

NC COUNCIL'S PEER REVIEW PROGRAM

**EXTERNAL QUALITY
ASSESSMENT**

FOR THE

**NC DEPARTMENT OF AGRICULTURE &
CONSUMER SERVICES**

December 22, 2022

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December 22, 2022

Steve Troxler, Commissioner
David Smith, Chief Deputy Commissioner
Derek Allred, Chief Audit Officer
North Carolina Department of Agriculture and Consumer Services

Greetings,

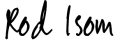
We have completed the External Quality Assessment (Assessment) of the North Carolina Department of Agriculture and Consumer Services (DACS) Internal Audit function as required every five years by the Institute of Internal Auditors *International Standards for the Professional Practice of Internal Auditing* (“*Standards*”). The objectives of the Assessment were to:

1. Assess conformance with the mandatory requirements of the Standards and Code of Ethics;
2. Assess Internal Audit’s effectiveness in carrying out its mission; and
3. Identify opportunities for improving the Internal Audit function at the Agency.

Overall, it is our opinion that the DACS Internal Audit Function “**Generally Conforms**” to the Standards. Within this report, we have noted opportunities for improvement that will enhance Internal Audit’s conformance to the Standards and improve its overall effectiveness in carrying out its mission.

We appreciate the courtesy and cooperation extended to the assessment team by agency personnel. We will be pleased to respond to further questions concerning this report and to furnish any desired information.

Rod Isom, CICA
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Winston-Salem State University/University of North Carolina School of the Arts

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EXECUTIVE SUMMARY

The *International Standards for the Professional Practice of Internal Auditing (Standards)* requires that an external quality assessment of an internal audit activity must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization. The qualified assessor or assessment team must demonstrate competence in both the professional practice of internal auditing and the quality assessment process. The quality assessment can be accomplished through a full external assessment or a self-assessment with independent validation.

The chief audit executive (CAE) discussed the form and frequency of the quality assessment, as well as the independence and qualifications of the external assessor or assessment team, including any potential conflicts of interest with the appropriate oversight. The North Carolina Department of Agriculture and Consumer Services (DACs) was assigned Rod Isom, CICA and Robert Olman, CFE as the qualified assessment team to conduct a full external assessment of the internal audit function of DACs.

The Agency's Internal Audit function currently consists of the CAE and two full-time employees. The CAE reports functionally and administratively to the Chief Deputy Commissioner of Administration.

Opinion as to Conformance with the Standards

It is our overall opinion that DACs's Internal Audit function **Generally Conforms** to the *Standards*. Please see Attachment A.

The IIA's *Quality Assessment Manual for the Internal Audit Activity* suggests a scale of three rankings when opining on the internal audit function: "Generally Conforms," "Partially Conforms," and "Does Not Conform." The ranking of "Generally Conforms" means that an IA has a charter, policies, and processes that are judged to be in conformance with the *Standards* and the Code of Ethics. "Partially Conforms" means that deficiencies in practice are noted and are judged to deviate from the *Standards* and the Code of Ethics; however, these deficiencies did not preclude the IA from performing its responsibilities in an acceptable manner. "Does Not Conform" means that deficiencies in practice are judged to deviate from the *Standards* and the Code of Ethics and are significant enough to seriously impair or preclude the IA from performing adequately in all or in significant areas of its responsibilities. A detailed description of conformance criteria can be found in Attachment A.

Objectives

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

- Assess IA's conformance with the *Standards* and the Code of Ethics.

- Evaluate IA's effectiveness in carrying out its mission (as set forth in the internal audit charter and expressed in the expectations of management);
- Identified successful internal audit practices demonstrated by IA; and
- Identified opportunities for continuous improvement to enhance the efficiency and effectiveness of the infrastructure, processes, and the value to their stakeholders.

Scope and Methodology

As part of the preparation for the QA, the CAE prepared documents with detailed information and sent surveys to a representative sample of the DACS' key stakeholders. A summary of the survey results (without identifying the individual survey respondents) has been furnished to the CAE. Prior to commencement of the onsite work by the peer review team, the team lead worked with the CAE to gather additional background information related to the IA governance, staff management and process. During the onsite fieldwork, extensive interviews were conducted with stakeholders and IA staff. We also reviewed IA's risk assessment and audit planning processes, audit tools and methodologies, engagements and staff management processes, and a representative sample of IA's working papers and reports.

Summary of Observations

The IA environment where the external assessment was performed is well structured and progressive, where the *Standards* are understood, the Code of Ethics is being applied, and management endeavors to provide useful audit tools and implement appropriate practices. Consequently, comments and recommendations are intended to build on this foundation already in place in the IA.

Observations are divided into three categories:

- **Successful Internal Audit Practices** – Areas where IA is operating in a particularly effective or efficient manner when compared to the practice of internal auditing demonstrated in other internal audit functions. Successful internal audit practices identified during this QA are summarized and detailed in the following section(s) of this report:

- Trusted Advisor – The IA function is viewed as a supportive trusted advisor to the organization and not as a reactionary or punitive function. Administrators clearly recognize the importance of the IA function and see the unit as a valued resource;
- Risk Assessment & Audit Planning - The IA function has developed a robust risk assessment process for the development of the risk-based audit plan that is well documented;
- Internal Audit Strategic Plan – The IA function developed a five-year strategic plan to establish goals that further enhances IA services to the organization;
- Continuing Professional Development - Coaching and feedback is conducted throughout the engagement. All staff noted a strong encouragement by the CAE to obtain professional certifications;
- Use of Audit Software for Planning Considerations, Documenting Information, & Engagement Supervision - AutoAudit has contributed to engagement efficiency and effectiveness, allowing for improvement across several processes; and
- Establish an Understanding with Engagement Clients - Client is given multiple opportunities to provide feedback and gain an understanding through the entrance

conference, survey of the customer, and interviews.

• **Gaps to Conformance with the *Standards* or the Code of Ethics** – Areas identified during the QA where the assessment team has concluded that IA is operating in a manner that falls short of achieving one or more major objectives, with the *Standards* or the Code of Ethics that results in an opinion for an individual standard of “partially conforms” or “does not conform.” These items will include recommendations offered by the external assessment team for actions to be implemented for achieving “generally in conformance” with the standard and will include an IA response and an action plan to address the gap. Gaps to conformance with the *Standards* or Code of Ethics identified during this QA are summarized and detailed in the following section(s) of this report:

- Standard 1100 – Independence and Objectivity – Enhance organizational independence through dual reporting.

• **Opportunities for Continuous Improvement** – Observations of opportunities to enhance the efficiency or effectiveness of IA’s infrastructure of processes. These items do not indicate a lack of conformance with the *Standards* or the Code of Ethics, but rather offer suggestions on how to better align with criteria defined in the *Standards* or the Code of Ethics. They may also be operational ideas based on the experiences of the external assessment team from working with other internal audit activities. A management response and an action plan to address each opportunity for continuous improvement noted are normally included. Opportunities for continuous improvement identified during this QA are summarized and detailed in the following section(s) of this report:

- Standard 2030 – Resource Management – Increase resources to improve risk coverage; and
- Standard 2430 – Quality of Communications - Additional time and resources should be considered when the engagement involves a Federal Relief Fund.

DETAIL OBSERVATIONS

SUCCESSFUL INTERNAL AUDIT PRACTICES

1. **Trusted Advisor**

The IA function is viewed as a supportive trusted advisor to the organization and not as a reactionary or punitive function. Administrators clearly recognize the importance of the IA function and see the unit as a valued resource. Being viewed as a trusted advisor marks the pinnacle accomplishment for which internal auditors strive. Customers share a very positive view of IA as noted in the surveys and interviews conducted during the assessment. Respondents described the IA function as: “critical to the organization”; “very professional”; “they work to develop a healthy relationship, so they are not viewed as negative”; “objective team and good to work with”; “they are credible and people trust them”; “improving the agency”; and “the IA function is one of the best agencies in the state and is integral to the success of the organization”.

2. **Risk Assessment & Audit Planning (Standard 2010)**

The IA function has developed a robust risk assessment process for the development of the risk-based audit plan that is well documented. A systematic process is used to identify the auditable universe, which considers input from senior management, and is conducted at least annually. The risk-based audit plan factors in the agency’s strategic goals to ensure the planned engagements will add value and improve operations for the agency. The process also has a separate component for the information technology related risks, as well as an assurance map. Given the unit’s limited resources, the assurance map is a strategic mechanism to assist with audit efficiency and coordinating audit coverage.

3. **Internal Audit Strategic Plan**

The IA function developed a five-year strategic plan to establish goals that further enhances IA services to the organization. The strategic plan is comprised of metrics that allows the IA function to measure its activity for efficiency, effectiveness, and continuous development. *Practice Guide – Developing the Internal Audit Strategic Plan*, provides internal audit functions with a step-by-step approach to developing a strategic plan. Practices Guides are strongly recommended and endorsed by IIA; however, compliance is not mandatory.

4. **Continuing Professional Development (Standard 1230)**

Coaching and feedback are conducted throughout the engagement process. When notes or changes are made, staff or the CAE will get an email notification to review. Previous versions of workpapers are stored via AutoAudit for all IA activity members to review and monitor the evolution of the workpapers. All staff noted a strong encouragement by the CAE to obtain professional certifications.

5. **Use of Audit Software for Planning Considerations, Documenting Information, & Engagement Supervision (Standards 2201, 2330, & 2340)**

AutoAudit has contributed to engagement efficiency and effectiveness, allowing for improvement across several processes.

- Engagement planning is robust in its detail and information provided.
- The framework set up within AutoAudit provides clear descriptions of workpapers. Workpapers were consistent and organized for ease of use and review. The workpapers observed contained all relevant data to support the observations made.

- Engagement supervision using AutoAudit is evident and contributes to professional development. Staff and CAE are alerted to documents uploaded or updated within AutoAudit for review. Notes are included in the workpapers for improvement and previous versions are saved and can be reviewed.

6. **Establish an Understanding with Engagement Clients (Standard 2201)**

The IA section and client has multiple opportunities to provide feedback and gain an understanding throughout the engagement. This is done using the entrance conference, survey of the customer, and interviews.

GAPS TO CONFORMANCE WITH THE *STANDARDS* OR CODE OF ETHICS

1. Dual Reporting Relationship

Observation: DACS does not have a dual reporting structure. The CAE reports administratively and functionally to the same person, the Chief Deputy Commissioner. Further, DACS does not have a board, specifically an audit committee, that provides oversight of governance, risk management, and internal control practices. Although there is no evidence that conditions exist that threaten the ability of the IA function to carry out internal audit responsibilities in an unbiased manner, a dual reporting requirement enhances organizational independence mitigating the appearance of an independence issue. *This is a repeated gap to conformance observation that was identified in the previous 2017 QAR assessment.*

Often, the Chief Audit Executive (CAE) has a direct functional reporting line to the board and an administrative reporting line to a member of senior management. The reporting line to the board provides the CAE with direct board access for sensitive matters and enables sufficient organizational status. Administrative reporting to a member of senior management also provides the CAE with sufficient organizational status, as well as authority to perform duties without impediment and to address difficult issues with other senior leaders. The IIA recommends that the CAE report administratively to the Chief Executive Officer (CEO), both so that the CAE is clearly a senior position and so that internal audit is not positioned within an operation that is subject to audit¹.

The optimal option to enhance organizational independence is to create an independent audit committee to serve as the functional report. An independent board member is not an employee, or member of the DACS. An independent board member may not carry out any other activities on behalf of the DACS. The N.C. Board of Agriculture is a statutory agency with members appointed by the Governor. The board is a policy and rule-making body that adopts regulations for many of the programs administered by the DACS. Since an oversight board exists, it may be possible to create an independent audit committee, as the functional report for the Internal Audit Director. This structure is a leading practice in the profession of internal auditing.

¹ IIA Implementation Guide 1100

Another option to enhance organizational independence is to require the CAE to report functionally to the head of DACS, in this case, the Commissioner of Agriculture and administratively to the Chief Deputy Commissioner of Administration. This reporting structure elevates IA; improves organizational status, and improves independence; however, is not considered the most optimal option.

Standard 1100 – Independence and Objectivity: The internal audit activity must be independent, and internal auditors must be objective in performing their work.

Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship. Threats to independence must be managed at the individual auditor, engagement, functional, and organizational levels.

Standard 1110 – Organizational Independence: The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

According to the IIA’s Global Public Sector Insight: Independent Audit Committees in Public Sector Organizations, the term board refers to the highest level of the governing body charged with the responsibility to direct and/or oversee the activities and management of the organization. If such a group does not exist, board may refer to the head of the organization.

Recommendation: Management should consider enhancement to Internal Audit’s organizational independence by creating a dual reporting structure, allowing the CAE to report functionally to the CEO or the board. This may include consulting with the board about the creation of an audit committee.

Response: According to the Internal Auditing statute, 143-746 (d), an agency head is given options on who the Director of Internal Auditing reports to. The statute is copied below.

(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 of staff, or (iii) the agency governing board, or subcommittee thereof, if such a governing board exists.

Based on the statute, the agency head, in this case the Commissioner of Agriculture, is operating in compliance with Internal Auditing statute. Furthermore, the Director of Internal Auditing has unfettered access to the Commissioner either through scheduling an appointment or placing a call to the Commissioner’s cell phone. In addition, there are monthly division director meetings with the Commissioner in which the Director of Internal Auditing is a regular participant.

OPPORTUNITIES FOR CONTINUOUS IMPROVEMENT

1. Resource Improvement

Observation: IA does not appear to have sufficient resources to ensure appropriate risk coverage. In IA’s Annual Report that was submitted to senior management in July 2022, it noted that 38 high risk audit topics were declined for fiscal year 2023.

IA’s previous 2017 QAR assessment, recommended IA, whose department consisted of four internal auditors, conduct an in-depth staff analysis to determine the optimal number of internal auditors needed to effectively mitigate risks within the organization. In 2019, IA loaned one of their positions to assist the agency with filling a preferred vacancy, which decreased the number of internal auditors from four to three. In 2022, IA conducted the in-depth staff analysis as recommended and provided the results to leadership. According to the analysis, IA should have at least five full-time auditors. During the survey and interview process of the QAR assessment, numerous respondents indicated the need for additional staff within IA.

Standard 2030 – Resources Management: The chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan.

Recommendation: To ensure adequate assurance and consultative services exists to cover the agency’s risks, IA and leadership should work together to ensure a plan is in place to efficiently and effectively address resource limitations identified by IA.

Response: This recommendation could be applied to every division in the Department. Management makes every effort to provide resources to IA to maximize their ability to accomplish their mission with the current staff. These resources include access to software, training, and if needed, temporary personnel.

2. Timely Delivery of Reported Results

Observation: The IA function did not allocate the proper amount of time and resources needed for the timely delivery of results for engagement A22-04. However, this was due to the extraordinary circumstances surrounding the Covid-19 pandemic and not due to a lack of management and staff competency. The CAE was able to adjust and adapt the audit to unusual circumstances. However, the timely delivery of results suffered.

Standard 2420 - Quality of Communications: Communications must be accurate, objective, clear, concise, constructive, complete, and timely.

Recommendation: Additional time and resources should be considered when the engagement involves a Federal Relief Fund.

Response: The Chief Audit Officer will consider additional time and resources for future engagements involving Federal relief funding based on the internal audit function's experience with A22-04 and the level of risk associated with the program under review.

ATTACHMENT A: EVALUATION SUMMARY AND RATING DEFINITIONS

	GC	PC	DNC
OVERALL EVALUATION:	X		

IIA Code of Ethics	GC	PC	DNC
Code of Ethics	X		

Attribute Standard (1000 – 1300)		Standards			Major Category		
		GC	PC	DNC	GC	PC	DNC
1000	Purpose, Authority, and Responsibility	X			X		
1010	Recognition of the Definition of Internal Auditing	X					
1100	Independence and Objectivity	X			X		
1110	Organizational Independence		X				
1111	Direct Interaction with the Board	X					
1112	Chief Audit Executive Roles Beyond Internal Auditing	X					
1120	Individual Objectivity	X					
1130	Impairments to Independence or Objectivity	X					
1200	Proficiency and Due Professional Care	X			X		
1210	Proficiency	X					
1220	Due Professional Care	X					
1230	Continuing Professional Development	X					
1300	Quality Assurance and Improvement Program	X			X		
1310	Requirements of the Quality Assurance and Improvement Program	X					
1311	Internal Assessments	X					
1312	External Assessments	X					
1320	Reporting on the Quality Assurance and Improvement Program	X					
1321	Use of “Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”	X					
1322	Disclosure of Nonconformance	X					

Performance Standards (2000- 2600)		Standards			Major Category		
		GC	PC	DN C	GC	PC	DNC
2000	Managing the Internal Audit Activity	X			X		
2010	Planning	X					
2020	Communication and Approval	X					
2030	Resource Management	X					
2040	Policies and Procedures	X					
2050	Coordination	X					
2060	Reporting to Senior Management and the Board	X					
2070	External Service Provider and Organizational Responsibility for IA	X					
2100	Nature of Work	X			X		
2110	Governance	X					
2120	Risk Management	X					
2130	Control	X					
2200	Engagement Planning	X			X		
2201	Planning Considerations	X					
2210	Engagement Objectives	X					
2220	Engagement Scope	X					
2230	Engagement Resource Allocation	X					
2240	Engagement Work Program	X					
2300	Performing the Engagement	X			X		
2310	Identifying Information	X					
2320	Analysis and Evaluation	X					
2330	Documenting Information	X					
2340	Engagement Supervision	X					
2400	Communicating Results	X			X		
2410	Criteria for Communicating	X					
2420	Quality of Communications	X					
2421	Errors and Omissions	X					
2430	Use of “Conducted in conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”	X					
2431	Engagement Disclosure of Nonconformance	X					
2440	Disseminating Results	X					
2450	Overall Opinions	X					
2500	Monitoring Progress	X			X		
2600	Communicating the Acceptance of Risks	X			X		

Rating Definitions

GC – “Generally Conforms” means that the assessor or the assessment team has concluded that the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, comply with the requirements of the individual standard or elements of the Code of Ethics in all material respects. For the sections and major categories, this means that there is general conformity to a majority of the individual Standard or element of the Code of Ethics and at least partial conformity to the others within the section/category. There may be significant opportunities for improvement, but these should not represent situations where the activity has not implemented the *Standards* or the Code of Ethics, and has not applied them effectively or achieved their stated objectives. As indicated above, general conformance does not require complete or perfect conformance, the ideal situation, or successful practice, etc.

PC – “Partially Conforms” means that the assessor or assessment team has concluded that the activity is making good-faith efforts to comply with the requirements of the individual standard or elements of the Code of Ethics or a section or major category, but falls short of achieving some major objectives. These will usually represent significant opportunities for improvement in effectively applying the *Standards* or the Code of Ethics and/or achieving their objectives. Some deficiencies may be beyond the control of the internal audit activity and may result in recommendations to senior management or the board of the organization.

DNC – “Does Not Conform” means that the assessor or assessment team has concluded that the internal audit activity is not aware of, is not making good-faith efforts to comply with, or is failing to achieve many or all of the objectives of the individual standard or element of the Code of Ethics or a section or major category. These deficiencies will usually have a significantly negative impact on the internal audit activity’s effectiveness and its potential to add value to the organization. These may also represent significant opportunities for improvement, including actions by senior management or the board.