

**RISK BASED AUDIT WORK GROUP
GUIDELINES FOR ANNUAL AUDIT PLANNING AND RESOURCE ALLOCATION
FISCAL YEAR 2001**

The following risk model is for use in all University audit environments (campuses, laboratories, and medical centers.) Each predictive factor is assigned a score of one (lowest risk) to five (highest risk) on a judgmental basis. Scores are then multiplied by the proposed value weight indicated. The highest resulting risk index for any topic would be one thousand. It is anticipated that risk index results for audit topics in one environment would be comparable to risk index results for audit topics in other environments. For example, an index of 700 for a medical center topic would indicate the same level of risk as an index of 700 for a campus or laboratory topic.

DEFINITION OF PREDICTIVE FACTORS AND VALUE WEIGHTS

Management Control Environment

Assessment of control environment should be based on factors such as the adequacy of the existing control structure, expertise of management, historical problems, interval since the last audit review, conditions found during recent reviews, adherence to the budget, complexity of operations and technology, and the overall effectiveness and efficiency of operations. The relative performance of a function as perceived by other managers may influence risk. In general, effective management reduces overall risk.

Descriptive Key Phrases to Assist in Assignment of Subjective Judgement Factor

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|-------|---|
| One | <i>High confidence in control environment, well run organization, good reputation, efficient and effective operations, sound system of internal control, recently audited with good results</i> |
| Two | <i>Good confidence in control environment, audited within the last three years with reasonable results</i> |
| Three | <i>Reasonable confidence in control environment, audited with significant issues within the last five years but follow-up completed and corrective action implemented</i> |
| Four | <i>Limited confidence in control environment, not audited within the last five years</i> |
| Five | <i>Little or no confidence in control environment, no prior audit coverage, or fairly recent audit with significant unresolved issues or material cash losses, poor campus reputation, high whistleblower or grievance activity</i> |

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Business Exposure

Larger potential losses are normally associated with larger sized activities, as indicated by revenues and expenditures. Other things being equal, large dollar amounts either flowing through a system or committed to an activity or project will increase audit interest. Dollar amount and relative liquidity of assets safeguarded will impact this factor. Other objective information to be considered for each auditable unit includes: the dollar amount of cash receipts, receivables, inventory, and plant and property safeguarded.

Descriptive Key Phrases to Assist in Assignment of Subjective Judgement Factor

- One *Low probability of loss*
- Two *Exposure potential is relatively immaterial*
- Three *Exposure represents a relatively low percentage of total campus operations*
- Four *Exposure represents a moderate percentage of total campus operations*
- Five *Exposure represents a significant percentage of total campus operations*

Public and Political Sensitivity

A public relations exposure exists whenever an event occurs which would erode public confidence in the University. The probability of adverse publicity, reduced support, a tarnished reputation, erosion of the legitimacy of the University's mission, depletion of goodwill, and miscommunication of traditional values will influence this factor. Selected audit topics may not appear to be material, but could nevertheless influence risk. As sensitivity, exposure, or potential for public embarrassment increases, the risk factor assigned will increase. The amount of interest that The Regents or the Office of the President expresses in a particular unit or function could also impact this factor.

Descriptive Key Phrases to Assist in Assignment of Subjective Judgement Factor

- One *No press or local press interest in generic topic*
- Two *Exposure potential is relatively immaterial*
- Three *Somewhat politically sensitive, but interest is narrowly focused to a limited audience*
- Four *G-29 potential, State or Federal audit interest, high public interest*
- Five *Regents, national exposure, loss of funding, extreme public interest*

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Compliance Requirements

Compliance requirements addresses all internal and external policy, procedure, regulatory, and statutory matters affecting the operations of the organization as a whole or any of its sub-units. Complexity and clarity of internal/external requirements impacts an organization's ability to comply, and therefore influences risk. Risk associated with non-compliance relates to the inability to meet business objectives which can result in monetary loss due to improper business practices, the levy of fines or litigation, loss of funding sources, and disallowed costs from funding agencies.

Descriptive Key Phrases to Assist in Assignment of Subjective Judgement Factor

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|-------|--|
| One | <i>Few regulations, clear and simple policies, procedures, & guidance</i> |
| Two | <i>Limited regulations, flexibility permitted in meeting policies, procedures & regulations</i> |
| Three | <i>Moderate or significant percentage of transactions subject to policies, procedures & regulations; effective and efficient business processes</i> |
| Four | <i>Significant or high percentage of transactions subject to complex policies, procedures, & regulations; heavy fines, unallowable costs, somewhat inefficient or ineffective processes</i> |
| Five | <i>Significant or high percentage of transactions subject to complex and changing policies, procedures, and regulations; ineffective or inefficient processes; high probability of monetary or funding source loss</i> |

Information & Reporting

Information is needed at all levels of an organization to run the business, and move toward achievement of the entity's objectives in all categories. Information is used in developing financial statements for external dissemination, for operating decisions, and for monitoring performance, providing services, and allocating resources. Reliable internal measurements are also essential to planning, budgeting, pricing, evaluating vendor performance, evaluating joint ventures, and other activities. Other objective information to be considered for each auditable unit includes: the accuracy, availability, and integrity of the information provided either via manual or automated systems. Risk factors in weighting information/ reporting include the extent to which the process or entity depends upon a computerized information system and the complexity of that system. Issues to be considered include time sensitivity, mission criticality, support of life safety processes, campus wide impact due to the loss of access to information or reporting.

Descriptive Key Phrases to Assist in Assignment of Subjective Judgement Factor

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- One Point *High degree of accuracy, availability, timeliness & usefulness of information. Associated information systems or applications are fairly simple, stable, low criticality, loss of access to system generated information or reporting capability would have low campus, process, or entity impact.*
- Two Points *Some minor issues of accuracy, timeliness, or usefulness of information, Automated systems have some complexity, most reporting needs are met, and loss of access to system or reporting would have minor impact to campus, process or entity.*
- Three Points *Some potential for information to be not timely, useful, or meaningful. Automated systems may require some special training or expertise. Systems in mid-life of implementation cycle. (Not yet outdated or just newly implemented). Associated information systems or application has medium criticality, impacts more than one entity or processing systems.*
- Four Points *Uncertain reliability of data, timeliness of information or usefulness, Associated information system or applications are fairly complex, potentially unstable, loss of access to system or reporting will have fairly major campus, process or entity impact. Automated system may be older, with inability to provide necessary data, or newly implemented system not been fully tested/ bugs/ reporting worked out. System is complex, impacts other processes or entities, may support life safety process or entities.*
- Five Points *Low degree of information accuracy, availability, timeliness and usefulness, Information system is manual or outdated or new and untested. System is highly complex, has campus-wide impact, mission critical or supports life safety processes or activities. Computing risks have not been adequately addressed or controlled.*

Organizational Change/Growth

A function's existing and future operations can influence risk. Changes in management personnel or structure influence risk. Organizational structures may change significantly as the University moves from transactional and procedural controls to more innovative and diagnostic controls associated with paperless processing. In some cases, reorganization of responsibilities and activities can result in significant changes that compromise the internal control environment. Significant downsizing, early retirement programs, and reengineering efforts to streamline processes may also increase control risk.

Descriptive Key Phrases to Assist in Assignment of Subjective Judgement Factor

- One *Stable organization, no increase or decline in budget.*
- Two *Limited management change or personnel turnover*

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- Three *Average turnover in key personnel, average change in prior year budget*
- Four *Significant change in processes, downsizing, early retirements, turnover in key personnel*
- Five *High turnover, major system changes, significant reengineering, significant change in prior year budget*

Value Weights by Environment

Factor	Points (percentage)		
	Laboratory	Campus	Health Sciences
Management Control Environment	50 (25%)	50(25%)	50 (25%)
Business Exposure	40 (20%)	50 (25%)	30 (15%)
Public & Political Sensitivity	20 (10%)	20 (10%)	20 (10%)
Compliance Requirements	40 (20%)	20 (10%)	50 (25%)
Information & Financial Reporting	30 (15%)	40(20%)	30 (15%)
Organizational Change/Growth	20 (10%)	20 (10%)	20 (10%)