This white paper is designed to
(1) provide the Audit Committee of the Board of Governors with some of the best practices for audit committees and internal auditors and
(2) be used as a road map to assist the committee in carrying out its governance responsibilities.

AUDIT COMMITTEES

The accounting scandals at Enron, WorldCom, and Tyco\(^1\) created resurgence in audit committees for public corporations. The Sarbanes-Oxley Act of 2002\(^2\) (SOX) required, in part, the establishment of an audit committee for any publicly traded company as well as specific responsibilities for the audit committee. However, as an oversight concept, audit committees predate SOX by at least two decades.

In 1989, the American Institute of Certified Public Accountants established Statement on Auditing Standards No. 61 entitled “Communication with Audit Committees”\(^3\). Essentially SAS 61 required auditors to communicate significant matters to the audit committee, which has responsibility for oversight of the financial reporting process. Generally Accepted Government Auditing Standards, also known as the Yellow Book, incorporate similar requirements as does the Institute of Internal Auditors’ International Standards for the Professional Practice of Internal Auditing\(^4\).

Institutions of higher education are not required to comply with SOX; however, SOX requirements for audit committees can be a basis for best practices. The National Association of College and University Business Officers\(^5\) (NACUBO) along with PriceWaterhouseCoopers\(^6\) reviewed the SOX requirements and identified sections of the Act that could represent best practices in higher education. This guidance includes:

- The institution should have an audit committee or incorporate audit in an existing committee, such as Finance and Audit Committee.
• The audit committee should have a charter and the necessary authority to carry out its duties.
• The audit committee should include at least one financial expert. Universities should consider rotating the financial expert and planning for the process and cost of recruiting, training, and retaining financial expertise.
• Institutions with internal audit departments should consider using them to periodically report on internal controls to the audit committee in addition to reporting to management.
• The audit committee should ensure a process exists for receiving confidential complaints and reviewing the nature and disposition of reported matters.
• The audit committee should consider periodic inquiries of executives on the adequacy of financial controls.
• Executive incentives related to financial results should be disclosed to the audit committee.
• The audit committee should be aware of and review policies on ownership interests in related ventures or start-ups. Existing conflict of interest policies can be leveraged and should be reviewed with the audit committee.
• The audit committee should review the code of ethics for senior financial officers and periodically review how compliance is assured.
• The audit committee should review the performance of the external auditor annually and consider rotating the external audit among different audit firms. For the SUS, external audits are performed by the Florida Auditor General, so rotation of external audit firms is not applicable. However, rotation of external auditors for the university’s direct support organizations and athletics program, if applicable, is a consideration. Also, the audit committee should approve, in advance, any non-audit work performed by external auditors.

NACUBO and PriceWaterhouseCoopers gave these guidelines for higher education audit committees based on SOX.
The Institute of Internal Auditors (IIA), an international professional organization for internal auditors, provides a global perspective on audit committee best practices. The IIA lists ten key areas of responsibility for audit committees, which can be incorporated into the audit committee charter:

1. **Financial statements.** The audit committee should understand financial statements and review significant accounting and reporting issues. The committee should also review the results of external audits, including financial statements, federal awards, and operational audits at SUS institutions. The Auditor General (AG) performs financial and operational audits of the universities as required by Florida Statutes, using Governmental Auditing Standards. The audit committee should consider meeting with the AG staff each year about the scope and time frame of the engagement. Also, the BOG may need to determine if direct support and affiliated organizations’ audited financial statements should follow the requirements of the Governmental Accounting Standards Board as the universities do.

2. **Risk management and internal control.** The audit committee should discuss risk assessment and risk management policies with management and the chief audit executive. The committee should consider the effectiveness of the university’s internal control system and review any report on significant audit findings and recommendations, including management’s responses and corrective action.

3. **Compliance and ethics.** The audit committee should review the effectiveness of the system for monitoring compliance with laws and regulations. Procedures should exist for receiving complaints and performing investigations. Also, the committee should ensure that evolving expectations are met and the university’s reputation is protected.

4. **Oversight of internal auditing.** The audit committee should review the internal audit charter, risk assessments, work plans, activities, staffing, organizational structure, and reporting lines. The committee should review the effectiveness of the internal auditing function and review and concur with the appointment and
dismissal of the chief audit executive. Regular meetings should be held with the chief audit executive to discuss sensitive or confidential matters privately. (While the Florida Sunshine Law does not allow private business-related conversations with more than one audit committee member, audit committee members can, and should, hold individual private conversations with the chief audit executive as needed to address sensitive or confidential matters.)

The IIA Research Foundation sponsored a document titled “20 Questions Directors Should Ask About Internal Audit” authored by John Fraser, CA, CIA, CISA and Lindsay Hugh, FCA, CIP, which addresses issues such as:

- Internal Audit role and mandate
- Internal Audit relationships
- Internal Audit resources
- Internal Audit process
- Closing questions
- Audit Committee assessment

Each question has a brief discussion and, where appropriate, practice recommendations. The questions and recommendations contained in this publication are very helpful in the evaluation of the effectiveness of internal audit functions and should be reviewed by audit committee members and university management.

5. **Relationship with external auditors.** The audit committee should impart guidance on how to establish and maintain the relationship with the external auditors.

6. **Resources.** The audit committee should use sufficient resources to effectively carry out their responsibilities.

7. **Committee composition.** The audit committee should have membership with a breadth of skill and expertise to assure success.
8. **Training.** Plans should be made to obtain requisite knowledge.

9. **Meetings.** Suggestions should be made to improve meeting effectiveness, through agendas, targeted advance materials, and active participation.

10. **Charter and evaluation.** Members should recommend methods for self-assessing the adequacy of the charter and the effectiveness of the committee’s performance.

Underlying these responsibilities is the all-encompassing concept of governance. Sy Sternberg, CEO of New York Life Insurance Co., put it this way: “Proper corporate governance is the cornerstone of all internal control systems. Governance means establishing, communicating, and enforcing clear accountabilities and responsibilities. And, as far as I’m concerned, the three most critical roles in governance belong to the internal auditor, the board’s audit committee, and the CEO. All three must be fully engaged. All three must take leadership roles. And all three must work closely together.”

**INTERNAL AUDITORS**

An effective internal auditing activity provides assurance that internal controls are sufficient to mitigate risks, that governance processes are adequate, and that organizational goals and objectives are met.

The IIA\(^9\) outlines best practices of the internal auditing activity as follows:

- **Organizational independence and reporting structure.** The audit activity should have sufficient independence to conduct work without interference. Best practice has the chief audit executive reporting functionally to the audit committee with administrative reporting to the university president. The publication “20 Questions Directors Should Ask about Internal Audit” further clarifies these reporting relationships.
• **Unrestricted access.** Internal auditors should have complete and unrestricted access to employees, property, and records of the university. If the scope of the internal audit activity extends to the direct support and affiliated organizations of the university, this access should be expanded to the records and employees of those organizations as well,

• **Audit charter.** The purpose, mission, and authority of internal auditing should be established in a formal charter. The charter should address independence, duties, responsibilities, and professional standards and should be approved by the audit committee.

• **Professional audit standards.** Standards provide a framework to promote quality audit work. The IIA’s International Standards for the Professional Practice of Internal Auditing and Code of Ethics are generally accepted and give internal auditors an approach that provides a systematic, objective, and evidentiary basis for their work.

• **Training and quality assessment.** To stay abreast of emerging issues facing universities and the internal audit profession, internal auditors should participate in continuing education programs. Also, professional standards require an external quality assessment of internal audit activity every five years as well as ongoing self-assessments.

• **Prioritization, a risk-based approach.** The internal auditing function must assess organizational risks and operational changes for the most effective use of internal audit resources. This risk-based approach should also be applied to the development of the internal audit work plan as well as to each individual audit.

• **Audit reports and follow-up.** The results of audits are communicated through formal audit reports that should be distributed to appropriate levels of management. The audit reports may also be distributed to the audit committee. Internal auditing should follow up on its observations and recommendations to ensure management’s action plans were effectively implemented. Results of the follow-up may be conveyed to the audit committee.

• **Advisory services and investigations.** In addition to audits, internal auditing should provide advisory services to management and investigate complaints or
allegations of fraud. Advisory services are generally a more informal approach to improving controls and operations. Investigations should be handled in a confidential manner with communication to the audit committee as needed to keep them informed and up-to-date on issues facing the university.

SUMMARY
The Board of Governors has significant oversight responsibilities for Florida’s higher education system. The BOG audit committee in collaboration with the universities’ audit committees and their respective internal audit executives can ensure that processes are in place to meet those responsibilities. This white paper is the roadmap of best practices to achieve effective governance at the institutions related to audit committees and internal audit.
Footnotes


3 American Institute of Certified Public Accountants Statement on Auditing Standards No. 61 Communication with Audit Committees http://www.aicpa.org/download/members/div/auditstd/AU-00380.PDF


6 NACUBO and PriceWaterhouseCoopers “Sarbanes Summit: Taking the Right Path” http://www.nacubo.org/x8028.xml?s=x40


9 The Institute of Internal Auditors has two publications relevant to audit committees and internal auditing, especially in the public sector. “Role of Auditing in Public Sector Governance” http://www.theiia.org/download.cfm?file=3512 and “The Audit Committee: Purpose, Process, Professionalism” http://xrl.us/uiw3

Other Reading

American Institute of Certified Public Accountants, Audit Committee Toolkit for not-for-profits http://www.aicpa.org/Audcommctr/toolkitsnpo/homepage.htm

Association of Governing Boards, Effective Committees: The Audit Committee http://www.agb.org/wmspage.cfm?parm1=547 (available for purchase)

State of Tennessee Audit Committee Act http://comptroller.state.tn.us/Attachment_A.pdf
State Universities Audit Council
Florida Agricultural and Mechanical University
Division of Compliance & Audit
Rufus R. Little, III, Vice President

Florida Atlantic University
Office of the Inspector General
Morley Barnett, Inspector General

Florida Gulf Coast University
Office of Internal Audit
Carol Slade, Director

Florida International University
Office of Internal Audit
Ted Guba, Audit Director

Florida State University
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David Coury, Chief Audit Officer

University of Central Florida
University Audit
Amy S. Voelker, Director

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