

# COUNCIL OF INTERNAL AUDITING

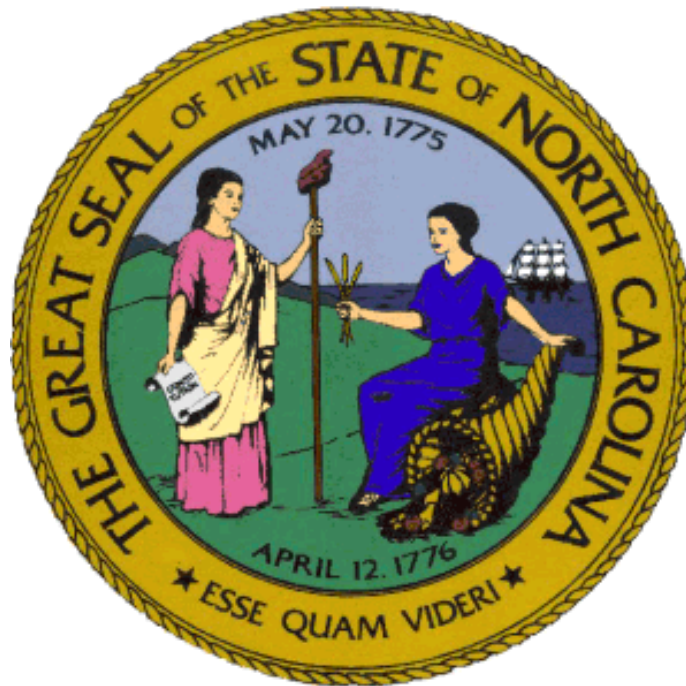
## OFFICE OF INTERNAL AUDIT

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North Carolina

# Internal Audit Manual



Guidelines, Policies, and Procedures for Statewide  
Internal Auditing

<http://www.osbm.state.nc.us>

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COUNCIL OF INTERNAL AUDITING  
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**Effective Date: May 14, 2008**

**Updated: September 30, 2015**

## **INTRODUCTION**

The Office of Internal Audit prepares the State Internal Audit Manual in conjunction with the Council of Internal Auditing (Council) for the State of North Carolina for use by state departments, agencies and institutions in planning and conducting internal audits. The foundation for this manual is the North Carolina Internal Audit Act and [Professional Practice Framework \(Standards\)](#) issued by the Institute for Internal Auditors (IIA). This Manual is for guidance; internal auditors should use professional judgment in the application of these guidelines and if appropriate, follow [Government Auditing Standards](#). It is the responsibility of department management and their internal audit staffs to acquaint themselves with the guidelines in this Manual.

The Manual is divided into seven major sections:

1. Internal Audit Act
2. Internal Audit Participation and Application
3. Internal Audit Organization
4. Audit Process
5. Professional Proficiency
6. Quality Assurance
7. Glossary

There are several features that should facilitate referencing and navigating throughout the Manual. First, there is a table of contents at the beginning that will assist users with quick referencing. Second, specific General Statute citations are referenced throughout the Manual and the online version includes direct links to the appropriate General Statute. Third, in the online version are direct links to other sites for useful information and documents. Finally, all guidelines are referenced to the IIA Standard and Practice Advisory. IIA Practice Advisories help interpret the IIA Standards and can provide additional assistance when implementing the requirements of this manual.

All revisions, supplements and deletions to the Manual will be issued through the Council of Internal Auditing. Departmental officials and their staffs should maintain a current version of the Manual that will be updated online periodically by the Office of Internal Audit. The header at the top of each page in the Manual reflects the effective date of this version of the Manual and the date of the most recent updates to this version. The appendix at the end of the Manual lists revisions to date.

Any exceptions to the guidelines stated in the Internal Audit Manual, except those exceptions expressly delegated, must be approved by the Council of Internal Auditing. Written requests for exceptions should be submitted to the Council for approval.

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These policies may be superseded by the Council of Internal Auditing bulletins or State agency policies as long as they conform to the basic principles of the State Internal Audit Manual and the IIA Standards. An [Office of Internal Audit Staff Directory](#) is available on the Office of Budget and Management's website.

Questions, comments, or suggestions concerning the Internal Audit Guidelines may be sent to [InternalAuditInfo@osbm.nc.gov](mailto:InternalAuditInfo@osbm.nc.gov) or you can call 919-807-4700. Periodically, the Council of Internal Auditing will revise the Internal Audit Manual to reflect policy and procedure changes and to make the Internal Audit Manual more user-friendly.

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**1.0 INTERNAL AUDIT ACT**

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Article 79.  
Internal Auditing.

**§ 143 745. Definitions; intent; applicability.**

(a) For the purposes of this section:

- (1) "Agency head" means the Governor, a Council of State member, a cabinet secretary, the President of The University of North Carolina, the President of the Community College System, the State Controller, and other independent appointed officers with authority over a State agency. The agency head for the Department of Public Instruction shall be the State Board of Education.
- (2) "State agency" means each department created pursuant to Chapter 143A or 143B of the General Statutes, and includes all institutions, boards, commissions, authorities, by whatever name, that is a unit of the executive branch of State government, including The University of North Carolina, Community Colleges System Office. The term does not include a unit of local government.

(b) This Article applies only to a State agency that:

- (1) Has an annual operating budget that exceeds ten million dollars (\$10,000,000);
- (2) Has more than 100 full-time equivalent employees; or
- (3) Receives and processes more than ten million dollars (\$10,000,000) in cash in a fiscal year.

**§ 143 746. Internal auditing required.**

(a) Requirements. – A State agency shall establish a program of internal auditing that:

- (1) Promotes an effective system of internal controls that safeguards public funds and assets and minimizes incidences of fraud, waste, and abuse.
- (2) Determines if programs and business operations are administered in compliance with federal and state laws, regulations, and other requirements.
- (3) Reviews the effectiveness and efficiency of agency and program operations and service delivery.
- (4) Periodically audits the agency's major systems and controls, including:
  - a. Accounting systems and controls.
  - b. Administrative systems and controls.
  - c. Information technology systems and controls.

(b) Internal Audit Standards. – Internal audits shall comply with current [Standards for the Professional Practice of Internal Auditing](#) issued by the Institute for Internal

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Auditors or, if appropriate, [Government Auditing Standards](#) issued by the Comptroller General of the United States.

(c) Any State employee who performs the internal audit function shall Page 2 Session Law 2013-406 SL2013-406 meet the minimum qualifications for internal auditors established by the Office of State Personnel, in consultation with the Council of Internal Auditing.

(d) Director of Internal Auditing. – The agency head shall appoint a Director of Internal Auditing who shall report to, as designated by the agency head (i) the agency head, (ii) the chief deputy or chief administrative assistant, or (iii) the agency governing board, or subcommittee thereof, if such a governing board exists. The Director of Internal Auditing shall be organizationally situated to avoid impairments to independence as defined in the auditing standards referenced in subsection (b) of this section.

(e) If a State agency has insufficient personnel to comply with this section, the Office of State Budget and Management shall provide technical assistance.

**§ 143 747. Council of Internal Auditing.**

(a) The Council of Internal Auditing is created, consisting of the following members:

- (1) The State Controller who shall serve as Chair.
- (2) The State Budget Officer.
- (3) The Secretary of Administration.
- (4) The Attorney General.
- (5) The Secretary of Revenue.
- (6) The State Auditor who shall serve as a nonvoting member. The State Auditor may appoint a designee.

(b) The Council shall be supported by the Office of State Budget and Management.

(c) The Council shall:

- (1) Hold meetings at the call of the Chair or upon written request to the Chair by two members of the Council.
- (2) Keep minutes of all proceedings.
- (3) Promulgate guidelines for the uniformity and quality of State agency internal audit activities.
- (4) Recommend the number of internal audit employees required by each State agency.
- (5) Develop internal audit guides, technical manuals, and suggested best internal audit practices.
- (6) Administer an independent peer review system for each State agency internal audit activity; specify the frequency of such reviews consistent with applicable national standards; and assist agencies with selection of independent peer reviewers from other State agencies.



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- (7) Provide central training sessions, professional development opportunities, and recognition programs for internal auditors.
- (8) Administer a program for sharing internal auditors among State agencies needing temporary assistance and assembly of interagency teams of internal auditors to conduct internal audits beyond the capacity of a single agency.
- (9) Maintain a central database of all annual internal audit plans; topics for review proposed by internal audit plans; internal audit reports issued and individual findings and recommendations from those reports.
- (10) Require reports in writing from any State agency relative to any internal audit matter.
- (11) If determined necessary by a majority vote of the council:
  - a. Conduct hearings relative to any attempts to interfere with, compromise, or intimidate an internal auditor.
  - b. Inquire as to the effectiveness of any internal audit unit.
  - c. Authorize the Chair to issue subpoenas for the appearance of any person or internal audit working papers, report drafts, and any other pertinent document or record regardless of physical form needed for the hearing.
- (12) Issue an annual report including, but not limited to, service efforts and accomplishments of State agency internal auditors and to propose legislation for consideration by the Governor and General Assembly.

**§ 143-748. Confidentiality of internal audit work papers.**

Internal audit work papers are confidential except as otherwise provided in this section or upon subpoena issued by a duly authorized court. A published internal audit report is a public record as defined in G.S. 132-1 to the extent it does not include information which is confidential under State or federal law or would compromise the security of a State agency. An internal auditor shall maintain for 10 years a complete file of all audit reports and reports of other examinations, investigations, surveys, and reviews conducted under the internal auditor's authority. Audit work papers and other evidence and related supportive material directly pertaining to the work of the internal auditor's office shall be retained in accordance with Chapter 132 of the General Statutes. Unless otherwise prohibited by law and to promote intergovernmental cooperation and avoid unnecessary duplication of audit effort, audit work papers related to released audit reports shall be made available for inspection by duly authorized representatives of the State and federal government in connection with some matter officially before them.

**§ 143-749. Obstruction of audit.**

It shall be a Class 2 misdemeanor for any officer, employee, or agent of a State agency subject to the provisions of this Article to willfully make or cause to be made to a State agency internal auditor or the internal auditor's designated representatives any false,

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misleading, or unfounded report for the purpose of interfering with the performance of any audit, special review, or investigation or to hinder or obstruct the State agency internal auditor or the internal auditor's designated representatives in the performance of their duties.

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**2.0 INTERNAL AUDIT PARTICIPATION AND  
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## **2.1 Internal Audit Participation**

### **2.1.1 Participation Requirements**

All State agencies created pursuant to Chapter 143A or 143B of the General Statutes, including all institutions, boards, commissions, authorities, by whatever name, that is a unit of the executive branch of State government, including The University of North Carolina, Community Colleges System Office (from here in will be called State agencies) are required to comply with the Internal Audit Act if:

- a. The annual operating budget exceeds ten million dollars;
- b. Has more than 100 full-time equivalent employees; or
- c. Receives and processes more than ten million dollars in cash in a fiscal year.

All State agencies that meet the above requirements should appoint a Director of Internal Auditing (director). See Section 3.1.1 for appointment of the director.

Reference: [NCGS 143-745](#)

### **2.1.2 Requirements for using Office of Internal Audit Staff**

State agencies meeting the following requirements should use the Office of Internal Audit for internal audit services:

- a. Has an annual operating budget exceeds ten million dollars but is less than seventy million dollars; or
- b. Has less than 100 full-time equivalent employees; or
- c. Receives and processes more than ten million dollars but less than seventy million dollars in cash in a fiscal year; or
- d. Is deemed appropriate by the Council of Internal Auditing.

Reference: [North Carolina Council of Internal Auditing January 30, 2008](#)

### **2.1.3 Requirements for establishing an Internal Audit Program**

State agencies that meet the requirements as stated in this manual at Section 2.1.1 must establish an internal auditing program. See Section 3.1 of this manual for additional requirements of the internal audit organizational structure.

Reference: [NCGS 143-746](#)

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## **2.2 Definition of Internal Auditing**

### **2.2.1 Institute of Internal Auditors Definition**

The [Institute of Internal Auditors](#) defines internal auditing as:

Internal auditing 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.

Reference: [IIA Standard Definition of Internal Auditing](#)

## **2.3 Application of Internal Auditing**

### **2.3.1 Standards**

Internal audits shall comply with current [Standards for the Professional Practice of Internal Audit](#) or, if appropriate, [Government Auditing Standards](#).

Reference: [NCGS 143-746\(b\)](#)

### **2.3.2 Activities**

State agency internal audit programs, at a minimum, should:

- a. Implement an effective system of internal controls that safeguards public funds and assets and minimizes incidences of fraud, waste and abuse.
- b. Ensure programs and business operations are administered in compliance with federal and state laws, regulations and other agency or program requirements.
- c. Review the effectiveness and efficiency of agency and program operations and service delivery.
- d. Periodically audit the agency's major systems and controls to include, but is not limited to,
  - Accounting systems and controls.
  - Administrative controls.
  - Information technology systems and controls.

Reference: [NCGS 143-746\(a\)](#)

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## **3.0 INTERNAL AUDIT ORGANIZATION**

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### **3.1 Organizational Status and Job Qualification**

#### **3.1.1 Organizational Status**

It is important that the director report to a level within the State agency which allows fulfillment of the internal audit program responsibilities. The director will be appointed by the State agency head and report functionally to the State agency head, or their designee or an audit committee (from here in will be called appropriate authority) as described in General Statute 143-746(d) and may report administratively to the State agency head or to those charged with governance or their designee.

The director's reporting line is critical to achieve the independence, objectivity and organizational status for an internal audit program to effectively fulfill its obligations. The scope of potential engagements is greatest when the reporting line is at the highest level. The director should not report to any employee or person directly responsible for activities that are subject to internal audit.

The organizational chart should demonstrate the placement of the internal audit program and/or the director. The organizational chart should be provided to the Council of Internal Auditing within 10 days of establishing the internal audit program or after the chart is modified and the modification affects the placement or reporting line of the internal audit program.

Reference: [NCGS 143-746\(d\)](#) and [IIA Standard 1110, Practice Advisories 1110-1](#)

#### **3.1.2 Job Qualification and Descriptions**

Any internal auditor employed by a State agency shall at a minimum meet the following qualifications as described below. ***Small internal audit programs (one or two persons) must hire at or above the journey level.***

- a) **Contributing:** Bachelor's degree in Accounting or a discipline related to the program area assigned; or an equivalent combination of education and experience.
- b) **Journey:** Bachelor's degree in Accounting or a discipline related to the program area assigned and two years of related experience; or a Bachelor's degree in any field and certification/licensure as a certified public accountant, certified internal auditor, certified fraud examiner, certified information system auditor or related certification or licensure and two years of related experience; or an equivalent combination of education and experience.
- c) **Advanced:** Bachelor's degree in Accounting or a discipline related to the program area assigned and three years of related experience; or a Bachelor's degree in any field and certification/licensure as a certified

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public accountant, certified internal auditor, certified fraud examiner, certified information system auditor or related certification/license and three years of related experience; or an equivalent combination of education and experience.

- d) **Manager:** Bachelor's degree in Accounting or a discipline related to program area assigned and five years of related experience including three years of audit experience; or a Bachelor's degree in any field and certification/licensure as a certified public accountant, certified internal auditor, certified fraud examiner, certified information system auditor or related certification/license and five years of related experience including three years of audit experience; or an equivalent combination of education and experience.
- e) **Director:** Bachelor's degree in Accounting or a discipline related to program area assigned and five years of related experience including three years of supervisory audit experience; or a Bachelor's degree in any field and certification/licensure as a certified public accountant, certified internal auditor, certified fraud examiner, certified information system auditor or related certification/license and five years of related experience including three years of supervisory audit experience; or an equivalent combination of education and experience.

Job descriptions for all positions within the internal audit program must be maintained. It is the responsibility of the director to ensure job descriptions are accurate and up-to-date.

Reference: [NCGS 143-746\(c\)](#)

## **3.2 Internal Audit Charter**

### **3.2.1 Establishing an Internal Audit Charter**

The purpose, authority, and responsibility of the internal audit program should be formally defined in a charter, consistent with the IIA's [Standards for the Professional Practice of Internal Auditing](#). The nature of assurances and consulting services should be defined in the Charter.

Reference: [IIA Standard 1000, 1000.A1, 1000.C1, and Practice Advisory 1000-1](#) and [IIA Standard 1010](#)

### **3.2.2 Review and Approval of Internal Audit Charter**

The written internal audit charter should be discussed and approved by the appropriate authorities. The approval of the charter should be documented to provide a formal agreement about the role and responsibilities of the internal audit program within a State agency. The approved internal audit charter documents the creation of the internal audit function.



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The director should periodically assess whether the purpose, authority, and responsibility, as defined in the charter, continue to be adequate to enable the internal audit program to accomplish its objectives. The result of this periodic assessment should be documented. Any modifications to the internal audit charter should be communicated to the appropriate authorities.

This document should be provided to the Council of Internal Auditing within 10 working days after a charter has been established and approved. Whenever the audit charter is modified, the modified audit charter should be submitted to the Council of Internal Auditing within 10 working days.

Reference: [IIA Standard 1000, 1000.A1, 1000.C1, and Practice Advisory 1000-1](#) and [IIA Standard 1010](#)

### **3.3 Code of Ethics**

#### **3.3.1 Code of Ethics**

All internal auditors will abide by the [Code of Ethics](#) established by the Institute of Internal Auditors.

Reference: [IIA Code of Ethics](#)

### **3.4 Independence and Objectivity**

#### **3.4.1 Independence**

Independence is essential to the effectiveness of the internal audit program. This independence is based primarily upon organizational status. Guidelines for organizational status are in Section 3.1 of this manual.

Internal auditors are independent when they can carry out the functions freely and objectively. To be effective in performing internal audits the audit staff must be independent and objective both in fact and appearance.

If the State agency has a governing board the Internal Audit Director must communicate and interact directly with the board. Direct communication can occur during the board meetings and/or private meetings with board members.

Reference: [IIA Standard 1100, IIA Standard 1110, 1110.A1 and Practice Advisory 1110-1](#), and [IIA Standard 1111 and Practice Advisory 1111-1](#)

#### **3.4.2 Objectivity**

Internal auditors should have an impartial, unbiased attitude and avoid conflicts of interest. Internal auditors should not be placed in situations in which they feel unable to make objective professional judgments.

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Reference: [IIA Standard 1120 and Practice Advisory 1120-1](#)

### **3.4.3 Impairments**

When independence and objectivity is impaired in fact or appearance, the details of the impairment should be disclosed to the appropriate parties. Some instance of impairments to independence and objectivity include, but are not limited to, situation where:

- a. A conflict of interest or bias is present.
- b. A member of the auditor's immediate or close family member exists.
- c. An operating authority or responsibility is assumed.
- d. An operating authority or responsibility was assumed within the last year.
- e. A direct or significant/material indirect financial interest exists.

To minimize auditor impairment, internal audit programs should establish policies and procedures to identify report and resolve impairments to independence and objectivity. The policy and procedure should address conflict of interest issues including acceptance of gifts and entertainment.

Auditors should refrain from conducting assurance engagements if there is independence or objectivity impairments. An auditor can conduct consulting services however; all potential impairments must be disclosed to the State agency's management prior to accepting the engagement.

State agencies may request services from the Council's Office of Internal Audit to mitigate any impairments or conflicts to independence or objectivity.

Reference: [IIA Standard 1130, 1130.A1, 1130.A2, 1130.C1, and 1130.C2 Practice Advisory 1130-1, 1130.A1-1, 1130.A1-2](#)

### **3.4.4 Interference**

The internal audit program must be free from interference in determining the scope of audit work, performing work, and communicating results. Internal Audit Director must report any alleged interference to the Council of Internal Auditing immediately. This includes, but is not limited to State agency's officer, employee, or agent: hindering the identification of the audit universe or the development of a risk based audit plan, overrule or modify audit reports, limiting access to records and/or employees, and willfully make false, misleading, or unfounded statements for the purpose of interfering with the performance of any audit.

Reference: [IIA Standard 1110.A1](#) and [NCGS 143-749](#)

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**4.0 AUDIT PROCESS**

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## **4.1 Managing Internal Audit Programs**

### **4.1.1 Managing**

The director is responsible for properly managing the internal audit program so that audit work:

- a. Fulfills the purpose, authority, and responsibility described in the Charter.
- b. Uses resources efficiently and effectively.
- c. Complies with the North Carolina [Internal Audit Act](#) and [Standards for the Professional Practice of Internal Auditing](#) or, if appropriate, [Government Auditing Standards](#).

Reference: [IIA Standard 2000](#)

### **4.1.2 Planning**

The director should establish a risk-based audit plan to determine the priorities of the internal audit program. The audit plan should:

- a. Be consistent with the internal audit program's Charter.
- b. Be based on a risk assessment.
- c. Consider available resources.

Consulting service engagements should be considered if the engagement may potentially improve management of risks, add value, and/or improve the organization operations. Accepted engagements must be included in the plan.

The audit plan and resource requirements should be provided to the appropriate authorities for review and approval.

Reference: [IIA Standard 2010, 2010.A1, 2010.C1 Practice Advisory 2010-1](#) and [IIA Standard 2020 and Practice Advisory 2020-1](#)

### **4.1.3 Resource Management**

It is the responsibility of the director to ensure that internal audit resources are appropriate, sufficient, and effectively deployed. Resource limitations that impact the plan should be reported to the appropriate authority within the State agency.

Reference: [IIA Standard 2030 and Practice Advisory 2030-1](#)

### **4.1.4 Policies and Procedures**

The director is responsible for establishment of internal audit policies and procedures to guide the internal audit program activities. Policies and procedures should, at a minimum, comply with this manual, IIA Standards, and other laws, rules and regulations.

Reference: [IIA Standard 2040 and Practice Advisory 2040-1](#)

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#### **4.1.5 Coordination**

The director should share appropriate information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts. Internal audit programs should not duplicate the work of external auditors but instead should rely on the work of the external auditor. When relying on the work of others, internal auditors should take sufficient steps to satisfy acceptability of the third party's work.

Reference: [IIA Standard 2050, Practice Advisory 2050-1](#)

#### **4.1.6 Reporting Requirements**

The director should report periodically to the appropriate authority on the internal audit activities and performance relative to its audit plan. Any deviations from the approved audit plan and the reasons for the deviations should be reported.

Each State agency is required to submit the approved audit plan to the Council of Internal Auditing. The audit plan will be submitted electronically to [internalauditinfo@osbm.nc.gov](mailto:internalauditinfo@osbm.nc.gov) no later than September 30 of each year.

Each Director is required to collaborate with Council staff during the development of the annual internal audit service efforts and accomplishments report.

Reference: [NCGS 143-747\(c\)\(9\)](#) and [NCGS 143-747\(c\)\(10\)](#) and [IIA Standard 2060 and Practice Advisory 2060-1](#)

## **4.2. Nature of Work**

### **4.2.1 Risk Management**

The internal audit program should assist the State agency by identifying and evaluating significant exposures to risk and contribute to the improvement of risk management and control systems. The internal audit program should monitor and evaluate the effectiveness of the State agency's risk management system.

The internal audit program should evaluate risk exposures relating to the State agency's governance, operations, and information systems regarding the:

- a. Reliability and integrity of financial and operational information.
- b. Effectiveness and efficiency of operations.
- c. Safeguarding of assets.
- d. Compliance with laws, regulations, and contracts.

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During consulting engagements, internal auditors should address risk consistent with the engagement's objectives and be alert to the existence of other significant risks. Internal auditors should incorporate knowledge of risks gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the State agency.

Reference: [IIA Standard 2100](#) and [IIA Standard 2120, 2120.A1, 2120.A2, 2120.C1, 2120.C2 and 2120.C3, Practice Advisory 2120-1](#)

#### **4.2.2 Control**

The internal audit program should assist the State agency in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement. Based on the results of the risk assessment, the internal audit program should evaluate the adequacy and effectiveness of controls encompassing the State agency's governance, operations, and information systems. This should include:

- a. Reliability and integrity of financial and operational information.
- b. Effectiveness and efficiency of operations.
- c. Safeguarding of assets.
- d. Compliance with laws, regulations, and contracts.

Internal auditors should ascertain the extent to which operating and program goals and objectives have been established and conform to those of the State agency.

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.

Adequate criteria are needed to evaluate controls. Internal auditors should ascertain the extent to which management has established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, internal auditors should use such criteria in their evaluation. If inadequate, internal auditors should work with management to develop appropriate evaluation criteria.

During consulting engagements, internal auditors should address controls consistent with the engagement's objectives and be alert to the existence of any significant control weaknesses. Internal auditors should incorporate knowledge of controls gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the State agency.

Reference: [IIA Standard 2100](#) and [IIA Standard 2130, 2130.A1 - 2130.C2, Practice Advisory 2130-1, 2130.A1-1, 2130.A1-2,](#)

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### **4.2.3 Governance**

The internal audit program should assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

- a. Promoting appropriate ethics and values within the State agency.
- b. Ensuring effective organizational performance management and accountability.
- c. Effectively communicating risk and control information to appropriate areas of the State agency.
- d. Effectively coordinating the activities of and communicating information among the appropriate authority, external and internal auditors and management.

The internal audit program should evaluate the design, implementation, and effectiveness of the State agency's ethics-related objectives, programs and activities.

The internal audit program should assess whether the information technology governance sustains and supports the State agency's strategies and objectives.

Consulting engagement objectives must be consistent with the overall values and goals of the organization.

Reference: [IIA Standard 2100](#) and [IIA Standard 2110, 2110.A1, 2110.A2 and 2110.C1](#)

## **4.3 Engagement Planning**

### **4.3.1 Engagement Planning Consideration**

Internal auditors should develop a written plan for each engagement, including the scope, objectives, timing and resource allocations.

In planning the engagement, internal auditors should consider:

- a. The objectives of the activity being reviewed and the means by which the activity controls its performance.
- b. The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level.
- c. The adequacy and effectiveness of the activity's risk management and control systems compared to a relevant control framework or model.
- d. The opportunities for making significant improvements to the activity's risk management and control systems.

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Internal auditors must establish an understanding with management about the objectives, scope, respective responsibilities and other management expectations when engaging in consulting activities. When consulting engagements are significant, this understanding should be documented.

Reference: [IIA Standard 2200 and Practice Advisory 2200-1](#) and [IIA Standard 2201, 2201.A1 and 2201.C1](#)

#### **4.3.2 Engagement Objectives**

Objectives should be established for each engagement. These objectives should reflect the results of a preliminary assessment of the risks relevant to the activity under review. The internal auditor should consider the probability of significant errors, irregularities, noncompliance, and other exposures when developing the engagement objectives.

Adequate criteria are needed to evaluate controls. If management has not established adequate criteria, the internal auditor must work with management to develop appropriate evaluation criteria.

For consulting service engagements, objectives must address governance, risk management and controls processes to the extent agreed upon with management.

Reference: [IIA Standard 2200 and Practice Advisory 2200-1](#) and [IIA Standard 2210, 2210.A1, 2210.A2, 2201.A3, 2210.C1, Practice Advisory 2210-1 and 2210.A1-1](#)

#### **4.3.3 Engagement Scope**

The scope of the engagement should include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties. The engagement scope should be sufficient to satisfy the engagement objectives.

If significant consulting opportunities arise during an assurance engagement, the objectives, scope and responsibilities and other expectations must be formally documented and the results communicated in accordance with these policies and IIA standards.

Reference: [IIA Standard 2200 and Practice Advisory 2200-1](#) and [IIA Standard 2220, 2220.A1, 2220.A2, and 2220.C1](#)

#### **4.3.4 Engagement Resource Allocation**

Appropriate resources should be determined to achieve engagement objectives. Staffing should be based on an evaluation of the nature and complexity of each engagement, time constraints and available resources.

Reference: [IIA Standard 2200 and Practice Advisory 2200-1](#) and [IIA Standard 2230 and Practice Advisory 2230-1](#)



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#### **4.3.5 Engagement Work Program**

For each engagement, written work programs should be developed to achieve the engagement objectives. Work programs establish the procedures for identifying, analyzing, and recording information during the engagement. The work program should be approved by the director, in writing, prior to initiating work and any changes to the work programs should be approved by the director in a timely manner.

Reference: [IIA Standard 2200 and Practice Advisory 2200-1](#) and [IIA Standard 2240, 2240.A1, 2240.C1, Practice Advisory 2240-1 and 2240.A1-1](#)

### **4.4 Fieldwork**

#### **4.4.1 Data Gathering and Analysis**

Information should be sufficient, reliable, relevant and useful to achieve the engagement objectives and provide a sound basis for engagement observations and recommendations. Conclusions and engagement results should be based on appropriate analyses and evaluations.

The sufficiency and appropriateness of information and analyses will vary depending on the engagement objectives.

Reference: and [IIA Standard 2310 and Practice Advisory 2310-1](#) and IIA Standard 2320 and Practice Advisory 2320-1

#### **4.4.2 Working Papers Documentation, Access and Retention**

Relevant information should be documented in the working papers to support the conclusions and engagement results or discontinuance an engagement. Working papers and internal audit reports must be retained (see [Section 4.4.2c](#)). The director should develop policies governing the custody, access and retention of working papers, reports and other related documents for engagements.

a. Documentation

The organization, design and content of working papers may vary depending on the engagement. Working papers may be in the form of paper, tapes, disks, films or other media.

To reduce paper consumption, it is acceptable to provide adequate documentation so an experienced auditor can re-perform the work and arrive at the same conclusion.

Work papers generally:

- i. Aid in the planning performance and review of the engagement.
- ii. Provide the principal support for results.

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- iii. Document whether engagement objectives were achieved.
- iv. Support the accuracy and completeness of the work performed.
- v. Provide a basis for the internal audit activity's quality assurance and improvement program.
- vi. Facilitate third-party reviews.

**b. Access and Custody**

The director should control access to the audit reports, working papers and related documents. Any laws, rules, regulations, policies, or procedures (e.g. HIPPA, Personnel rules, etc...) concerning the confidentiality of sensitive data should be considered when providing third party access to reports. If a State agency has any questions about whether information within internal audit reports are public records or not, the State agency should consult its legal counsel.

Work papers are confidential per G.S.143-748 and are not part of the public records law except as otherwise provided in this section or upon subpoena issued by a duly authorized court. Unless otherwise prohibited by law and to promote intergovernmental cooperation and avoid unnecessary duplication of audit effort, audit work papers related to released audit reports shall be made available for inspection by duly authorized representatives of the State and federal government.

**c. Records Retention**

Record retention requirements cover internal audit reports, other reports, working papers and any other documents that support any reports observations, conclusions, findings or results. Record retention requirements should be consistent with any pertinent regulatory or other requirements and at minimum records should be maintained for a minimum of ten years.

Reference: [Technical Bulletins and Best Practice TB08-01-02 and TB08-01-03](#) and [IIA Standard 2330, 2330.A1, 2330.A2, 2330.C1, Practice Advisory 2330-1, 2330.A1-1, and 2330.A2-1](#)

### **4.4.3 Supervision**

Engagements should be properly supervised to ensure objectives are achieved, quality is assured and staff is developed. Supervision begins with planning and continues through the engagement including follow-up. The extent of supervision will depend on the proficiency and experience of the internal auditors and the complexity of the engagement.

All working papers should be reviewed to ensure the work adequately supports the reports observations, findings, conclusions and results. Supervision can extend to staff training and development, employee performance evaluation, time and expense control

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and other administrative areas. Appropriate evidence of supervision should be documented.

Reference: [IIA Standard 2340 and Practice Advisory 2340-1](#)

## **4.5 Communicating Results**

### **4.5.1 Criteria for Communicating Results**

All internal audit results should be communicated in a formal manner to the appropriate authority and management once the engagement is completed. The communication, at a minimum, should include the internal audit objectives and scope, as well as applicable conclusions, observations, opinions, and recommendations. Internal auditors are encouraged to acknowledge satisfactory performance identified during the engagement.

The communication may be a report in paper or electronic format. The final report should be signed by the director or designee and include management action plans.

Reference: [IIA Standard 2400](#) and [IIA Standard 2410, 2410.A1 2410.A2, 2410.A3, 2410.C1, and Practice Advisory 2410-1](#)

### **4.5.2 Quality of Communications**

Communications should be accurate, objective, clear, concise, constructive, complete, and timely. If a final communication contains a significant error or omission, the director should communicate corrected information to all parties who received the original communication.

Reference: [IIA Standard 2420 and Practice Advisory 2420-1](#) and [IIA Standard 2421](#)

### **4.5.2 Use of Conducted in Conformance with Standards**

Report can use the statement “conducted in conformance with *International Standards for the Professional Practice of Internal Auditing*” only if the results of the quality assurance and improvement program support the statement.

Reference: [IIA Standard 2430](#)

### **4.5.3 Engagement Disclosure of Noncompliance with the Standard**

When noncompliance with the Statewide Internal Audit Manual and/or IIA Standards impacts a specific engagement, communication of the results should disclose the:

- a. Standard(s) or Guideline(s) with which full compliance was not achieved.
- b. Reason(s) for noncompliance.
- c. Impact of noncompliance on the engagement.

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Reference: [IIA Standard 2431](#)

#### **4.5.4 Disseminating Results**

The director is responsible for communicating the final results of assurances and consulting service engagements to the appropriate authority and other individuals who can ensure that the results are given due consideration.

The director must submit, electronically to [internalauditinfo@osbm.nc.gov](mailto:internalauditinfo@osbm.nc.gov), a copy of all final communications of engagements (reports and letters) to the Council of Internal Auditing within 10 working\_days of completion. It is the responsibility of the Internal Audit Director to redact all confidential and protected information prior to submitting final engagement communications to the Council of Internal Auditing.

Reference: [NCGS 143-747\(c\)\(9\) and NCGS 143-747\(c\)\(10\)](#), [Technical Bulletins and Best Practice TB08-05-01](#) and [IIA Standard 2440, 2440.A1, 2440.A2, 2440.C1, 2440.C2, Practice Advisory 2440-1](#)

#### **4.5.5 Monitoring Progress**

The director should establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that management has accepted the risk of not taking action.

When the director believes that senior management has accepted a level of residual risk that may be unacceptable to the State agency, the director should discuss the matter with management. If the matter is not resolved, the director should report the matter to the appropriate authority or to those charged with governance.

Reference: [IIA Standard 2500, 2500.A1, 2500.C1, Practice Advisory 2500-1 and 2500.A1-1](#) and [IIA Standard 2600](#)

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**5.0 PROFESSIONAL PROFICIENCY**

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## **5.1 Proficiency**

### **5.1.1 Professional Proficiency**

Engagement should be conducted with proficiency to ensure engagement objectives are accomplished. Internal auditors should possess the knowledge, skills and other competencies needed to perform their individual responsibilities. An internal audit program should collectively possess or obtain the knowledge, skills and other competencies needed to perform its responsibilities.

The director is responsible to ensure that the staff assigned to an engagement collectively possesses the necessary knowledge, skills and other competencies to conduct the engagement properly.

Reference: [IIA Standard 1200 and Practice Advisory 1200-1](#) and [IIA Standard 1210, 1210.A1, 1210.C1, Practice Advisory 1210-1 and 1210.A1-1](#)

### **5.1.2 Fraud**

Internal auditors should have sufficient knowledge to evaluate the risk of fraud and how it is managed by the State agency but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.

Reference: [IIA Standard 1210.A2 and Practice Advisory 1210-1](#)

### **5.1.3 Information Technology**

Internal auditors should have knowledge of key information technology risk and controls but are not expected to have the expertise of a person whose primary responsibility is information technology auditing.

Reference: [IIA Standard 1210.A3, Practice Advisory 1210-1](#)

## **5.2 Due Professional Care**

### **5.2.1 Due Professional Care**

Internal auditors should apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility.

The internal auditor should exercise due professional care by considering the:

- a. Extent, nature and timing of work needed to achieve the engagement's objectives.
- b. Relative complexity, materiality, or significance of matters to which assurance procedures are applied.

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- c. Adequacy and effectiveness of risk management, control, and governance processes.
- d. Probability of significant errors, irregularities, or noncompliance.
- e. Cost of assurance in relation to potential benefits.

The internal auditor should be alert to the significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

Reference: [IIA Standard 1220, 1220.A1 and Practice Advisory 1220-1](#)

### **5.2.2 Computer-Assisted Audit Tools**

In exercising due professional care the internal auditor should consider the use of computer-assisted audit tools and other data analysis techniques.

Reference: [IIA Standard 1220.A2](#)

### **5.2.3 Consulting Services**

Internal auditors must exercise due professional care during a consulting engagement by considering the:

- a. Needs and expectations of clients, including the nature, timing, and communication of engagement results;
- b. Relative complexity and extent of work needed to achieve the engagement's objectives; and
- c. Cost of the consulting engagement in relation to potential benefits.

Reference: [IIA Standard 1220.C1](#)

## **5.3 Continuing Professional Development**

### **5.3.1 Continuing Professional Development**

Internal auditors should enhance their knowledge, skills, and other competencies through continuing professional development. The internal auditor is responsible for continuing their education to maintain their proficiency. The director is responsible for ensuring that the internal audit program's staff collectively maintains knowledge, skills and other competencies needed to allow the internal audit program to fulfill its responsibilities.

Reference: [IIA Standard 1230 and Practice Advisory 1230-1](#)

### **5.3.2 Types of Continuing Professional Development**

Continuing professional development programs are structured education activities with learning objectives designed to maintain or enhance participants' knowledge, skills and other competencies. Education activities included, but are not limited to:

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- a. Membership and participation in professional societies.
- b. Attendance at conferences and seminars.
- c. Completion of college and self study courses.
- d. Participation with in-house training programs.
- e. Participation in research projects.

Reference: [IIA Standard 1230 and Practice Advisory 1230-1](#)



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**6.0 QUALITY ASSURANCE**

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## **6.1 Quality Assurance Programs**

### **6.1.1 Programs**

The director should develop and maintain a quality assurance program that covers all aspects of the internal audit program and continuously monitors its effectiveness. This program includes periodic internal assessments, ongoing internal monitoring and external assessments.

Each State agency may participate in the external quality assurance program that will be administered by the Council of Internal Auditing. See [Section 6.1.3](#) for more details on the external quality assurance program.

Reference: [IIA Standard 1300 and Practice Advisory 1300-1](#) and [IIA Standards 1310 and Practice Advisory 1310-1](#)

### **6.1.2 Internal Assessment**

Internal assessments should include:

- a. Ongoing reviews of the performance of the internal audit program.
- b. Periodic reviews performed through self-assessment or by other persons within the State agency, with knowledge of internal auditing practices and the IIA Standards.

Reference: [IIA Standard 1311 and Practice Advisory 1311-1](#)

### **6.1.3 External Assessment**

The Council of Internal Auditing's Program Administrator will administer an independent peer review system (external quality assurance program) for State agencies with an internal audit program. External quality reviews will be conducted, at a minimum, every five years. For newly established internal audit programs, the five year period begins when the Internal Audit Charter has been established. See Section [3.2 Internal Audit Charter](#) for information related to Audit Charters.

For further details surrounding the Peer Review program administered by the Council, See the Peer Review Manual located on the [Council of Internal Auditing](#) website.

Reference: [NCGS 143-747\(c\)\(6\)](#) and [IIA Standard 1312, Practice Advisory 1312-1 and 1312-2](#)

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## **6.2 Quality Assurance Report Requirements**

### **6.2.1 Reporting on the External Reviews**

The program administrator should communicate the results of the internal assessments and external quality reviews, necessary action plans and successful implementation to the appropriate authority.

Reference: [IIA Standard 1320](#)

### **6.2.2 Use of “Conforms with the International Standards for Professional Practices of Internal Auditing”**

An internal audit program can only use the phrase “conforms with the International Standards for Professional Practices of Internal Auditing” if the results of the quality assurance and improvement program support this statement.

Reference: [IIA Standard 1321 and Practice Advisory 1321-1](#)

### **6.2.3 Disclosure of Noncompliance**

There may be instances when full compliance with these guidelines or IIA Standards is not achieved. When noncompliance impacts the overall scope or operation of the internal audit program, disclosure should be made to the appropriate authority.

Reference: [IIA Standard 1322](#)

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## **7.0 GLOSSARY**

### **Add Value**

Value is provided by improving opportunities to achieve organizational objectives, identifying operational improvement, and/or reducing risk exposure through both assurance and consulting services.

### **Adequate Control**

Present if management has planned and organized (designed) in a manner that provides reasonable assurance that the State agency's risks have been managed effectively and that the State agency's goals and objectives will be achieved efficiently and economically.

### **Agency Head**

The Governor, a Council of State member, a cabinet secretary, the Chief Justice of the Supreme Court, The President of the University of North Carolina, and the Superintendent of Public Instruction.

### **Appropriate Authority**

The agency head.

### **Board**

A board is an organization's governing body, such as a board of directors, supervisory board, head of an agency or legislative body, board of governors or trustees, or any other designated body of the State agency, including the audit committee to whom the Director may functionally report.

### **Charter**

The charter of the internal audit program is a formal written document that defines the activity's purpose, authority, and responsibility. The charter should (a) establish the internal audit program's position within the State agency; (b) authorize access to records, personnel, and physical properties relevant to the performance of engagements; and (c) define the scope of internal audit program.

### **Code of Ethics**

The Code of Ethics are Principles relevant to the profession and practice of internal auditing, and Rules of Conduct that describe behavior expected of internal auditors. The Code of Ethics applies to both parties and entities that provide internal audit services. The purpose of the Code of Ethics is to promote an ethical culture in internal auditing.

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**Compliance**

Conformity and adherence to policies, plans, procedures, laws, regulations, contracts, or other requirements.

**Conflict of Interest**

Any relationship that is, or appears to be, not in the best interest of the State agency. A conflict of interest would prejudice an individual's ability to perform his or her duties and responsibilities objectively.

**Control**

Any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organizes, and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved.

**Control Environment**

The attitude and actions of the board and management regarding the significance of control within the State agency. The control environment provides the discipline and structure for the achievement of the primary objectives of the system of internal control. The control environment includes the following elements:

- a. Integrity and ethical values.
- b. Management's philosophy and operating style.
- c. Organizational structure.
- d. Assignment of authority and responsibility.
- e. Human resource policies and practices.
- f. Competence of personnel.

**Control Processes**

The policies, procedures, and activities that are part of a control framework, designed to ensure that risks are contained within the risk tolerances established by the risk management process.

**Consulting Services**

Advisory and related client service activities, the nature and scope of which are agreed with the client and which are intended to add value and improve an State agency's governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation and training.

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**Director**

Top position within the State agency responsible for internal audit activities and is the director of internal auditing. The term may also include such titles as chief executive auditor, chief internal auditor, and internal audit director.

**Engagement**

A specific internal audit assignment, task, or review activity, such as an internal audit, Control Self-Assessment review, fraud examination, or consultancy. An engagement may include multiple tasks or activities designed to accomplish a specific set of related objectives.

**Engagement Objectives**

Broad statements developed by internal auditors that define intended engagement accomplishments.

**Fraud**

Any illegal acts characterized by deceit, concealment or violation of trust. These acts are not dependent upon the application of threat of violence or of physical force. Frauds are perpetrated by parties and organizations to obtain money, property or services; to avoid payment or loss of services; or to secure personal or business advantage.

**Governance**

The combination of processes and structures implemented by the agency head or board in order to inform, direct, manage and monitor the activities of the State agency toward the achievement of its objectives.

**Impairments**

Impairments to individual objectivity and organizational independence may include personal conflicts of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations (funding).

**Independence**

The freedom from conditions that threaten objectivity or the appearance of objectivity. Such threats to objectivity must be managed at the individual auditor, engagement, functional and organizational levels.

**Internal Audit Program**

A department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve a State agency's operations. The internal audit program helps a State agency accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

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**International Professional Practices Framework**

The conceptual framework that organizes the authoritative guidance promulgated by The Institute of Internal Auditors. Authoritative Guidance is comprised of two categories – (1) mandatory and (2) Strongly recommended.

**Objectivity**

An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made. Objectivity requires internal auditors not to subordinate their judgment on audit matters to that of others.

**Residual Risk**

The risk remaining after management takes action to reduce the impact and likelihood of an adverse event, including control activities in responding to risk.

**Risk**

The possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood.

**Risk Management**

A process to identify, assess, manage, and control potential events or situations, to provide reasonable assurance regarding the achievement of the State agency's objectives.

**Should**

The use of the word "should" in the guidelines represents a mandatory obligation.

**Significance**

The relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors, such as magnitude, nature, effect, relevance, and impact. Professional judgment assists internal auditors when evaluating the significance of matters within the context of the relevant objectives.

**Standard**

A professional pronouncement promulgated by the Internal Auditing Standards Board that delineates the requirements for performing a broad range of internal audit activities, and for evaluating internal audit performance.

**State Agency**

Each department created pursuant to Chapter [143A](#) or [143B](#) of the General Statutes, the Judicial Branch, the University of North Carolina, and the Department of Public Instruction.

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**Work Program**

A document that lists the procedures to be followed during an engagement, designed to achieve the engagement plan.



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## 8.0 INTERNAL AUDIT MANUAL REVISIONS

Date of Revision	Topic	Section	Reference
April 8, 2009	January 2009 IIA Standard Revisions	3.2 <a href="#">Internal Audit Charter</a> 3.4.1 <a href="#">Independence</a> 3.4.3 <a href="#">Impairment</a> 4.1.2 <a href="#">Planning CS</a> 4.1.6 <a href="#">Reporting Requirements</a> 4.2.3 <a href="#">Governance</a> 4.3.1 <a href="#">Planning Consideration</a> 4.3.2 <a href="#">Objectives</a> 4.3.3 <a href="#">Engagement Scope</a> 4.5.2 <a href="#">Use of Conforms with Stds</a> 4.5.4 <a href="#">Disseminating Results</a> 5.1.2 <a href="#">Fraud</a> 5.2.3 <a href="#">Due Care Consulting Services</a> 6.2.2 <a href="#">Statement Conforms with Stds</a> 7.0 <a href="#">Boards</a> <a href="#">IPPF</a> <a href="#">Residual Risk</a> <a href="#">Significance</a>	
July 13, 2009	Defining when an internal audit function is established for QAR purposes	3.2.2 <a href="#">Internal Audit Charter</a> 6.1.3 <a href="#">Quality Assurance Programs</a> 4.1.6 <a href="#">Reporting Requirements</a>	Council of Internal Auditing July 8, 2009 Meeting
April 3, 2012	Amendment to Act	<a href="#">143-475 Definitions</a>	S.L.2009-516
October 9, 2013	Amendment to Act	143 745 <a href="#">Definitions; intent; applicability</a> 143 746. <a href="#">Internal auditing required</a> 143 747 <a href="#">Council of Internal Auditing</a> 143-748 <a href="#">Confidentiality of internal audit work papers</a> 143-749 <a href="#">Obstruction of audit</a> 3.4.4 <a href="#">Independence and Objectivity</a> 4.4.2 <a href="#">Fieldwork</a>	S.L.2013-406
January 8, 2014	New hire requirement for small internal audit shops.	3.1. <a href="#">Organizational Status and Job Qualification</a>	Council of Internal Auditing January 8, 2014 Meeting

**STATE OF NORTH CAROLINA  
INTERNAL AUDIT MANUAL  
COUNCIL OF INTERNAL AUDITING  
OFFICE OF INTERNAL AUDIT**

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