned or leased property or held in a center which is not under the supervision of a resident supervisor or director who is on-site during the entire period the instruction is taking place. A distance education class is defined as a class that is offered through distance education technology (including information highway, internet, and telecourses) and which does not physically meet on campus for at least half of the time scheduled. For internet courses for which it is not possible to physically visit the class, visitation should be conducted electronically, using a system that allows the instructor's supervisor and senior continuing education officers to log on and check the activity in the class. System Office Program Auditors must also have access to this system so that they may do unannounced class visits for these classes as well.

2. Student Membership Verification

- A. In situations where the class meets physically with the instructor or other college staff, student signatures on appropriate forms (class receipt forms, class registration forms, etc.) is required for student membership verification. If the form must be signed by a teacher (most likely ABE or Compensatory Education), appropriate measures should be taken to assure that the students are enrolled properly. In all instances, state Board policies in the Administrative Code and the System's Accounting Procedures Manual shall be followed.
- B. In situations where the class does not meet physically (such as internet or other distance education courses), one of the following two criteria is required for student membership verification:
 - 1. Evidence of payment of the applicable registration fee by the student. This evidence must link a specific student's payment to the specific class paid for.
 - 2. In cases where no registration fee is paid (i.e., the student is 65 or over, etc.) electronic certification by the student, such as an electronic signature on an email, will be required for student membership verification in the course.

State Board of Community Colleges

Internal Audit Plan for Continuing Education

Plan Compliance Review Checklist

3. Instructor Verification

Procedures associated with the payment of full-time and part-time personnel must include verification that services have been rendered and that proper personnel are being paid.

4. College Approval Process for Conducting a Continuing Education Class

- A. The senior continuing education administrator shall be responsible for approving the establishment/offering of all continuing education classes consistent with the mission and role of the Community College System. Classes which are held without prior approval will be subject to audit exception. Criteria for accreditation by the Southern Association of Colleges and Schools (SACS) prescribes that each college must have a planning and evaluation process. Applicable segments of these criteria should be utilized in developing the college internal plan and evaluating educational progress.
- B. The college shall maintain an up-to-date master schedule, including day, time, and location, for all continuing education classes. Directions to all off-campus classes must be on file with the continuing education office.

5. College Responsibility for Accuracy in Reporting Practices in Continuing Education Programs

The college president, having overall responsibility for college administration, must take appropriate measures to ensure that the internal audit plan is applied and maintained consistent with the local board approved plan. A process for reporting internal audit results to the president on a regular basis (at least twice a year) must be outline in the college plan. The president or the president's designee must maintain this documentation and ensure that it is available for audit review.

Revised by the State Board of Community Colleges
May 19, 2000

ATTACHMENT 3

Community Colleges with Internal Auditors

10/5/2006

	Community College	Number of Employees	Status			Reports To:	Title of Position	Classification of Person in Position
			Full-Time	1/2 Time	3/4 Time			
1	Cape Fear Community College	1		X		VP - Academic Svcs.	Internal Auditor	Support Staff
2	Catawba Valley Community College	1	X			Systems Administrator (IS)	FTE Coordinator	Support Staff
3	Central Piedmont Community College	5	X			Vice President	Assoc. VP for Compliance and Internal Auditing	Professional Staff
4	Forsyth Technical Community College	1	X			VP - Instructional Services	Coordinator, Program Development & Audits	Professional Staff
5	Guilford Technical Community College	1	X			VP - Education Support Services	Director, FTE Auditing	Professional Staff
6	Pitt Community College	1			X	VP Academic Information Services	Internal Auditor	Support Staff
7	Randolph Community College	2	X			Dean of Curriculum Records Dean of Continuing Education Records	Curriculum Specialist (1) and Continuing Education Registrar (1)	Support Staff
8	Rockingham Community College	1	X			Dean, Community & Workforce Education	Continuing Education Internal Auditor	Support Staff
9	Rowan Cabarrus Community College	1	X			Director, Administrative Compliance Operations	Internal FTE Auditor	Support Staff
10	Sandhills Community College	1	X			Dean of Continuing Education	Internal Auditor - Continuing Education	Support Staff
11	Wake Technical Community College	1	X				Registrar for Continuing Education	Professional Staff



North Carolina Department of Correction

214 West Jones Street • 4201 MSC • Raleigh, North Carolina 27699-4201
(919) 716-3700 • (919) 716-3794 (fax)

Michael F. Easley
Governor

Theodis Beck
Secretary

October 4, 2006

Mr. Leslie W. Merritt, Jr., CPA, CFP
State Auditor
2 S. Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Mr. Merritt:

Attached please find the Department of Correction's response to your letter dated September 29, 2006 regarding the Performance Audit entitled *Internal Auditing in North Carolina Agencies and Institutions*. Department management and our Director of Internal Audit have reviewed the report and recommendations.

All findings related to the Department of Correction have been addressed.

We appreciate the opportunity to respond to the Performance Audit. Should you have any questions or need additional information, please feel free to contact me.

Sincerely,

A handwritten signature in black ink that reads "Tracy A. Little".

Tracy A. Little
Deputy Secretary

Attachment

cc: Theodis Beck, Secretary
Dan Stieneke, Chief Deputy Secretary
Vickie Haddock, Internal Audit Director

North Carolina Department of Correction
Response to Performance Audit of Internal Auditing in North Carolina Agencies
and Institutions

State Auditor Finding:

1. Internal Audit Organizations are not obtaining Quality Assurance Reviews by outside parties.

State Auditor Recommendations:

Internal Audit organizations should obtain as part of their quality assurance program an external quality assessment review at regular intervals. State universities currently have their North Carolina University Auditors Association that might be utilized to coordinate reviews of the universities. State agencies should consider establishing a similar mechanism as a means to greatly reduce the cost of an external assessment.

Department of Correction Response:

We agree with the recommendations that Internal Audit organizations should obtain as part of their quality assurance program an external quality assessment review (QAR) at regular intervals. Due to the lack of qualified responses to our recruitment efforts, the ability to retain qualified personnel over the past few years and cost associated with the QAR, it has not been completed. We currently have scheduled a QAR to be completed before the end of 2006 as required by the *International Standards for the Professional Practice of Internal Auditing*. We have obtained the services from an out of state government agency with staff qualified as an independent validator by the Institution of Internal Auditors to complete the QAR. We also are in the process of completing a quality assessment advanced preparation tool, provided by the Institution of Internal Auditors, to ensure adequate documentation availability to the assessment team.

State Auditor Finding:

2. Some Internal Audit Sections lacked adequate policies and procedures. The Department of Correction's policies and procedures manual was out-dated and disorganized.

State Auditor Recommendations:

Policies and procedures governing the internal audit function should be established and maintained.

Department of Correction Response:

We agree the policies and procedures manual was outdated. Due to staffing issues the manual had not been completely updated or organized in the new current Standard Operating Procedures (SOP) format. We have integrated the available documentation into the new format and are in the process of editing and updating all our SOP's. This update is scheduled to be completed and available for the quality assessment review scheduled for completion by the end of 2006.



North Carolina Department of Environment and Natural Resources

Michael F. Easley, Governor

William G. Ross Jr., Secretary

October 3, 2006

Leslie W. Merritt, Jr., CPA, CFP
State Auditor
20601 Mail Service Center
2 South Salisbury Street
Raleigh, North Carolina 27699-0601

Dear Mr. Merritt:

As requested in your letter of September 29, 2006 regarding the performance audit entitled *Internal Auditing in North Carolina Agencies and Institutions*, the Department of Environment and Natural Resources' (DENR) response to the preliminary draft report is as follows:

1. DENR Lacks Sufficient Internal Audit Resources.

Plans are currently underway to increase the Internal Audit Staff from one to three. These plans include two new Internal Auditor II positions, and a reclassification of the Internal Audit Manager I to an Internal Audit Manager II position.

Additional resources requested include internal audit software tools, staffing costs, travel costs, and educational costs to remain abreast of internal audit issues.

Funding sources for this expansion have not been identified at this time.

2. DENR Internal Audit Does Not Follow Any Professional Auditing Standards.

DENR Internal Audit now has an Audit Charter (Copy Attached). According to that Charter, the DENR Internal Audit staff shall be governed by adherence to the Institute of Internal Auditor's "Code of Ethics." The Institute's "International Standards for the Professional Practice of Internal Auditing" and "Statement of Responsibilities" shall constitute the operating procedures for Internal Audit. These three documents constitute an Addendum to this Charter. In addition, Internal Audit will adhere to Internal Audit's Standard Operating Procedures Manual and Department of Environment and Natural Resources' policies and procedures.

3. DENR Internal Audit is Not Obtaining Quality Assurance Reviews by Outside Parties.

DENR Internal Audit will study the need for quality assurance reviews and make recommendations to management.

4. DENR Internal Audit Section Does Not Report to the Highest Management Level Within DENR.

It is the Department of Environment and Natural Resources' policy to support an Internal Auditing Section as an independent appraisal function. The Internal Auditing Section reports directly to the Office of the Controller of the DENR. Because of the organizational decentralization of DENR, having Internal Audit report directly to the Office of the Controller is not deemed to materially affect the independence of this Section. In the accomplishment of Internal Audit's duties and responsibilities, members of the audit staff will have full, free, and unrestricted access to all files, records, property, and personnel.

In addition to internal audit staff assigned directly to the Internal Audit Section, Internal Audit will utilize the services of divisional personnel to assist in carrying out its responsibilities. It is incumbent upon the Director of Internal Audit to utilize divisional staff in a manner that maximizes the independence of the appraisal function.

5. DENR Internal Audit Did Not Perform Risk Assessments To Develop an Audit Plan.

Included in the current DENR Internal Audit Plan for 2006-2007 FYE (Copy Attached) is the requirement to conduct a risk assessment for the purpose of developing future audit plans.

6. DENR Internal Auditors Were Often Assigned Tasks Unrelated to Their Primary Job Responsibilities.

The Internal Audit Director will continue to be assigned some tasks unrelated to internal audit functions. However, the two new internal audit positions being requested by Internal Audit will be assigned only to internal audit functions.

7. DENR Internal Audit Section Did Not Have an Audit Charter.

DENR Internal Audit Section now has an Audit Charter, and a Mission Statement (Copies Attached).

8. DENR Internal Audit Section Lacks Adequate Policies and Procedures.

The Institute's "International Standards for the Professional Practice of Internal Auditing" and "Statement of Responsibilities" shall constitute the operating procedures for Internal Audit. In addition, DENR Internal Audit will develop a policies and procedures manual for its Internal Audit Section.

Thank you for the opportunity to respond to this preliminary audit report. If you have any questions, or need additional information, please contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Dempsey Benton". The signature is fluid and cursive, with a long horizontal stroke at the end.

Dempsey Benton
Chief Deputy Secretary

DB/RD

Attachments

CC: Bill Ross, Secretary
Harlan Frye, Director of Human Resources
George Dennis, Director of Internal Audit
Rod Davis, Controller

NORTH CAROLINA DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

INTERNAL AUDIT

CHARTER

INTRODUCTION

Internal Audit is an independent appraisal activity established within the Department to examine and evaluate the activities as a service to management. The objectives of Internal Audit are to assist all levels of Departmental Management in the effective discharge of their responsibilities by furnishing them with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed, and by promoting effective controls at reasonable costs.

PROFESSIONAL STANDARDS

The Internal Audit staff shall be governed by adherence to the Institute of Internal Auditor's "Code of Ethics." The Institute's "International Standards for the Professional Practice of Internal Auditing" and "Statement of Responsibilities" shall constitute the operating procedures for Internal Audit. These three documents constitute an Addendum to this Charter. In addition, Internal Audit will adhere to Internal Audit's Standard Operating Procedures Manual and Department of Environment and Natural Resources' policies and procedures.

AUTHORITY

Authority is granted for full, free, and unrestricted access to any and all of the Department's records, physical properties, and personnel relevant to any function under review. All employees shall assist Internal Audit in fulfilling their staff function. Internal Audit shall also have free and unrestricted access to the Secretary and Chief Deputy Secretary of the Department of Environment and Natural Resources.

ORGANIZATION

The Director of Internal Audit shall report directly to the Controller of the Department of Environment and Natural Resources.

INDEPENDENCE

All audit activities shall remain free of influence by any element in the Department, including matters of audit scope, procedures, frequency, timing, or report content to permit maintenance of an independent mental attitude necessary in rendering objective reports.

Internal Auditors shall have no direct operational responsibility or authority over any of the activities they review. Additionally, they shall not develop or install systems or procedures, prepare records, or engage in any other activity that would normally be audited.

AUDIT SCOPE

The scope of Internal Audit encompasses the examination and evaluation of the adequacy and effectiveness of the Department's internal control structure and the quality of performance in carrying out assigned responsibilities to achieve the Department's stated goals and objectives. It includes:

Reviewing the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.

Reviewing the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on operations and reports and whether the Department is in compliance.

Reviewing the means of safeguarding assets and, as appropriate, verifying the existence of such assets.

Reviewing and appraising the economy and efficiency with which resources are utilized.

Reviewing operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.

Reviewing specific operations and conducting investigations at the request of the Secretary.

AUDIT PLANNING

Annually, the Director of Internal Audit shall submit to the Secretary, Chief Deputy Secretary and Controller a report on Internal Audit activity during the preceding year, and a summary of the planned audit schedule for the coming year. The audit schedule shall be developed based on a prioritization of the Department's audit needs as determined by the Director of Audits with input from the Secretary, Chief Deputy Secretary, Controller and other senior management as appropriate. Any significant deviation from the formally approved audit schedule shall be communicated to the Secretary and Controller through periodic activity reports.

REPORTING

A written report shall be prepared and issued by the Director of Internal Audit or a designee following the conclusion of each audit, and shall be distributed as appropriate. A copy of each audit report, or a summarization, shall be forwarded to the Secretary, Chief Deputy Secretary, Controller and other departmental managers as deemed appropriate. The Director of Internal Audit may include in the audit report the auditee's response and corrective action taken or to be taken in regard to the specific findings and recommendations.

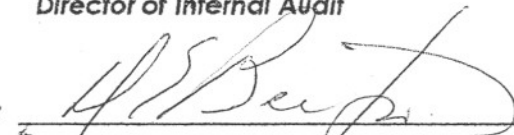
Internal Audit shall be responsible for follow-up on audit findings and recommendations in accordance with Internal Audit's Standard Operating Procedures.



Director of Internal Audit

10/3/06

Date

APPROVED: 

Secretary, Department Environment and Natural Resources

10/3/06

Date

NORTH CAROLINA DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

INTERNAL AUDIT

OVERALL OBJECTIVE AND MISSION STATEMENT

Internal auditing is a systematic, objective appraisal by the Internal Audit staff of the various diverse operations and controls within the organization to determine whether: (1) financial and operating information is accurate and reliable; (2) risks of the Department are identified and minimized; (3) external regulations and internal policies and procedures are followed; (4) operating standards are met; and (5) resources are used efficiently and economically.

The purpose of this appraisal is to provide management of the Department with information necessary to effectively meet their responsibilities. To accomplish these responsibilities, Internal Audit will:

- Review the Department of Environment and Natural Resources' administration and divisions at appropriate levels to determine whether they efficiently and effectively carry out their functions of planning, organizing, directing and controlling in accordance with management's established policies and procedures, directives, and in a manner consistent with DENR objectives and standards of administrative practice.

- We will examine the adequacy and effectiveness of the Department's systems of accounting and operating controls.
- We will provide Department of Environment and Natural Resources management with analyses, evaluations, and reviews of controls over computer systems and related support functions.
- We will determine whether the units are in compliance with policies, procedures, laws and regulations that could have significant impact on operations.
- We will review the means of safeguarding assets and verify the existence of such assets.
- We will appraise the cost effectiveness and efficiency with which resources are administered, and provide recommendations to improve operating performance, and recommend solutions to problems where appropriate.
- We will respond to management's special requests in a timely, effective manner.

It is the Department of Environment and Natural Resources' policy to support an Internal Auditing Section as an independent appraisal function. The Internal Auditing Section reports directly to the Office of the Controller of the DENR. Because of the organizational decentralization of DENR, having Internal Audit report directly to the Office of the Controller is not deemed to materially affect the independence of this Section. In the accomplishment of Internal Audit's duties and responsibilities, members of

the audit staff will have full, free, and unrestricted access to all files, records, property, and personnel.

In addition to internal audit staff assigned directly to the Internal Audit Section, Internal Audit will utilize the services of divisional personnel to assist in carrying out its responsibilities. It is incumbent upon the Director of Internal Audit to utilize divisional staff in a manner that maximizes the independence of the appraisal function.

The function of the Internal Auditors is not to make policy or to judge whether a policy is good or bad. While specific divisional personnel will be providing assistance to Internal Audit in carrying out specific monitoring and other internal audit activities for the Internal Audit Section, the Internal Audit Section does not exercise or direct any authority over personnel in any other sections of the Department. We are to provide independent, accurate, reliable information to the management officials within the Department who do have authority and responsibility, and to make recommendations for improvements and changes for consideration by appropriate Department management.

Department of Environment and Natural Resources

Internal Audit Section

Internal Audit Plan for 07/2006 – 6/2007, Including Proposals for Additional Staffing Needs and Organizational Changes

PURPOSE

The purpose of this writing is to propose changes to the current structure of the Internal Audit Section. It is estimated that at least two new full-time internal auditors, supplemented by divisional staff under temporary assignment would greatly broaden our ability to provide audit coverage to the Department.

DETERMINATION OF AREAS OF FOCUS

The first priority is to undertake a risk assessment for the entire Department. This risk assessment will identify where the department is at risk and be determinative as to the areas in which Internal Audit should focus its resources. The risk assessment will begin in June of 2006

ANTICIPATED AREAS OF FOCUS

It is anticipated that a major portion of one of the Internal Auditor II positions will be to audit contracts and grants, and a major portion of the other Internal Auditor II position will be to conduct cash management reviews at the larger divisional locations throughout the state. DFR, DPR, Aquarium, and Zoo operations are anticipated to be the main focus in this area. Currently, no internal audit work is being provided for any reviews of non-financial divisional program reviews. An audit plan will be developed to address audit coverage in this area utilizing divisional staff.

AUDIT PLAN FOR 07/06 – 06/07

- Risk Assessment – 06/06-07/06. Used to identify and prioritize audit areas.
- Contracts and Grants – 08/06-06/07. Continuous work in this area by Internal Auditor II position #1.
- Non-financial Program Audits – 07/06-06/07. To be conducted by technical Divisional personnel with assistance and under the direction of Internal Audit.
- Cash Management Audits (Including Purchasing/AP) – 08/06-06/07. Continuous work in this area by Internal Auditor position #2.
 - DFR
 - DPR
 - Zoo
 - Aquariums
 - Museum
 - Regional Offices
- Cash Management Plan Compliance Reviews – 05/06. All divisions.
- Concession Contract Monitoring

- Senate Bill 991 for IT Operations
- Internal Control Review – 06/06-07/06. Conduct interviews with Divisions to completed the annual Self-Assessment of Internal Controls as required by OSC. This Internal Control Questionnaire is used to identify weaknesses in internal control that need to be addressed by Internal Audit.
- Travel Advances and Reimbursements – Quarterly reviews in this area for the upcoming fiscal year. Travel advances outstanding for over 30 days will be selected for review. A sample of travel expense reimbursements will be selected for review. Divisional personnel will participate in this review with under the direction and assistance of Internal Audit.
- AP Reviews – Quarterly reviews in this area for the upcoming fiscal year.
- Inventories – 05/06-06/06. DFR, Parks, Zoo, Aquariums, and Museum particularly will be required to submit inventory-taking procedures for their year-end inventories, or other than year-end for perpetual inventories. Internal Audit will revise/approve those plans as appropriate. Divisional staff will be used to provide additional coverage in inventory taking procedures. For instance, DFR staff not directly responsible for the aircraft inventories at Kinston can assist in the inventory-taking.
- Fixed Assets – Testing will be undertaken to verify the existence of booked assets.
- Fraud, Embezzlement, Misuse of State Property – Internal Audit will develop procedures to be pro-active in this area, and will also respond to specific instances of abuse needing investigation.
- Purchase Card, Credit Card Acceptance, American Express Card Use – Internal Audit will conduct quarterly reviews in this area.

CURRENT STRUCTURE OF INTERNAL AUDIT

Internal Audit, organizationally, currently reports to the Office of Controller. The Internal Audit Manager has duties that typically fall in the category of internal audit, but also has duties that include special projects under the direct supervision of the Controller.

NEED FOR ASSISTANCE FROM DIVISIONAL STAFF FOR INTERNAL AUDIT ASSISTANCE ON AN ON-GOING BASIS FOR TEMPORARY ASSIGNMENTS

The use of divisional staff would greatly increase the audit coverage for the department. In the area of non-financial program reviews, professional staff from various divisions can be used to review compliance to program directives. In order to address independence issues, the divisional staff could be assigned to review programs in divisions other than the one to which they are assigned.

Additionally, in financial reviews, divisional staff not directly assigned to specific duties within a particular division could be used to provide some of the internal audit effort necessary within that division. For instance, at the Zoo, the fiscal officer could be utilized to provide a surprise audit of the cash on hand, and reconcile the counts.

CURRENT DUTIES OF INTERNAL AUDIT MANAGER

During the last year, current duties have included:

- Assistance to divisions implementing new credit card acceptance
- Development of departmental policies and procedures
- Internal control assessments
- Compliance reviews for concession activities
- Make revisions to the Cash Management Plan
- Implement changes to the Department's Cash Management Plan
- Revise Cash Management Plan Supplements for all DENR locations
- Investigate charges by the Town of Carolina Beach for sewer fees to Fort Fisher Aquarium
- DFR Overtime Review
- DENR IT Review
- EEP Investigation
- Inventory Assistance - Zoo
- Investigate the appropriateness of FEMA reimbursements from Hurricane Fran damage and involvement in the response to the OIG's audit and request for payment for improper reimbursement.
- Security clearance review
- Cash Management Review - DPR
- Review of reported employee time reporting abuse at DFR-Pitt County
- Cash theft at Lake James and Jordan Lake
- Investigation of well water contamination in Newport, NC
- Travel advance and travel reimbursement review
- American Express usage review
- PCI Compliance issues for credit card acceptance at Geo Survey, Zoo, and DFR Seedling operations.
- Identity theft issues at DFR Seedling operations.
- Development of Pcard policies and procedures, and review of instances of improper usage of those cards.
- Monitor reporting of the Monthly Closing Checklist.

INDEPENDENCE ISSUES

In their upcoming report of the Internal Audit function statewide, it is likely that the Office of the State Auditor will point out the need for an Independent Internal Audit function free of any influence by any element in the Department.

The Institute of Internal Auditors (IIA), which is the defining authority for the Internal Auditing Profession, promotes a best practice that includes an audit section that is free of influence by any element in the Department, including matter of scope, procedures, frequency, timing, or report content to permit maintenance of an independent mental attitude necessary in rendering objective reports. Toward that end, the IIA recommends that Internal Auditors shall have no direct operational responsibility or authority over any

of the activities they review. Additionally, they shall not develop or install systems or procedures, prepare records, or engage in any other activity that would normally be audited.

As discussed earlier, the current duties of the Internal Audit Manager include matters that would prevent the ability of the Internal Audit Section to be independent. The potential actions that can be taken would be the following:

- No Change to the Current Structure – The Internal Audit Manager would still be responsible for Internal Audit, and also other special projects not related to internal auditing. The Internal Audit Section would not be independent from operational responsibility and would have authority over some of the activities subject to review by Internal Audit. Internal Audit continues to report to the Controller.
- Internal Audit is pulled out from the Controller's Office and placed organizationally under the Secretary's Office. Internal Audit would then be independent. The Controller's Office would need an additional position to replace the activities currently being addressed by Internal Audit.

PLANNED GROWTH FOR INTERNAL AUDIT

There is a definite need for two additional Internal Auditor positions within DENR. This proposal includes changing the current Internal Audit Section to include a Director of Internal Audit (PG80), two Internal Auditor II's (PG's 75), and the temporary assignment of ten (Estimated) divisional staff for internal audit activity. Internal Audit will make an assessment annually of the need for Internal Audit services for the coming year, and the report on the need for additional Internal Audit resources. Current assessments are that 50% of the time of one Internal Auditor II position will be necessary for the increased level of effort in contracts and grants. 50% of the other Internal Auditor position is expected to be necessary for Purchasing/AP compliance and divisional cash management audits. 10% for fixed assets and inventory, 10% for fraud and embezzlement identification and investigation activities, 20% for other financial and performance reviews, and 10% for administrative duties is expected for the remaining time available for the two new positions.

SUPPORT COSTS

In addition to salary and fringe benefits for the new internal auditors, support costs will be incurred. See the attached Excel spreadsheet.



North Carolina Department of Health and Human Services
2001 Mail Service Center • Raleigh, North Carolina 27699-2001
Tel 919-733-4534 • Fax 919-715-4645

Michael F. Easley, Governor

Carmen Hooker Odom, Secretary

October 6, 2006

The Honorable Leslie W. Merritt, Jr., State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Mr. Merritt:

Thank you for the opportunity to respond to the performance audit entitled *Internal Auditing in North Carolina Agencies and Institutions* dated September 29, 2006. The Department of Health and Human Services strongly agrees with the various report findings and recommendations.

While DHHS has a strong internal audit function in a professional sense, we are painfully aware that we do not have a sufficient number of internal auditors to adequately perform the internal audit function. As a result, we often deal only with a small portion of financial and compliance areas that need oversight by the internal audit function. In the current scenario, there is little opportunity to undertake proactive reviews and audits, identify deficiencies and recommend corrective actions. In recent years, the Department has been unable to expand this function due to the economic downturn and the need to minimize cuts in services to the State's citizens. We would welcome the opportunity to expand the internal audit function and feel that an expanded internal audit staff will yield rich dividends in terms of enhanced accountability and improved efficiencies.

Although auditing is often considered a painful process in that audits are inherently designed to point out flaws and deficiencies, audits also provide an opportunity for independent analyses that allow management to fix problems, sometimes before they happen. With a department as large as DHHS with hundreds of Federal grants, literally thousands of laws and regulations, and billions of dollars in funding, we know that there will undoubtedly be situations of non-compliance which need to be identified and corrected. That process of identification and corrective action can best be accomplished when both internal and external auditors as well as management work together to achieve the common goal of compliance and accountability of tax dollars.

We would be remiss not to applaud the recent efforts of the State Auditor to provide fiscal and compliance training at no cost to State agency and grantee personnel. This has been an



The Honorable Leslie W. Merritt, Jr.

October 6, 2006

Page 2

invaluable asset to State government. The Department of Health and Human Services management has designated some of these courses as "required employee training". Almost 300 DHHS staff have been trained to-date under this initiative by the State Auditor. The State Auditor's newsletter is another education initiative that we strongly support.

We recognize and appreciate the efforts of the State Auditor's Office in working closely and cooperatively with State agencies on improving accountability. The Department of Health and Human Services looks forward to a continuation of this outstanding working relationship with the State Auditor's Office and would like to express our sincere appreciation for the new approaches and philosophies that you have initiated in the State Auditor's Office.

Sincerely yours,



Carmen Hooker Odom

CHO/ds

cc: Dan Stewart, CPA, Deputy Secretary
Eddie Berryman, CPA, Director, DHHS Office of Internal Auditor
Laketha Miller, CPA, DHHS Controller
DHHS Division Directors
David Nance, CPA
Stan Wesner, CPA

STATE OF NORTH CAROLINA
DEPARTMENT OF TRANSPORTATION

MICHAEL F. EASLEY
GOVERNOR

1501 MAIL SERVICE CENTER, RALEIGH, N.C. 27699-1501

LYNDO TIPPETT
SECRETARY

October 6, 2006

Mr. Leslie W. Merritt, Jr., CPA, CFP
State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Auditor Merritt:

Thank you for the effort and resources that your office has devoted to internal auditing within the Department of Transportation and across state agencies. Internal auditing should perform a vital role in the Department's ability to manage its resources, risks and accountability. I am also very aware of the urgent need for effective internal auditing if government agencies wish to avoid significant financial losses, as well as the loss of public confidence and trust that have recently occurred in the private sector.

The report has findings and recommendations that are generic to all internal audit sections as well as recommendations specific to the Department. I have carefully reviewed each recommendation, and the Department's response is in the following paragraphs:

1. North Carolina State Government and Its Institutions Lack Sufficient Internal Audit Policies

Recommendation: The General Assembly should enact legislation clearly defining the internal audit expectations for each agency. Internal audit functions should be established in accordance with generally accepted internal audit principles and best practices.

Response: The Department endorses legislation that would set a statewide minimum standard for the operation of an internal audit function.

2. No finding or recommendation

3. Internal Audit Organizations Are Not Obtaining Quality Assurance Reviews by Outside Parties

Recommendation: Internal audit organizations should obtain as part of their quality assurance program an external quality assessment review at regular intervals.

Response: The Department will ensure that the Internal Audit Section obtain an external quality assessment review once every three years in accordance with the Government Auditing Standards under which it operates.

4. Some Internal Audit Sections Did Not Report To the Highest Management Level Within the Organization

Recommendation: The state entities noted in table 1 should revise their internal audit reporting structures so that the internal audit function reports to the highest level within the organization.

Response: The Department will alter the reporting by its Internal Audit Section and will also incorporate reporting to the Board of Transportation's Audit and Contract Committee.

5. Some Internal Audit Organizations Did not Execute an Annual Audit Plan While Others did Not Perform Risk Assessments to Develop an Audit Plan

Recommendation: All internal audit organizations should comply with internal auditing standards by establishing an annual audit plan based on an effective risk assessment.

Response: The Department will ensure that the Internal Audit Section's annual audit plan is based upon appropriate risk assessment measures.

6. No finding or recommendation

7. No finding or recommendation

8. Some Internal Audit Sections Lacked Adequate Policies and Procedures

Recommendation: No recommendation specific to the Department.

Response: Item #10 in the Report mentions that the Internal Audit Section has not complied with the latest peer review recommendations on policy and procedure issues. This will be immediately addressed.

9. No finding or recommendation

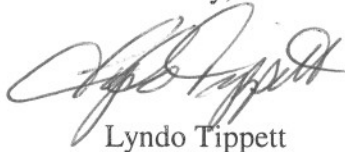
10. The Department of Transportation Internal Audit Section Has Experienced Significant Difficulties With Completing Audits and Producing Audit Reports

Recommendation: To achieve organizational independence and ensure proper oversight of operations, the Chief Internal Auditor should report directly to the Secretary, Chief Deputy Secretary, or to the audit committee of the Board of Transportation. The Secretary of Transportation should take steps to improve the performance of the Internal Audit Section that could include organizational and functional restructuring.

Response: Per recommendation #4, the reporting will be adjusted and expanded. Furthermore, an immediate review of the organization and functional structure will be conducted to ascertain that proper management oversight is exercised to increase productivity and performance.

I appreciate the opportunity to comment on the findings and recommendations contained in the "Performance Audit of Internal Auditing in North Carolina Agencies and Institutions." I also am grateful for the objectiveness and thoroughness of the audit team from the Office of the State Auditor. Their information gathering was comprehensive and has defined numerous opportunities for the Department and the state to strengthen internal auditing functions.

Sincerely,

A handwritten signature in black ink, appearing to read "Lyndo Tippett", is written over a light blue horizontal line.

Lyndo Tippett

LT:bd

cc: Daniel H. DeVane, Chief Deputy Secretary
Willie Riddick, Deputy Secretary of Administration and Business Development
Herb Henderson, Human Resources Director
Mark Foster, Chief Financial Officer



**State of North Carolina
Office of Information Technology Services**

Michael F. Easley, Governor

George Bakolia, State Chief Information Officer

October 2, 2006

The Honorable Leslie W. Merritt, Jr., State Auditor
2 Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601

Dear Mr. Merritt:

I have enclosed our responses to the draft report associated with the performance audit entitled *Internal Auditing in North Carolina Agencies and Institutions*. We welcome the opportunity to provide feedback to the draft report. The internal information systems audit function is an important element within our organization and performs valuable assessments of internal controls and processes.

The performance audit conducted by your staff has identified some areas that we will address immediately. We take exception to a few of the findings and we are providing comments to further clarify our position. If more discussion is needed or additional clarification is desired, please feel free to contact me or my staff.

I would like to express my thanks to your staff for the professionalism they exhibited in conducting this review. Your staff was very helpful at scheduling interviews and meetings to accommodate our schedules and, as a result, the audit process flowed smoothly. We look forward to working with you and your staff on this and future audits.

Sincerely,

A handwritten signature in cursive script that reads "George Bakolia".

George Bakolia

Management Responses

2) Some Internal Audit Organizations Sections Do Not Follow any Professional Auditing Standards (Page 14)

Response: We concur with the recommendation and will adopt internal audit standards as recommended. Our ability to execute the requirements of industry standards may be affected by staff and resource limitations.

4) Some Internal Audit Sections Did Not Report to the Highest Management Level within The Organization (Page 16)

Response: Management disagrees with this finding. Under the Office of Information Technology Service's (ITS) internal policy, all internal audit requests must be approved by the State Chief Information Officer (SCIO) and all internal audit reports are addressed to the SCIO. Therefore, the audit function at the ITS is accountable to the department head. The audit function is aligned with the statewide Strategic Initiatives Office to provide even greater independence from internal ITS operational functions. This independence allows the internal audit function to objectively evaluate internal controls and work as part of a team of certified audit and security professionals.

7) Some Internal Audit Sections Did Not Have an Audit Charter (Page 20)

Response: We concur with the recommendation and will establish an audit charter as recommended.

9) The Office of Information Technology Services No Longer Has Fully Dedicated Information Systems Internal Auditor Position (Page 22)

Response: Management disagrees with this finding. Internal auditing remains the emphasis of the internal auditor position. The 2005 reorganization strengthened the internal audit function by aligning the position with a team of certified audit and security professionals and by providing more independence from ITS operational functions.

The State Chief Information Officer (CIO) has both statewide and agency responsibilities. Legislation passed in 2003 and 2004 increased the CIO's statewide responsibilities in statewide security and other areas. Since then, the State CIO has constantly evaluated the roles and responsibilities of ITS personnel to carry out the dual roles. The 2005 re-organization was an attempt to structure the audit function so that both statewide and agency objectives could be met. The job description of the internal auditor was rewritten to provide flexibility for the internal auditor position to assist in statewide security assessments, but the emphasis of the position remains on internal audits. ITS has established an audit plan to conduct internal audits of critical ITS systems and shared this plan with the performance audit staff during the review. Management will re-examine the internal auditor's job description and rewrite it if necessary to more accurately reflect the position's responsibilities.

It is important to note that when the 1998 performance audit report was written, ITS did not have a fully staffed information security office. ITS has since established both the internal audit function and a staff of security professionals. Many of the internal information system security controls are routinely evaluated by our security office, which has two Certified Information Systems Auditors (CISAs) on staff. In total ITS has five (5) CISAs on staff and, although they are not classified as auditors, these individuals perform many audit related functions including risk, compliance, and security assessments.



State of North Carolina

Office of the State Controller

Michael F. Easley, Governor

Robert L. Powell, State Controller

October 5, 2006

The Honorable Leslie W. Merritt, Jr., CPA, CFP
State Auditor
Office of the State Auditor
2 South Salisbury Street
2601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Mr. Merritt,

Thank you for the opportunity to review and comment on the draft performance audit report entitled, ***Internal Auditing in North Carolina Agencies and Institutions***. Like you, I share the same concerns regarding the overall need to improve internal controls within the State's agencies and institutions. I also believe that a strong internal audit function not only provides value to an organization, but is also essential to ensuring a sound and effective system of internal control.

As you know, the Office of the State Controller launched its Statewide Internal Control Compliance Program in 2004. Since that time, we have recommended to agencies without an internal audit function that they consider implementing such function within their organization.

Mr. Merritt, I do have a few specific comments that I would like to make regarding the report.

First of all, I agree with the need for legislation as was noted in your report, along with appropriate funding. I would, however, like for you to consider that we have recently formed a Statewide Internal Control Task Force to review the current state of internal controls in state government and to make recommendations for improvement. It is envisioned that legislative action would result from the work of this Task Force. While the scope of their work would likely be broad in nature, I would assume that it would encompass the over-arching need for increasing the number of internal auditors within state government. I would like for us to work collaboratively in the support for this effort.

Secondly, I support your recommendation that "general government agencies should establish an interagency organization of internal auditors, the purpose of which is to share ideas, information, methodology, and other mutually beneficial information." I would like to propose that OSC, given our recent expanded role in internal control compliance monitoring, assume the lead role in this initiative.

Thirdly, I would like to make a point of clarification regarding our presentation within the report as being an agency without an internal audit function. The Office of the State Controller (OSC) has had an internal audit function since the early 1990's. OSC, in late 2004, expanded the scope of the internal audit function to include a statewide program which is responsible for performing internal control compliance reviews of state governmental entities. Since that time, OSC's primary emphasis has been on conducting these internal control compliance reviews. These reviews

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Website: www.ncosc.net

LOCATION
3512 Bush Street
Raleigh, NC

are performed by the three (3) employees assigned to the OSC's Risk Mitigation Services section. Although no internal audits have been performed since 2004, these employees also have responsibilities for performing internal audits on an as-needed or as-requested basis, in accordance with the appropriate auditing standards.

Mr. Merritt, I would like to again thank you for allowing me to provide input into this important initiative. I look forward to our continued collaboration efforts to ensure that a sound and effective system of internal controls is in place and properly functioning within state government.

Very truly yours,

A handwritten signature in black ink, appearing to read "Robert L. Powell", enclosed within a yellow rectangular border.

Robert L. Powell
State Controller



The University of North Carolina

GENERAL ADMINISTRATION

POST OFFICE BOX 2688, CHAPEL HILL, NC 27515-2688

ROBERT O. NELSON, *Vice President for Finance*

Telephone: (919) 962-4598 • Fax: (919) 962-0008 • E-mail: rnelson@northcarolina.edu

October 5, 2006

Appalachian State
University

East Carolina
University

Elizabeth City
State University

Fayetteville State
University

North Carolina
Agricultural and
Technical State
University

North Carolina
Central University

North Carolina
School of
the Arts

North Carolina
State University
at Raleigh

University of
North Carolina
at Asheville

University of
North Carolina
at Chapel Hill

University of
North Carolina
at Charlotte

University of
North Carolina
at Greensboro

University of
North Carolina
at Pembroke

University of
North Carolina
at Wilmington

Western Carolina
University

Winston-Salem
State University

An Equal Opportunity/
Affirmative Action
Employer

The Honorable Les Merritt, Jr.
State Auditor
Revenue Building
2 South Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601

Dear Mr. Merritt:

Thank you for the opportunity to respond to the State Auditor's performance audit on internal auditing. Under the auspices of the University of North Carolina Board of Governors, and under the direction of senior management at UNC-General Administration, the University's constituent institutions have for many years dedicated scarce resources to the internal audit function. This commitment to a good system of internal control has greatly benefited our financial operations and improved the reliability and integrity of our financial systems. During 2005, the University's commitment to strong internal controls and management was confirmed and renewed by a Best Financial Practices Task Force consisting of Board of Governors members and others.

Several constituent institutions mentioned in the audit will be responding directly. There are two recommendations in the audit that impact UNC-General Administration. In response to those recommendations, we will adopt an internal audit charter for this office. Secondly, we will increase the amount of time our internal auditor dedicates to internal controls. That effort, at the time of your report, was at the 50% level, and it has now been increased to 80%.

My other comments are more general but relevant to your findings.

The University would support legislation to establish minimum requirements for an internal audit function across all state agencies. We believe the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing (Standards) would provide excellent guidelines for legislators and their staff to consider as they draft changes to state law.

After the establishment of minimum requirements for State agencies, the University would support a legislative request for funds to establish or expand internal audit offices.

The Honorable Les Merritt, Jr.
Page Two
October 5, 2006

We agree that every organization should assess and establish its appropriate level of internal auditing, including information systems audits. It is always difficult for public agencies to balance many competing needs against available resources. While specific benchmarks do not exist, there should be a continuing review by the State Auditor to help state agencies assess the appropriate level of effort and funding.

We support the idea of staff from UNC-GA supplementing the efforts of smaller campuses as they further develop their auditing capabilities. As in all agencies, getting the funding to perform at an acceptable level will be a challenge.

The North Carolina Association of University Internal Auditors has committed to work together to assist each campus in peer review and quality assurance. Their effort will be implemented over a five-year period, and they will perform three or four peer reviews per year.

Following the report of the 2005 Best Financial Practices Task Force, the Board of Governors established an Audit Committee of the Board. That committee consists of Board members with financial training and professional experience in private and public financial institutions. The Audit Committee has focused on many of the same issues raised in the performance audit and shares the State Auditor's goal for solid internal controls. Staff at UNC-General Administration will continue to assist the committee as it works to ensure that every campus has an internal audit charter or mission statement, that every campus allows its internal auditors sufficient time and independence to properly perform their duties, that each campus has an annual audit plan based on an entity-wide risk assessment, that there be a periodic peer review of audit operations for quality assurance, and that internal auditors report to the appropriate level within the organization.

We appreciate the State Auditor's leadership in the area of internal auditing. The hard work of the team that performed the audit is reflected in its findings and recommendations.

Sincerely,



Robert O. Nelson

c: President Erskine Bowles
Mr. George Burnette
Mr. Stan Wesner



Office of the Chancellor
253 Phillips Hall, CPO #1400
UNC Asheville, One University Heights
Asheville, North Carolina 28804-8509

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October 5, 2006

Mr. Stan Wesner
Performance Audit Manager
Office of the State Auditor
2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601

Dear Mr. Wesner:

Thank you for the opportunity to respond to the issues outlined in your performance audit report entitled *Internal Auditing in North Carolina Agencies and Institutions*. We submit the following response to your office for inclusion in the final published report. The recommendations contained in your report are being implemented as detailed below. We affirm that the Internal Auditor is taking the appropriate steps to ensure the reported issues are remedied in a timely manner.

The University of North Carolina at Asheville
Response to Performance Audit – Internal Auditing in North Carolina Agencies and Institutions

Several factors may provide some perspective on the findings that reference UNC Asheville, as well as some assurance that remedies are already underway.

- From November 2005, when our only Internal Auditor was on leave, through Spring 2006 when she resigned upon her return from leave, to September 2006 when our current Internal Auditor was hired, we have not had the benefit of consistent Internal Audit counsel.
- During the spring 2006 semester, UNC Asheville solicited the help of George Burnette, then Associate Vice President for Finance at General Administration, for help in reviewing functions, staffing, and workload within the Finance and Internal Audit departments. Mr. Burnette also assisted by drafting the Internal Audit Committee Charter and staffing the May Audit Committee meeting. This proactive request for assistance by management resulted in several recommendations, some of which have been implemented, and others that are part of an ongoing plan for improvement in financial operations and reporting.

- UNC-Asheville has, over time, extended its limited resources to a degree that has proven to be unreasonable in the finance area. This audit report's issue citing the Internal Auditor's work in the controller's department highlights the vulnerabilities exposed by continued under funding of the university's finance function.

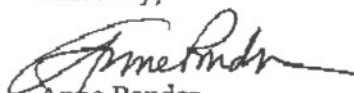
With a new Internal Auditor on staff, the University is committed to adopting the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing* and is referencing these standards in its Internal Audit Charter. In conjunction with the adoption of standards, the internal audit office is developing and implementing operating policies and procedures by December 31, 2006.

UNC-Asheville is developing an annual plan based upon a risk assessment. The Internal Auditor is currently performing a risk assessment and is using the results of the risk assessment as a basis for an audit plan. We intend to submit this plan for Board of Trustees approval at the November 2006 board meeting.

The Internal Auditor is monitoring project requests to prevent conflicts of interest and involvement with tasks unrelated to primary job responsibilities. She is reporting any unusual requests to senior management to ensure that they do not interfere with independence of the audit function and do not impede required progress of the annual audit plan. As an additional monitoring tool, the Internal Auditor will provide quarterly updates to management on the completion of audits identified in the annual audit plan.

Should you have any questions regarding this information, please contact Ms. Suzanne Bryson, Internal Auditor at 828-251-6716 or by e-mail at sbryson@unca.edu.

Sincerely,


Anne Ponder
Chancellor


Suzanne Bryson
Internal Audit Director



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

JAMES MOESER
Chancellor

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October 4, 2006

Mr. Leslie W. Merritt, Jr.
State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601

Dear Mr. Merritt:

Thank you for the opportunity to review this draft report and for your efforts to advance internal audit functions in state organizations. I share your opinion that an effective internal audit operation is essential for maintaining a well-run organization.

We concur with findings #1 and #3 and will work with General Administration to develop a corrective action plan for resolving these issues.

Our responses to finding #4, the Internal Audit reporting relationship, and finding #5, risk-based internal audit plans, are attached.

If you have questions about our responses please contact me at (919) 962-1365 or our Director of Internal Audit, Phyllis C. Petree, at (919) 962-7883.

Sincerely,

James Moeser

JM:bl
Attachment

cc: Mr. George Burnette
Ms. Karol Mason
Mr. David Perry
Ms. Phyllis C. Petree

Moeser/merritt2

RESPONSES FROM UNC-CHAPEL HILL

4. SOME INTERNAL AUDIT SECTIONS DID NOT REPORT TO THE HIGHEST MANAGEMENT LEVEL WITHIN THE ORGANIZATIONS

The internal audit function at the University of North Carolina at Chapel Hill does not report exclusively to the Vice Chancellor for Finance and Administration. The function reports directly to the Chancellor and to the Chairman of the Audit and Finance Committee of the University's Board of Trustees. For day-to-day administration, the function reports to the Vice Chancellor for Finance and Administration.

The Director of Internal Audit for UNC-Chapel Hill has unrestricted access to the Chancellor and members of the Board of Trustees and has final decision-making authority regarding what areas or activities will be audited and what audit procedures will be used. Also, the Audit and Finance Committee of the Board of Trustees must consult with the appointing authority regarding the selection and removal of the Director of Internal Audit. These factors enhance independence and mitigate the potential for impairment that could arise from the administrative reporting relationship.

The Director of Internal Audit has final authority regarding the content and wording of audit reports. Audit reports are directed to the Chancellor with copies provided to appropriate members of management. These reports include management's responses to any findings and recommendations in the report. Several times a year, members of the Board of Trustees receive full copies of all internal audit reports issued since the prior distribution of reports. This process for communicating results ensures that senior management and the Board are aware of the results of audit work and that the results can not be unduly influenced or suppressed.

However, to remove any possible independence impairments, effective immediately, the Chancellor will be responsible for performance reviews of the Internal Audit Director and budget request for the Internal Audit Department will be made through the Chancellor's Office. We will also revise the organizational chart to reflect this change. The Internal Audit Director will retain a "dotted line," informational reporting relationship to the Vice Chancellor for Finance and Administration because of the value that frequent communication between these two individuals provides to the University.

RESPONSES FROM UNC-CHAPEL HILL (CONTINUED)

5. SOME INTERNAL AUDIT ORGANIZATIONS DID NOT EXECUTE AN ANNUAL AUDIT PLAN WHILE OTHERS DID NOT PERFORM RISK ASSESSMENTS TO DEVELOP AND AUDIT PLAN

Since fiscal year 1997, internal audit plans at UNC-Chapel Hill have been based on an assessment of the relative risk of potential audit units through either a formal scoring processes or by a less structured process that considers risks without assigning quantitative risk scores.

In fiscal year 1996, the Internal Audit Office at the University of North Carolina at Chapel Hill performed a comprehensive, formal risk assessment of the university. As part of that process, all areas of the university were evaluated and combined into auditable units as individual departments, unique functions, or shared processes such as Payroll, Travel, and Accounts Payable. Risks were evaluated and scored using both quantitative and qualitative factors. The results of this process were used to set audit frequency - high risk units would be audit more frequently than lower risk; to identify very low risk units that would not be audited due to staffing constraints; and to develop a long-range audit plan for fiscal years 1997 to 2001.

The 1996 risk assessment and audit plan have not been formally updated but the Internal Audit Director periodically reviews the universe of auditable units to ensure it is complete, appropriate, and up-to-date. Currently, the Internal Audit Director selects units for the annual audit schedule based on such considerations as:

- Significance of an activity to the university;
- Changes in laws and regulations that affect higher education;
- Changes in higher education or problems noted at other institutions;
- Audits or special reviews of a one department that identified issues that may exist in other university departments;
- Information about changes or concerns at the University gained from meetings or discussion with other university employees and at meetings of the Board of Trustees and from internal communications such as posting to listservs for business or technology managers and memoranda sent to deans, directors, and department heads;
- Changes in a unit's management or its operating conditions;
- Length of time since any prior audit or an activity or area and the results of prior audits; and

RESPONSES FROM UNC-CHAPEL HILL (CONTINUED)

- Requests by university management or the members of the Board of Trustees.

In addition, the Internal Audit Director monitors risk factors during the year and revises the annual audit plan if new information becomes available showing that risks have changed significantly since the plan was developed. Also, audit plans contain a block of audit hours to use for important unplanned projects or reviews requested by management.

This less structured process provides adequate consideration of risks and produces an audit plan that focuses audit resources on the most significant activities of the university.



THE UNIVERSITY OF NORTH CAROLINA AT WILMINGTON

E-MEMORANDUM

Leslie Merritt, CPA, CFE, State Auditor
N.C. Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601

October 5, 2006

Mr. Merritt,

We have received the draft performance audit report from your office on the internal audit function in North Carolina state agencies and institutions. Included in that report is a finding that states the internal audit department at the University of North Carolina at Wilmington did not follow any professional auditing standards. The recommendation and our response are submitted for your information and inclusion in the final report.

Recommendation: Internal audit organizations should adopt and follow recognized professional auditing standards. We believe, at a minimum, the Institute of Internal Auditors *International Standards for the Professional Practice of Internal Auditing* should be adopted.

Response: The Chancellor and the Director of Internal Audit concur that the internal audit department at the University of North Carolina at Wilmington should adopt and follow recognized professional auditing standards. The internal audit activity at the University of North Carolina at Wilmington does follow the *International Standards for the Professional Practice of Internal Auditing (Standards)* of the Institute of Internal Auditors in its daily operations. A known exception to the *Standards* is the lack of external quality assessments or peer review. Also, the IA Charter does not specifically include a reference to the *Standards* followed. Discussion has begun with the Audit Committee of the Board of Trustees (Audit Committee) to review the IA Charter and to plan a self-review that would identify any deficiencies. Additionally, it is the university's intent to fully participate in a System-wide peer review process through NCUAA, as recommended by the Office of State Auditor. The University of North Carolina at Wilmington has demonstrated a long-standing commitment to the internal audit function. The university was one of the early adopters of having an internal audit function, a director reporting to the Chancellor, and was functionally reporting to the Audit Committee before there was a System requirement to do so. The effectiveness of the unit is supported by the university's outstanding record of 18 years with no significant findings during financial audits.

Thank you for the opportunity to respond to this audit finding.

Sincerely,

Rosemary DePaolo, Chancellor

Auditor Comments Related to Individual Agency Responses

Community College System

In its response, the Community College System Office submitted information related to various functions described or titled in one way or another as “internal audit” activities. The response also included a schedule showing a total of 16 internal auditors spread out among 11 community colleges. During the course of our audit we identified only two internal auditors at only one community college.

We believe the difference for the disparate information may involve definitions. The data in the Community College System’s response appear to support various functions unrelated to a true internal audit function, and related more to full-time equivalent (FTE) compliance and determining the accuracy of the Institution Class Report, a document used to determine the amount of state funding each college receives. These functions do not comprise internal audit activities as defined by authoritative bodies and as expounded upon in this report.

The response of the Community College System indicates that they are in the process of responding to the need for an internal audit function for its colleges. We are unable to determine if those actions will be adequate to meet those needs until that process is completed.

Office of Information Technology Services

As for finding 4, titled “Some Internal Audit Sections Did Not Report to the Highest Management Level Within the Organization,” ITS offered the following response:

Response: Management disagrees with this finding. Under the Office of Information Technology Service’s (ITS) internal policy, all internal audit requests must be approved by the State Chief Information Officer (SCIO) and all internal audit reports are addressed to the SCIO. Therefore, the audit function at the ITS is accountable to the department head. The audit function is aligned with the statewide Strategic Initiatives Office to provide even greater independence from internal ITS operational functions. This independence allows the internal audit function to objectively evaluate internal controls and work as part of a team of certified audit and security professionals.

We maintain our position relative to this finding and recommendation. According to the Information Technology organization chart, the internal auditor reports to the information technology manager, who reports to the information technology director who, in turn, reports to the State Chief Information Officer. The reporting structure is further defined by the internal auditor’s job description and the Office of State Personnel Information Management System which identifies the internal auditor’s supervisor as the enterprise information technology manager. Further, the audit function is aligned with the statewide Strategic Initiatives Office. As part of its function, internal audit should be able to audit the activities of the Strategic Initiatives Office. However, as currently structured, the internal audit function may not have sufficient independence to do so.

Auditor Comments Related to Individual Agency Responses

As for finding 9, titled “The Office of Information Technology Services No Longer Has a Fully Dedicated Information Systems Internal Auditor Position,” ITS offered the following response:

Response: Management disagrees with this finding. Internal auditing remains the emphasis of the internal auditor position. The 2005 reorganization strengthened the internal audit function by aligning the position with a team of certified audit and security professionals and by providing more independence from ITS operational functions.

The State Chief Information Officer (CIO) has both statewide and agency responsibilities. Legislation passed in 2003 and 2004 increased the CIO’s statewide responsibilities in statewide security and other areas. Since then, the State CIO has constantly evaluated the roles and responsibilities of ITS personnel to carry out the dual roles. The 2005 re-organization was an attempt to structure the audit function so that both statewide and agency objectives could be met. The job description of the internal auditor was rewritten to provide flexibility for the internal auditor position to assist in statewide security assessments, but the emphasis of the position remains on internal audits. ITS has established an audit plan to conduct internal audits of critical ITS systems and shared this plan with the performance audit staff during the review. Management will re-examine the internal auditor’s job description and rewrite it if necessary to more accurately reflect the position’s responsibilities.

It is important to note that when the 1998 performance audit report was written, ITS did not have a fully staffed information security office. ITS has since established both the internal audit function and a staff of security professionals. Many of the internal information system security controls are routinely evaluated by our security office, which has two Certified Information Systems Auditors (CISAs) on staff. In total ITS has five (5) CISAs on staff and, although they are not classified as auditors, these individuals perform many audit related functions including risk, compliance, and security assessments.

We maintain our position relative to this finding and recommendation. The internal auditor’s position description identifies the working title of the position as “IT Compliance Auditor.” The position description further states:

Primary Purpose of Position:

According to the North Carolina General Statutes, the State CIO is authorized to periodically review existing security standards and practices in place among the various State agencies to determine whether those standards and practices meet statewide security and encryption requirements. The position will perform compliance assessments and technical compliance reviews for those agencies within the scope of the State CIO’s authority.

Description of Responsibilities and Duties (in part):

Auditor Comments Related to Individual Agency Responses

Conducts statewide (emphasis added) reviews and assessments of information processing functions to determine the adequacy of the internal controls for the prevention or detection of fraud or error.

These responsibilities and job functions are clearly external to internal audit activities. We recognize the vital role the Office of Information Technology plays in statewide strategic technology initiatives; however, we do not believe those activities should be incorporated within the internal audit function. Given the criticality of the Office of Technology Services functions and operations, we believe a full-time dedicated internal audit function is absolutely vital to ensure both the financial integrity and effectiveness of the agency.

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