



THE INSTITUTE OF INTERNAL AUDITORS

**QUALITY AUDITING
SERVICES**

QUALITY ASSESSMENT REPORT

***UNIVERSITY OF NEW MEXICO
INTERNAL AUDIT ACTIVITY***

October 18, 2004

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EXECUTIVE SUMMARY

In April 2004, The Institute of Internal Auditors (IIA) conducted a Quality Assessment (QA) of the Internal Audit Department (IA Activity) of the University of New Mexico (UNM). The principal objectives of the QA were to assess the IA Activity's conformity to the IIA *International Standards for the Professional Practice of Internal Auditing (Standards)*, evaluate the IA Activity's effectiveness in carrying out its mission (as set forth in its charter and expressed in the expectations of UNM management), and identify opportunities to enhance its management and work processes, as well as its value to UNM management.

The mission of the UNM is to serve educational needs. This mission involves three interrelated dimensions:

- (1) The University develops and offers comprehensive educational programs at the associate, baccalaureate, master, and doctoral levels in a wide range of academic, professional and occupational fields.
- (2) The University, a designated Carnegie I research university, conducts research and engages in scholarly and other creative activities to support undergraduate, graduate, and professional educational programs, and to create, interpret, apply and accumulate knowledge.
- (3) The University contributes to the quality of life in New Mexico by providing selected services to the public that are part of, contribute to, or originate from the University's teaching and scholarly activity programs.

The UNM has established an IA Activity whose reporting responsibility is to the President of the University. The Director of Internal Audit is authorized to direct a broad, comprehensive program of internal auditing within the UNM. The IA Activity is charged with examining and evaluating the adequacy and effectiveness of the systems of control provided by the UNM and directing its activities toward the accomplishment of its objectives in accordance with UNM policies and plans. The UNM is considering changing the reporting relationship to have the Chief Audit Executive (CAE) report functionally to a committee of the Board of Regents and administratively to the President.

The previous Director of Internal Audit retired in July 2003 and was responsible for the management and direction of the IA Activity for the past twenty years. The previous Director and previous Presidents are responsible for most of the policies, procedures and practices of the current IA Activity.

In preparation for the QA, the IA Activity performed a self-study and provided detailed documentation about the UNM. The on-site work included interviews with UNM executives and the staff of the IA Activity. In addition, we reviewed the IA Activity's risk assessment and audit planning processes, audit tools, and methodologies, engagement and staff management processes, and a representative sample of the IA activity's working papers and reports.

The IIA gathered survey information about the audit function, but only received responses from 6 of 21 questionnaires sent to managers and executives.

We found positive aspects about UNM's IA Activity. As evidenced by interviews, document reviews, and observations, the IA Activity currently uses a number of "Successful Practices" in its audit operations and administration. These include:

- a. Participating on UNM task forces and critical committees.
- b. Educating operating management on internal control responsibilities and fraud awareness.
- c. Distributing internal control self-assessment questionnaires to auditable entities via its web site. =
- d. Maintaining a program for providing continuing education to audit staff members.

It was also noteworthy that several interviewees at the operating level were quite satisfied with the responsiveness and quality of the work done by the IA Activity.

OPINION AND RECOMMENDATIONS

The Quality Assessment (QA) team rates the IA Activity as *does not conform* to the *International Standards for the Professional Practice of Internal Auditing* (*Standards*).

As indicated below, *does not conform* is the lowest rating awarded by The IIA in connection with a QA. The IIA provides a system of rating the level of compliance with the *Standards*, which consists of three categories: **generally conforms**, **partially conforms**, and **does not conform**.

In our lexicon, "**generally conforms**" means that an IA Activity has a charter, policies, and processes that are judged to be in accordance with the *Standards*, with some opportunities for improvement. "**Partially conforms**" means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies did not preclude the IA Activity from performing its responsibilities in an acceptable manner. "**Does not conform**" means deficiencies in practice are judged to be so significant as to seriously impair or preclude the IA Activity from performing adequately in all or in significant areas of its responsibilities.

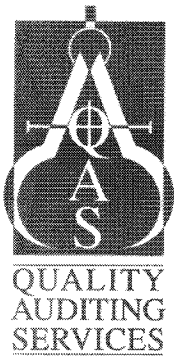
Opportunities for improvement in audit procedures and activities that enhance compliance with the *Standards* and improve professionalism are listed below.

PART I – MATTERS FOR CONSIDERATION OF UNIVERSITY OF NEW MEXICO EXECUTIVE MANAGEMENT

1. Ensure that the IA Activity develops a risk assessment model that will facilitate preparation of annual audit planning documents that address the most serious risks in the UNM.
2. Create an Audit Committee of the Board of Regents to provide focus on effective oversight of the auditing and financial matters of the UNM.
3. Ensure that the IA Activity concentrates its efforts on audits with objectives that address compliance, economy, efficiency, effectiveness and process improvement issues.
4. Realign the internal auditing activities of the UNM hospital more closely with the UNM Board of Regents and the UNM IA Activity.
5. Direct the Chief Audit Executive (CAE) to draft a Management Control Policy Statement for Regents review and approval that defines the roles of the senior management, the Board of Regents, the IA Activity and the external auditors in the UNM governance process.
6. Create separate processes for audits, investigations, and advisory services within the IA Activity to protect the integrity of investigations of fraud and program abuse.

PART II – ISSUES SPECIFIC TO THE INTERNAL AUDIT ACTIVITY

1. Develop a universe of auditable areas in the UNM by using strategic planning documents, university budgets, IIA Global Audit Information Network (GAIN) data on educational institutions, organization charts, input from executive management, and other relevant management information.
2. Update the IA Activity charter to conform to the new IIA definition of internal auditing and to expand on some of the language addressing a new internal auditing focus on adding value, and improving the effectiveness of risk management, control, and governance that the *Standards* now embody.
3. Complete the draft of the audit practices manual and include subjects such as standard working paper preparation techniques, interview techniques, report writing guidelines, report distribution, administrative procedures, opening and closing conference procedures and report preparation methods.
4. Develop an information technology audit universe upon which to conduct risk assessments and to prepare annual audit plans. Increase the use of automated auditing tools within the IA Activity.



5. Institute a strong audit follow-up system featuring elapsed time thresholds that trigger escalation of the issues to higher management levels when resolution cannot be achieved.
6. Track, summarize, and analyze time used to complete audit projects and compare it to budgeted hours providing a tool for managing the audit activities and achieving audit plans and other management goals.
7. Institute quarterly review meetings with business heads to discuss audit findings, responses to audits, needs of customers, staffing issues for internal auditing and other subjects that educate and lead to more cooperation, understanding, and support.
8. Establish management performance measures against which to evaluate the overall efficiency and effectiveness of internal audit operations.
9. Develop and implement working paper standards, including sample formats, documentation requirements, indexing, and cross-referencing techniques with sufficient flexibility to serve as guidance for all types of audits, reviews, evaluations, and investigations.

The above recommendations are addressed in more detail in the *Observations and Recommendations* section of this report.

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OBSERVATIONS AND RECOMMENDATIONS

The following observations and recommendations are presented in two parts: General Observation, Part I - for UNM executive management's attention, and Part II - for the IA Activity management's attention. These parts are integral to each other and need to be addressed in tandem to maximize their benefits.

PART I – MATTERS FOR CONSIDERATION OF UNIVERSITY OF NEW MEXICO EXECUTIVE MANAGEMENT

1. DEVELOP A RISK ASSESSMENT MODEL

The IA Activity does not have a risk assessment model for audit planning. The IA Activity attempted to develop a risk assessment and annual audit planning system in the mid 1990's, but the effort was abandoned because the departmental workload became one that was almost totally driven by the requests for reviews of complaints and allegation of fraud and program abuse. The Global Auditing Information Network (GAIN), the IIA's benchmarking service, indicates that 72 percent of the UNM IA Activity peer group uses a formal risk assessment system to assess risk and allocate audit resources to the areas of most critical need.

The consequences of the IA Activity using most of its resources to service complaints is that the \$1 billion UNM program has not had comprehensive internal audit coverage in the highest areas of risk exposure for at least the past 5-years and most likely much longer. Our assessment is that the condition occurred because of an absence of effective leadership by the IA Activity and by the executive leadership of the UNM.

Recommendation

We recommend the Board of Regents and the UNM President ensure that the IA Activity develops a risk assessment model to assure that there is a common understanding of risk within the audit department that can be shared with UNM management to facilitate discussion of risk and assist in audit planning. IIA Standard 2110, Risk Management, states that: "The internal audit activity should assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems."

IIA Practice Advisory (PA) 2110-1, Assessing the Adequacy of Risk Management Processes, provides best practice guidance to assist organizations in developing risk assessment models. It provides guidance on the major risk management objectives that the internal auditor should consider in formulating an opinion on the adequacy of the organization's risk management process. The PA also recognizes that an organization's risk management process is an important business process that can and should be evaluated in a manner similar to other strategically important processes.

**Executive
Management Response**

The University of New Mexico agrees with the observation and recommendation. A new Director of Internal Audit (CAE) was hired effective August 2, 2004. A risk assessment rating spreadsheet was developed by the new CAE and the Internal Audit staff and distributed electronically to 130 top Administrators at the University. The spreadsheet was accompanied by a cover memo from the University President, which stressed the importance of the risk assessment process. The spreadsheet allows ratings of 141 different areas, programs, processes and systems.

Ratings were requested for:

- Impact – What would be the impact on the University if this item failed to function?
High Impact – Medium Impact – Low Impact?
- Probability – Without considering existing process controls that may exist, what is the probability that this breakdown could occur?
High Probability – Medium Probability – Low Probability?
- Controls – How well does the University manage this potential risk, i.e., how good are the controls in this area? Good – Average – Poor?

The ratings received will be combined and the combined ratings will be assigned a numerical ranking using a predetermined formula. The areas ranked in the top 25% will be subjected to a second ranking based on the type of risk using various weights. A risk based audit plan will then be developed from the results to address those areas that pose the greatest risks to the University. The number of audits to be included in the Audit Plan will depend upon the complexity of the audits and the staff hours that will be available during the year.

Target Date: A draft Audit Plan was prepared and presented to the Audit Committee for approval at its October 2004 meeting.

2. CREATE AN AUDIT COMMITTEE OF THE BOARD OF REGENTS

The UNM does not have an Audit Committee of the Board of Regents. Such a committee gives management and the internal and external auditors a direct method of communication with the Board. Audit committees usually have at least three members. The current Finance and Facilities Committee of the Board of Regents fulfills some of the functions of an audit committee in the current environment.

The UNM has a draft policy under review to realign the IA Activity so that it reports to the Board of Regent's Finance and Facilities Committee or perhaps a newly created Audit Committee. The external auditor, KPMG, recommended in its 2003 audit report that the IA Activity should report functionally to the Board of Regents and administratively to the President. We agree with this recommendation because it is a best practice with wide application in the internal auditing profession. IIA Practice Advisories 1110-2, Chief Audit Executive Reporting Lines and 2060-2, Relationship with the Audit Committee, provide best practice guidance to organizations. In addition, we have included a sample Audit Committee Charter (Attachment A) for your consideration.

Recommendation

We recommend that the UNM establish an Audit Committee of the Board of Regents. The audit committee may have some or all of the following duties:

- *Assist the Board in its fiduciary responsibilities relating to the organizations accounting policies, reporting practices, and internal controls.*
- *Advise the Board on the adequacy of audits, accounting policies, disclosure, the quality of financial management, and the effectiveness of accounting systems and internal controls.*
- *Maintain a direct line of communication with the organization's internal and external auditors, monitor the scope of their audit activities, and assess their performance.*
- *Review the organizations audited financial statements prior to their approval by the Board.*
- *Review the organization's quarterly financial statements prior to their review by the Board.*
- *Review the annual report including Management's Responsibility for Financial Reporting included therein.*
- *Review litigation claims and contingencies that could have a material impact on the financial position or operating results of the organization and ensure that appropriate disclosure is made.*
- *Review, discuss, and consider the external and internal auditors approach to risk assessment.*
- *Review the annual audit plans of both the internal and external auditors and the results of the audits they have conducted.*
- *Review any unresolved significant issues between management and either the internal or external auditor.*
- *Review and approve the appointment and termination of the Chief Audit Executive and the external auditor.*
- *Review the performance of both the internal and external auditor annually.*

**Executive
Management Response**

The University of New Mexico agrees with the observation and recommendation. The Board of Regents approved Regents Policy No. 7.3 at its meeting on August 10, 2004. Policy No. 7.3 provides for the creation of an Audit Committee consisting of three Board members appointed by the President of the Board of Regents, with one member from each of the previously existing standing committees. The Audit Committee will meet at least four times per year. The Director of Internal Audit will submit quarterly reports to the Audit Committee, which will provide the status and results of the audit plan, and significant audit findings. (Regents Policy 7.3 is available on the Internet at <http://www.unm.edu/~brpm/r73.htm>).

**3. BROADEN THE
FOCUS OF
INTERNAL AUDITS**

The IA Activity needs to broaden its focus from one of mainly performing work on complaints of abuse and fraud to business process and operational auditing that addresses the highest risk components of the UNM. The shift would increase the value added by the IA Activity. Interviews indicated that executives wanted more audit focus on the systems and processes of the UNM instead of a focus on pointing out individual errors or instances of non-compliance, other than required regulatory compliance monitoring.

The Professional Practice of Internal Auditing *Standard 2000* states, “The CAE should effectively manage the IA Activity to ensure it adds value to the organization.” In addition, the 2003 annual audit by the external auditor suggested that the audit program be revised to broaden the coverage and reduce the percentage of resources devoted to servicing complaints and allegations of fraud and abuse.

Recommendations

We suggest that annual audit plans, which we recommend elsewhere in this report, focus the audit objectives on compliance, economy, efficiency, effectiveness, and process improvements. The IA Activity should better ensure resources are acquired economically, used efficiently, and adequately protected. The IA Activity should also identify opportunities for improving management control, financial viability, institutional image, and ensuring quality and continuous improvements that result in more value added from the IA Activity's work.

Executive Management Response

The University of New Mexico agrees with the observation and recommendation. The Internal Audit Department is developing an annual audit plan based on the risk assessment mentioned in the response to Observation No. 1, above. The audit plan will address compliance, economy, efficiency, effectiveness, and process improvements. Audits will review current policies to identify opportunities for improvement.

Target Date: A draft Audit Plan was prepared and presented to the Audit Committee for approval at its October 2004 meeting.

4. RE-EVALUATE INTERNAL AUDIT RESPONSIBILITY FOR THE UNIVERSITY HOSPITAL

The IA Activity does not have any audit responsibility for the UNM Hospital. The Hospital has engaged a CPA firm to perform some internal audit services related to accounting and finance issues. The results of the work by the CPA firm have not been shared with the UNM Board of Regents on a regular basis at Finance and Facilities Committee meetings or in full Board of Regents meetings and they may not have been forwarded to the State Auditor.

UNM Health Sciences executives feel very passionately that they need to maintain control of the internal audit activity under their responsibility.

Recommendations

Since the hospital is a major component of the UNM budget, we believe that efforts need to be made to realign the internal audit activities of the hospital more closely with the UNM Board of Regents and the IA Activity of the UNM. We believe that over time, the two audit operations should be folded into the one unit in the UNM system to ensure independent audit coverage of high-risk audit entities across the UNM. Further, the Board of Regent's should, in our opinion, oversee the audit activities in the hospital area as well as the audit activity in the other parts of the UNM.

Should the UNM executive management decide to leave the internal audit activity under the control of the Hospital, we recommend that a Quality Assessment be conducted for the internal audit activity. The IIA Standards require that a quality assessment be performed every five years for IA Activities who wish to state that they comply with the IIA Standards.

Executive Management Response

The University of New Mexico agrees with the observation and recommendation. The Board of Regents requested that the University Hospital provide information on its internal audit efforts to the Internal Audit Department. The Director of Internal Audit and the University Hospital Associate Vice President for Clinical Operations met in September 2004 to discuss better coordination of internal audit efforts. At this time, the Internal Audit Department does not have sufficient staff to assume the responsibility for internal audits at the University Hospital.

5. DEVELOP A MANAGEMENT CONTROL POLICY

The UNM does not have a written Management Control Policy Statement. As we envision the process of corporate governance, management is continuously charged with enhancing the structure by identifying all parties with governance responsibilities and by issuing policy statements controlling activities of an enterprise. In this regard, a Management Control Policy Statement clearly defines the responsibilities of the various parties including management's responsibilities for control, IA Activity's responsibilities to examine and

evaluate the control process, and the Board's responsibility to oversee UNM internal control. Further, it provides a basis for the IA Activity's Charter and for evaluating the accountabilities of the various parties involved in controlling the activities of the University. It is a best practice for organizations to have such a control policy statement. We have attached a model document (Attachment B) that The IIA has developed based on the work of the Committee on Sponsoring Organizations (COSO) to demonstrate the suggested approach.

Recommendation

The Board of Regents and the President should request that the Chief Audit Executive draft a Management Control Policy Statement that defines internal control, management responsibility and the Audit Committee, IA Activity and external audit roles and submit it for senior management and the Board of Regents for review and approval.

Executive Management Response

The University of New Mexico agrees with the observation and recommendation. The Director of Internal Audit will draft a Management Control Policy Statement for review and possible adoption by senior management and the Board of Regents. The draft policy will be based on the IIA Model Management Control Policy and policies adopted by other organizations.

Target Date: A draft Management Control Policy Statement was prepared and presented to the Audit Committee for approval at its October 2004 meeting.

6. RE-EVALUATE THE PRACTICE OF USING AUDIT REPORTS TO COMMUNICATE RESULTS OF INVESTIGATIONS

The majority of the work done in the IA Activity in the past several years has been investigations of complaints of fraud and abuse. The results of these investigations have been reported as audit results in documents labeled as audit reports. In our experience, investigations are reported in a different format and issued to different officials and audiences, than reports of audits of programs, activities, and functions. For example, prosecutors, management action officials, and law enforcement officials have a need for the information contained

in investigation reports while audit reports normally have a broader less restricted distribution. In addition, the information on potential criminal cases must have more restricted distribution to protect individual rights and the government's case material.

Investigation reports must contain exculpatory evidence and relevant mitigating information when discovered during any administrative investigation. Exculpatory evidence in a criminal or civil investigation must be brought to the attention of the assigned prosecutor.

Recommendation

We suggest that the Board of Regents and the University President request that the IA Activity ensure that work classified as investigations use a different set of policies and procedures than are used for audits that must meet the IIA Standards. The process for receiving and acting on requested work on allegations and complaints can be changed to separate the audit, investigation, and advisory service requests. The procedures for performing work on the three types of work would be three distinct and separate processes within the IA Activity.

**Executive Management
Response**

The University of New Mexico agrees with the observation and recommendation. The Internal Audit Department is responsible for the coordination of investigations of suspected fraudulent activity. When the investigation is conducted by the Internal Audit Department, a specific fraud investigation process will be followed. The results of investigations will be presented in a report format. The reports will identify the source and general nature of the complaint and broadly describe the procedures used to conduct the investigation. Significant findings will be reported individually and accompanied by recommendations and responses from management.

The reports on the results of investigations will contain only enough information to allow the reader to identify the nature of the allegations and the outcome of Internal Audit's investigation. Reports

will not include names of individuals involved in alleged wrongdoing.

The reports on the results of investigations will be submitted to the Audit Committee for approval. The University is striving to increase accountability and to pursue prosecution for criminal wrongdoing involving University assets. The Administration believes that it is necessary to publish reports on the results of investigations to send a strong message that University employees will be held accountable for their actions. University Counsel will review the reports on the results of investigations for any needed redactions before the reports are published on the Internal Audit Department web site.

PART II – ISSUES SPECIFIC TO THE INTERNAL AUDIT ACTIVITY

1. CREATE AN AUDIT UNIVERSE

The IA Activity has not developed an audit universe as an aid to audit planning. According to the IIA Global Audit Information Network (GAIN), 71 percent of the audit departments in the IA Activity peer group have a defined audit universe. Further, 84 percent of the audit departments of similar size to the IA Activity had a defined audit universe. We suggest that the IA Activity develop and maintain a universe of all potential audit areas, entities, processes, and management information systems. A universe was developed in the mid-1990's, but it has not been used for at least five years.

The universe should be developed using data from a number of sources and input from management, including UNM executives and external auditors. Areas for input include lines of business, business processes, organization charts, budgets, strategic plans, prior audits, and other relevant sources. Once a universe is established, the audit areas should be evaluated based on the risk-assessment process recommended in Part I of this report. This evaluation should be the basis for the annual audit plan.

Not every asset or every activity of an organization requires the attention of internal auditing. In order to become an auditable unit, the unit must:

- Contribute to the organization's goals.
- Have a noticeable impact on the organization (also known as materiality or significance).
- Justify the cost of control, so that the potential loss should be greater than the expense of control, including the cost of audit.

Organizational units that do not meet these criteria are not auditable units. Auditable units can be of numerous types:

- Locations - branches, divisions, plants, offices, etc.
- Projects – systems, programs, applications, products, etc.
- Activities – business units, functions, processes, etc.
- Assets – physical, accounts, cash, information, resources, people, etc.
- Any combinations of the above.

Recommendation

Using strategic planning documents, budgets, GAIN data on the education industry, organization charts, input from executive management, and other relevant information, the CAE should develop a universe of auditable areas.

To ensure no areas were missed, each auditable unit could be classified into the organization's business processes or cycles:

- *Treasury Cycle – Raises capital from debt and equity markets and manages the use of free reserves.*
- *Expenditure Cycle – Outlays for the purchase of goods and services, contracts, labor and employee benefits to acquire assets and create products and services for sale.*
- *Asset Utilization Cycle – Safeguards assets and ensures efficient and effective use of assets in producing goods and services.*
- *Revenue Cycle – Deals with all aspects of customer relationships from establishing accounts, recording sales, collections, adjustments, and the control of bad debts and credits.*

- *Financial Reporting Cycle – Records all transactions in the final books of account and creates the financial statements and reports used by management and others based on inputs from the other cycles.*
- *Information Technology Cycle – Acquires or develops software and hardware to efficiently and effectively support the University’s business model.*
- *Call Center Cycle – Deals with subscribers and is the University’s first line of contact with end users.*

Audit Management’s Response

The Internal Audit Department agrees with the observation and recommendation. An audit universe of approximately 250 potentially auditable areas was identified by researching UNM organization charts, UNM web pages, UNM directories, budget documents, information from other universities, Internal Audit staff knowledge of UNM and other available information. The universe is consolidated into 141 distinct areas, which are categorized by function as follows:

- Human Resources
- Payroll/Timekeeping
- Procurement Cycle
- Revenue, Funding, Billing & Collection
- Financial & Operational Control
- Student Welfare & Success
- Compliance
- Governance
- Facility Management
- Information Technology Management
- Component Units

Internal Audit distributed the audit universe, in the form of a risk assessment spreadsheet, to 130 University officials with a request that they rate the risks associated with each area. The risk ratings will be used to develop an audit plan.

2. UPDATE THE IA ACTIVITY CHARTER

The IA Activity Charter needs updating to conform to the new IIA definition of internal auditing and to expand on some of the language to address the new internal auditing focus on adding value, and improving the effectiveness of risk management,

control, and governance that the *Standards* now embody. The definition is as follows:

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.

The current IA Activity Charter addresses the main issues included in the definition of internal audit for the *Standards* that were in effect prior to January 1, 2002. The focus of the new IIA *Standards* has moved to adding value and improving the operations of the entities. Attachment C contains a model charter that is considered a best practice.

Additionally, the IA Activity Charter does not include language on the new Consulting Implementation *Standards* to clarify the nature of its internal consulting for management and the audit committee. *Standard* 1000.C1 requires the nature of consulting services be defined in the IA Activity Charter. Such language should clarify the roles and responsibilities of IA Activity with regard to formal, informal and special request consulting engagements, while facilitating a clear understanding with management of the specific guidelines and conditions for providing these services.

Recommendation

The IA Activity Charter should be updated to reflect:

- *The revised International Standards for the Professional Practice of Internal Auditing now in effect. A Model IA Activity Charter, incorporating the revised Standards is included (see Attachment C).*
- *The nature and scope of IA Activity consulting services.*
- *Other items as deemed necessary.*

Once revised, the document should be reviewed and approved by the Board of Regents.

Audit Management's Response

The Internal Audit Department agrees with the observation and recommendation. The Board of Regents adopted a revised Regent's Policy 7.2, Internal Auditing, on August 10, 2004. The revised policy contains the elements of the IIA's Model Internal Activity Charter and UNM specific policy. (Regents Policy 7.2 is available on the Internet <http://www.unm.edu/~brpm/r73.htm>).

3. DEVELOP AN AUDIT POLICIES AND PROCEDURES MANUAL

There are no formal policies and procedures governing the operating activities of the IA Activity. The IA Activity has prepared a draft manual that is still under development. Audit manuals serve two primary purposes: support for the induction and training of new staff and provide ongoing reference and guidance for the performance of work and on administrative matters. While manuals should not be voluminous, inflexible, or bureaucratic, they should be sufficiently comprehensive to provide guidance in all types of work and administrative matters of the department.

Recommendation

We recommend that the CAE complete the draft audit practices manual and include, for example, standard work paper preparation techniques, interview techniques, report writing guidelines, report distribution, administrative procedures, fraud awareness guidelines, training guidelines, opening and closing conference procedures and report preparation methods.

The IA Activity can use the recently purchased updated practice aid entitled: "Internal Auditing Manual, Shell on CD-ROM, 2nd Edition to ease the administrative burden and cost of preparation. Use of the CD, which has been updated to conform to the new Standards, coupled with the existing draft audit procedures manual provides a solid base line from which to start completion of the audit practices manual.

Audit Management's Response

The Internal Audit Department agrees with the observation and recommendation. The new CAE has begun the update of the draft audit policies and

procedures manual to reflect changes to the Regent Policies 7.2 and 7.3 and the Professional Practices Framework (dated January 2004). All of the significant Internal Audit Department processes will be flowcharted and reviewed for compliance with the Professional Practices Framework. The completed flowcharts will be incorporated into the audit policies and procedures manual. The manual will include distinct and separate processes for planned audits, investigations and advisory services. Internal Audit Department administrative policy will also be included in the manual.

Target date: A revised draft of the audit policies and procedures manual will be submitted to the Audit Committee for approval by October 31, 2004.

4. INCREASED EMPHASIS ON INFORMATION TECHNOLOGY AUDITING

Although some effort has been expended on information technology (IT) audits, specifically the SCT-Banner implementation; a more dynamic effort should be instituted to be more effective and efficient. There is no current risk assessment in the IT areas, including major business, student, and academic computer applications. Therefore many traditional IT audit areas such as reviews of data centers, application systems, operating systems, telecommunication, networks, e-commerce and disaster recovery have not been addressed.

In addition, there is limited use of automated audit tools by all auditors on staff. We suggest that the IA Activity continue to explore and develop the use of audit specific software tools, such as data extraction software, in order to further leverage existing internal audit resources. The expanded use of technology by the internal audit staff can improve productivity and efficiency while enabling the IA Activity to add depth to the audit scope. In addition, the newly issued revision to the *Standards*, effective January 1, 2004 raises the bar on the need to have computer auditing skills. *Standard* 1220.A2 now states that: “In exercising due professional care the internal auditor should consider the use of computer-assisted audit tools and other data analysis techniques.”

Recommendations

The CAE should develop the IT audit universe used to perform the risk assessment. The major business applications should be considered as separate areas in the audit universe, in addition, to adding other areas to ensure a more comprehensive risk assessment including data center reviews, application system reviews, operating system reviews, tele-communication, network, e-commerce and disaster recovery.

All staff members should increase the use of automated auditing tools or the utilization of reporting tools in SCT-Banner. Consideration should also be given to implementing continuous monitoring of key financial transactions.

The CAE should ensure that additional IT training is provided as needed and/or utilize the IT auditor once she returns from leave, to assist the other auditors in developing the skills to effectively utilize automated tools on their own.

Finally, given the technical complexity of some IT related systems development audits; specifically SCT-Banner, the CAE and executive management should consider developing specialized staff audit expertise in this area or, look towards augmenting existing department skills with a specialized third party partner. This may require immediate action because of the impending implementation of the SCT-Banner system.

Audit Management's Response

The Internal Audit Department agrees with the observation and recommendation. The audit universe and risk assessment spreadsheet include areas categorized as Information Technology (IT) Management. Those IT areas rated as high risk may be included in the Audit Plan, depending upon the audit hours available. Additionally, most planned audits will be integrated audits with system reviews/validations to verify the reliability of audit information obtained from the computer systems. This will increase coverage of the many stand-alone computer systems that exist at the University.

SCT-Banner is characterized as a system that will allow data extraction without the need for additional software. The Internal Audit Department will evaluate the capabilities of SCT-Banner when the finance modules are fully functional. If SCT-Banner is not compatible with the Internal Audit Department's data extraction needs, other data extraction software will be investigated.

The IT Auditor is now working full time and will split her efforts between system maintenance for the Internal Audit Department and performing information technology audits as described above. The Internal Audit Department will assess the need for additional IT-audit expertise when the risk-based audit plan is developed.

5. CREATE A SYSTEM FOR FOLLOW-UP OF OPEN AUDIT RECOMMENDATIONS

The IA Activity did not have an audit follow-up process to track and resolve open audit recommendations. IIA Practice Advisory (PA) 2500-1 defines follow-up by the internal auditors as a process in which they determine the adequacy, effectiveness, and timeliness of actions by management on reported engagement observations and recommendations, including those made by external auditors or others. PA 2500-1 suggests that the responsibility for follow-up should be defined in the internal audit activity's written charter. The nature, timing, and extent of audit follow-up should be determined by the (CAE).

Recommendation

We recommend that the CAE's audit follow-up responsibilities be highlighted in the update to the IA Activity Charter. In addition, the CAE should work with senior management to institute a strong audit follow-up system that contains elapsed time thresholds that trigger escalation of the issues to higher management levels when resolution cannot be achieved. The final threshold would be to refer the issues to the Board of Regents for final decision.

Audit Management's Response

The Internal Audit Department agrees with the observation and recommendation. The revised Regent's Policy 7.2, Internal Audit, states, "Internal Audit will perform follow-up reviews to ensure corrective actions indicated in the responses have been completed." The Internal Audit Department has

established a database to track the implementation of recommendations.

The auditor who performed the audit, follow-ups with the auditee(s) on a regular basis until all recommendations are fully implemented or otherwise cleared. The Internal Audit Department prepares a quarterly report indicating the status of each recommendation and submits the report to the Audit Committee for review. The report includes information on the length of time that a recommendation has been open. Unresolved issues will be referred to the President and Audit Committee for action.

**6. IMPROVE STAFF
MANAGEMENT
TECHNIQUES**

The Professional Practice of Internal Auditing *Standard* 2030 states: “The CAE should ensure that IA resources are appropriate, sufficient, and effectively deployed to achieve the approved plan. The IA Activity does not establish time budgets or summarize actual hours used during audits/projects and does not document anticipated completion dates. Use of one or both of these techniques helps the CAE better manage the audit process and increases the chances of delivering quality and timely value added audit results.

Recommendations

We suggest that actual hours are tracked, summarized, and analyzed by auditor and audit/project. In addition, we suggest that completion dates for audit phases, such as audit planning, field work and draft reporting, be compared to budgeted completion dates. This will help the CAE better supervise the IA Activity.

**Audit Management’s
Response**

The Internal Audit Department agrees with the observation and recommendation. Internal Audit has implemented Audit Assignment and Independence Statement forms. The forms include the budgeted hours for the audit and the anticipated completion date. The form also requires the auditor(s) to sign acknowledging the assignment and stating that he or she is independent and objective related to the specific project. The form includes a signed verification statement that the Director of Internal Audit has determined that the auditor(s) assigned to the project

is adequately skilled and that the Director is not aware of any impairments to the auditor(s)' independence and objectivity related to the project.

Internal Audit has implemented a database for tracking auditors' time spent on audits. Reports are available by auditor or by audit to determine the hours charged to date to each specific project. Timely completion of assigned work will be incorporated into the performance evaluation for each employee.

7. CREATE BETTER RELATIONS WITH CLIENTS

Interviews with university executives showed that there is little regular interface between the CAE and executives. One executive noted that he did not know the IA Activity existed for a number of years after he assumed his present position.

Recommendations

The CAE should meet with key members of management on a regular basis. One example of this process would be to institute quarterly review meetings with business unit heads to discuss audit findings, responses to audits, needs of customers, staffing issues for internal auditing and other subjects that educate and lead to more cooperation, understanding and support.

The CAE should also request that she attend the periodic strategic planning meetings to obtain a broader perspective of the Universities changing risks and to develop working relationships with key executives in the organization.

Audit Management's Response

The Internal Audit Department agrees with the observation and recommendation. The CAE will meet with top administrators at least quarterly to address their concerns and discuss significant control issues that may affect their areas. The CAE or a designee will attend all Board of Regents and Regents standing committee meetings to help obtain a broader perspective of the University and to increase the visibility of Internal Audit.

At the request of the University President, the CAE will be writing periodic articles/notices on University-wide issues identified in audits. This should help enhance the image of Internal Audit as a resource and create better relations with clients.

Internal Audit sent the risk assessment spreadsheet to 130 University officials requesting their input to assist in development of the annual audit plan. This has resulted in numerous contacts with University officials. Internal Audit personnel present a portion of the required training for the Principal Investigators at the University.

Internal Audit will send after-audit surveys along with the final versions of audit reports to give auditees an opportunity to provide feedback on the audit process. Surveys will ask respondents to rate the value added by the audit, auditor professionalism, readability of the report and other pertinent areas.

8. BETTER USE OF METRICS

The IA Activity should implement increased use of metrics to measure internal auditing performance against objectives. Useful measurements include tracking the number of process improvements, the number of major findings leading to recommendations, the percentage of recommendations implemented, the estimated amount of cost savings or revenue recoveries resulting from recommendations, and audit life cycle statistics such as elapsed time between audit phases.

Recommendation

We suggest that the IA Activity use the GAIN benchmarking data that they obtained from The IIA to establish management performance measures against which to evaluate the overall efficiency and effectiveness of audit operations. A one-page summary of results should be distributed to the UNM Board of Regents and the President on an annual basis, to assist in performance evaluation.

Audit Management's Response

The Internal Audit Department agrees with the observation and recommendation. The new CAE is establishing performance measures for the Internal Audit Department. The individual employee's performance expectations will be tied to the department performance goals. Measures will include:

Output

- the number of audits completed and the number of associated recommendations

Quality

- the percentage of recommendations implemented (closed) versus recommendations that are open
- the percentage of auditees who respond that the audit added value on after-audit surveys
- the total projected savings and increases to revenues as a percentage of the Internal Audit Department budget.

An annual report detailing the outcomes of the Internal Audit Department's efforts will be prepared for the Audit Committee. The report will include information on the actual performance and the established goals.

**9. IMPROVEMENTS
NEEDED IN
WORKING PAPERS**

We found that IA Activity working papers have room for improvement. The IA Activity did not have adequate procedures in its draft audit manual that conformed to the best practices outlined in the IIA Practice Advisory 2330-1. The working papers that we reviewed showed that:

- Draft reports are not kept in file. Keeping draft reports provides a trail of the way the audit issues noted in the audit are handled.
- Supervisory review notes were not kept. The Interim Audit Director indicated that the notes are destroyed after the concerns are resolved because maintaining them could result in future legal problems. Review notes provide a means of evaluating the quality of audit supervision and provide a basis for supporting auditor performance evaluations.
- A copy of final reports is not kept in the working paper file, nor is a copy cross-referenced to the working papers.
- Entrance and exit meeting notes for audits reviewed were not in the files. These documents are key to documenting what happened at the outset of the audit and what the reaction of management was at the conclusion of the work.

Benefits derived from work paper standards include consistent quality of output, retention of corporate knowledge, and an organized source of information for future, similar tasks. In addition, a standardized set of work papers enhances the process of replacing a team member or adding other staff part way through the assignment. One of the IIA *Standards*, 2330, Recording Information states that: “Internal auditors should record relevant information to support the conclusions and engagement results.” Work papers also serve to facilitate supervision and review.

Recommendations

We recommend that the IA Activity implement work paper standards, including sample formats, documentation requirements, indexing and cross-referencing techniques with sufficient flexibility to serve as guidance (not rigid mandates) for all types of audits/reviews/evaluations.

We also recommend that the CAE establish guidelines/minimum standards for performing and evidencing supervisory/peer review and approval of at least those summary work papers, which document performance of major phases of the work and support significant report comments and recommendations.

Audit Management’s Response

The Internal Audit Department agrees with the observation and recommendation. The revised Policies and Procedures Manual includes a section on work papers. Work paper standards that are/will be required include:

- Each work paper has standard heading information as well as the source and purpose.
- A copy of each version of the audit report sent to outside parties is maintained in the audit file. One file copy of the report is cross-referenced to the supporting documentation to facilitate the review process.
- Memos are prepared to document all audit meetings, including entrance and exit conferences.

- A log is prepared for each audit to help track the review process and document the Audit Manager and CAE's approval at various stages of the audit process.
- The Audit Manager's initials on each work paper reviewed evidence supervisory review. The Audit Manager initials the audit program for each section reviewed to indicate that the section meets standards.

The CAE is developing a post-audit checklist as an internal tool to ensure work paper compliance with *IIA Standards*.

Sample Audit Committee Charter

The following sample charter captures many of the best practices used today. Of course, no sample charter encompasses all activities that might be appropriate to a particular audit committee, nor will all activities identified in a sample charter be relevant to every committee. Accordingly, this charter must be tailored to each committee's needs and governing rules.

Audit Committee Charter

PURPOSE

To assist the board of directors in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the audit process, and the company's process for monitoring compliance with laws and regulations and the code of conduct.

AUTHORITY

The audit committee has authority to conduct or authorize investigations into any matters within its scope of responsibility. It is empowered to:

- Appoint, compensate, and oversee the work of any registered public accounting firm employed by the organization.
- Resolve any disagreements between management and the auditor regarding financial reporting.
- Pre-approve all auditing and non-audit services.
- Retain independent counsel, accountants, or others to advise the committee or assist in the conduct of an investigation.
- Seek any information it requires from employees—all of whom are directed to cooperate with the committee's requests—or external parties.
- Meet with company officers, external auditors, or outside counsel, as necessary.

COMPOSITION

The audit committee will consist of at least three and no more than six members of the board of directors. The board or its nominating committee will appoint committee members and the committee chair.

Each committee member will be both independent and financially literate. At least one member shall be designated as the “financial expert,” as defined by applicable legislation and regulation.

MEETINGS

The committee will meet at least four times a year, with authority to convene additional meetings, as circumstances require. All committee members are expected to attend each meeting, in person or via tele- or videoconference. The committee will invite members of management, auditors or others to attend meetings and provide pertinent information, as necessary. It will hold private meetings with auditors (see below) and executive sessions. Meeting agendas will be prepared and provided in advance to members, along with appropriate briefing materials. Minutes will be prepared.

RESPONSIBILITIES

The committee will carry out the following responsibilities:

Financial Statements

- Review significant accounting and reporting issues, including complex or unusual transactions and highly judgmental areas, and recent professional and regulatory pronouncements, and understand their impact on the financial statements.
- Review with management and the external auditors the results of the audit, including any difficulties encountered.
- Review the annual financial statements, and consider whether they are complete, consistent with information known to committee members, and reflect appropriate accounting principles.
- Review other sections of the annual report and related regulatory filings before release and consider the accuracy and completeness of the information.
- Review with management and the external auditors all matters required to be communicated to the committee under generally accepted auditing *Standards*.
- Understand how management develops interim financial information, and the nature and extent of internal and external auditor involvement.
- Review interim financial reports with management and the external auditors before filing with regulators, and consider whether they are complete and consistent with the information known to committee members.

Internal Control

- Consider the effectiveness of the company's internal control system, including information technology security and control.
- Understand the scope of internal and external auditors' review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses.

Internal Audit

- Review with management and the chief audit executive the charter, plans, activities, staffing, and organizational structure of the internal audit function.
- Ensure there are no unjustified restrictions or limitations, and review and concur in the appointment, replacement, or dismissal of the chief audit executive.
- Review the effectiveness of the internal audit function, including compliance with The Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing*.
- On a regular basis, meet separately with the chief audit executive to discuss any matters that the committee or internal audit believes should be discussed privately.

External Audit

- Review the external auditors' proposed audit scope and approach, including coordination of audit effort with internal audit.
- Review the performance of the external auditors, and exercise final approval on the appointment or discharge of the auditors.
- Review and confirm the independence of the external auditors by obtaining statements from the auditors on relationships between the auditors and the company, including non-audit services, and discussing the relationships with the auditors.
- On a regular basis, meet separately with the external auditors to discuss any matters that the committee or auditors believe should be discussed privately.

Compliance

- Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any instances of noncompliance.
- Review the findings of any examinations by regulatory agencies, and any auditor observations.
- Review the process for communicating the code of conduct to company personnel, and for monitoring compliance therewith.
- Obtain regular updates from management and company legal counsel regarding compliance matters.

Reporting Responsibilities

- Regularly report to the board of directors about committee activities, issues, and related recommendations.

Attachment A

- Provide an open avenue of communication between internal audit, the external auditors, and the board of directors.
- Report annually to the shareholders, describing the committee's composition, responsibilities and how they were discharged, and any other information required by rule, including approval of non-audit services.
- Review any other reports the company issues that relate to committee responsibilities.

Other Responsibilities

- Perform other activities related to this charter as requested by the board of directors.
- Institute and oversee special investigations as needed.
- Review and assess the adequacy of the committee charter annually, requesting board approval for proposed changes, and ensure appropriate disclosure as may be required by law or regulation.
- Confirm annually that all responsibilities outlined in this charter have been carried out.
- Evaluate the committee's and individual members' performance on a regular basis.

MODEL MANAGEMENT CONTROL POLICY

1. Management is charged with the responsibility for establishing a network of processes with the objective of controlling the operations of “XYZ Organization” in a manner which provides the board of director’s reasonable assurance that:
 - Data and information published either internally or externally is accurate, reliable, and timely.
 - The actions of directors, officers, and employees are in compliance with the organization’s policies, standards, plans and procedures, and all relevant laws and regulations.
 - The organization’s resources (including its people, systems, data/information bases, and customer goodwill) are adequately protected.
 - Resources are acquired economically and employed profitably; quality business processes and continuous improvement are emphasized.
 - The organization’s plans, programs, goals, and objectives are achieved.

Controlling is a function of management and is an integral part of the overall process of managing operations. As such, it is the responsibility of managers at all levels of the organization to:

- Identify and evaluate the exposures to loss which relate to their particular sphere of operations.
 - Specify and establish policies, plans, and operating standards, procedures, systems, and other disciplines to be used to minimize, mitigate, and/or limit the risks associated with the exposures identified.
 - Establish practical controlling processes that require and encourage directors, officers, and employees to carry out their duties and responsibilities in a manner that achieves the five control objectives outlined in the preceding paragraph.
 - Maintain the effectiveness of the controlling processes they have established and foster continuous improvement to these processes.
2. The internal auditing function is charged with the responsibility for ascertaining that the ongoing processes for controlling operations throughout the organization are adequately designed and are functioning in an effective manner. Internal auditing is also responsible for reporting to management and the audit committee of the board of directors on the adequacy and effectiveness of the organization’s systems of internal control, together with ideas, counsel, and recommendations to improve the systems.
 3. The audit committee is responsible for monitoring, overseeing, and evaluating the duties and responsibilities of management, the internal audit activity, and the external auditors as those duties and responsibilities relate to the organization’s processes for controlling its operations. The audit committee is also responsible for determining that all major issues reported by the internal auditing department, the external auditor, and other outside advisors have been satisfactorily resolved. Finally, the audit committee is responsible for reporting to the full board all-important matters’ pertaining to the organization’s controlling processes.

MODEL INTERNAL AUDIT ACTIVITY CHARTER

MISSION AND SCOPE OF WORK

The mission of the internal auditing department is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The scope of work of the internal auditing department is to determine whether the organization's network of risk management, control, and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- Risks are appropriately identified and managed.
- Interaction with the various governance groups occurs as needed.
- Significant financial, managerial, and operating information is accurate, reliable, and timely.
- Employee's actions are in compliance with policies, standards, procedures, and applicable laws and regulations.
- Resources are acquired economically, used efficiently, and adequately protected.
- Programs, plans, and objectives are achieved.
- Quality and continuous improvement are fostered in the organization's control process.
- Significant legislative or regulatory issues impacting the organization are recognized and addressed properly.

Opportunities for improving management control, profitability, and the organization's image may be identified during audits. They will be communicated to the appropriate level of management.

ACCOUNTABILITY

The chief audit executive (CAE), in the discharge of his/her duties, shall be accountable to management and the audit committee to:

- Provide annually an assessment on the adequacy and effectiveness of the organization's processes for controlling its activities and managing its risks in the areas set forth under the mission and scope of work.

- Report significant issues related to the processes for controlling the activities of the organization and its affiliates, including potential improvements to those processes, and provide information concerning such issues through resolution.
- Provide information periodically on the status and results of the annual audit plan and the sufficiency of department resources.
- Coordinate with and provide oversight of other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental, external audit).

INDEPENDENCE

To provide for the independence of the internal auditing department, its personnel report to the CAE, who reports functionally and administratively to the president and periodically to the audit committee in a manner outlined in the above section on Accountability. It will include as part of its reports to the audit committee a regular report on internal audit personnel.

RESPONSIBILITY

The CAE and staff of the internal auditing department have responsibility to:

- Develop a flexible annual audit plan using appropriate risk-based methodology, including any risks or control concerns identified by management, and submit that plan to the audit committee for review and approval.
- Implement the annual audit plan, as approved, including as appropriate any special tasks or projects requested by management and the audit committee.
- Maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications to meet the requirements of this *Charter*.
- Evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control processes coincident with their development, implementation, and/or expansion.
- Issue periodic reports to the audit committee and management summarizing results of audit activities.
- Keep the audit committee informed of emerging trends and successful practices in internal auditing.
- Provide a list of significant measurement goals and results to the audit committee.
- Assist in the investigation of significant suspected fraudulent activities within the organization and notify management and the audit committee of the results.

- Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the organization at a reasonable overall cost.

AUTHORITY

The CAE and staff of the internal auditing department are authorized to:

- Have unrestricted access to all functions, records, property, and personnel.
- Have full and free access to the audit committee.
- Allocate resources, set frequencies, select subjects, determine scopes of work, and apply the techniques required to accomplish audit objectives.
- Obtain the necessary assistance of personnel in units of the organization where they perform audits, as well as other specialized services from within or outside the organization.

The CAE and staff of the internal auditing department are not authorized to:

- Perform any operational duties for the organization or its affiliates.
- Initiate or approve accounting transactions external to the internal auditing department.
- Direct the activities of any organization employee not employed by the internal auditing department, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the internal auditors.

STANDARDS OF AUDIT PRACTICE

The internal auditing department will meet or exceed the *International Standards for the Professional Practice of Internal Auditing* of The Institute of Internal Auditors.

Chief Audit Executive

Chief Executive Officer

Audit Committee Chair

Dated _____