What Will the Future Bring?

INSIDE:

Increase Internal Audit Value through Co-sourced and Outsourced Models

The Importance of Workplace Conflict in an Investigation: It's Just not about the Technical

The Future of Auditing

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In March 2010, PwC released its sixth “State of the internal audit profession study” entitled *A Future Rich in Opportunity*. In that report, the question was asked “Needs and expectations are changing…is internal audit delivering?”

One of the interesting dynamics of internal audit is that while our primary objective – offering a “systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes” – remains the same, how management and governing boards want us to do that can change in reaction to the latest regulation, strategy session, or Chancellor’s initiative. So, how do we effectively manage our professional obligation to keep our eye on our primary objective while simultaneously adapting our audit plan, process, and philosophy as the environment changes?

To answer that question, two things seem to be necessary. First, we must have a solid understanding of the fundamental role and purpose of internal audit. Second, we need to correctly anticipate the changes in our industry and environment and posit how they will impact our organizations. In this issue of *CandU Auditor*, we’ve tried to help answer that question with articles that discuss the future of our industry and profession.

Michael Horn, co-author of *Disrupting Class: How Disruptive Innovation Will Change the Way the World Learns* (McGraw-Hill), contributed an excellent article on how higher education is changing. ACUA’s own Leigh Goller and Jim Sleezer provide some important insight on how the sourcing models of internal audit can change to meet the demands of our stakeholders.

I remember an ACUA-L thread a while back that included a few of our more experienced members discussing how audit has changed since the days of typewriters and six-column green sheets. With the rate of technological innovation only increasing, not anticipating the impact of new technologies – even over the next few years – would be bad. Because we can't anticipate every type of technology, Phil Hurd suggests four areas that technology will impact, and how we can prepare ourselves for those changes.

Of course, the future isn’t all about computers and changing compliance; even communication is changing in ways we need to understand. Don’t believe me? Put a 25-year-old auditor and a 60-year-old CAE in a room together and ask them to write an audit report; then step back and enjoy watching the difference a generation can make. Thanks to Anne McSorely, a presenter from our 2011 Annual Conference, you can read a bit about how to stay on top of your communication and interpersonal skills – regardless of the similarities or differences you share with your target audience.

To wrap it all together, I asked long-time ACUA member Don Holdegraver – on his way to make and enjoy his own future – to reflect on his nearly four decades of internal audit experience and leave us with some words of wisdom. His comments package this issue with a nice bow. Thanks Don.

The 2012 PwC “State of the internal audit profession study” leads with a section titled “The Heart of the Matter: Stakeholders Do Want Internal Audit at the Table.” The questions regarding internal auditors’ ability to adapt presented in the 2010 report seem to be answered by the 2012 issue with a resounding “Yes!” Even better, the resounding response seems to be coming from our stakeholders, not us.

We hope this issue helps you and your staff continue to understand higher education and internal audit, thereby preparing yourselves for the changes that are sure to come!
LETTER FROM
THE PRESIDENT

By Toni Messer,
President

Sesame Street debuted in 1969, when believe it or not I was still a little girl. I learned a lot of good lessons from that show, even though it may have caused my addiction to cookies. I learned to count, share and get along with others, follow the rules, listen, make decisions (One of these things is not like the other 7) and plan (7 Can you tell me how to get; how to get to Sesame Street?7) – all things that eventually prepared me to be an internal auditor, and President of the most VALUABLE resource that higher education audit, compliance, and risk professionals have: ACUA!

Many of you heard during the Business Meeting at the Annual Conference last September that the goal for the year is “Providing VALUE: Promoting ACUA in Higher Education.” The Board has been busy fulfilling that goal, with the assistance of our wonderful volunteers. For example:

• The Promoting Internal Audit video premiered at the Business Meeting.
• The Midyear Conference debuted ACUA’s first ever ACUA Leads! Group. This is an excellent program to help cultivate our future leaders.
• A Privacy Policy was approved to help ensure the protection and privacy of members’ personal information.
• The Best Practices Committee surveyed members about Institutional Compliance, and the results are included in this issue.
• The Start-Up Guide for new audit departments is about to be released!
• A new ACUA Faculty Director, Betsy Bowers from the University of West Florida, is working on enhancements to promote that program.
• ACUA is collaborating with other associations and promoting our knowledge and services, such as with the University Risk Management and Insurance Association (URMIA), the Higher Education Compliance Alliance, NACUBO, and the Society of Corporate Compliance and Ethics (SCCE).
• The Auditing and Accounting Principles Committee responded to an exposure draft of the proposed revisions to COSO on behalf of the ACUA Board. Its response will be posted to the Member Resources section of ACUA’s website.
• Is there an APP for that? Yes – there will be soon! Social Networking and Web Services are regrouping, and improvements continue. Are you an ACUA Facebook fan? Do you Tweet? Are you on LinkedIn? If not, see how you can be at our Social Networking website.
• And most importantly, the Board met for a one-day strategic planning session to focus on what ACUA needs to do differently in the future to sustain success. We had great discussions on ACUA’s Core Purpose, Core Values, a big audacious goal, goals for the future, and key success factors. Look for future communication regarding the strategic plan once it is formalized.

If you were unable to attend the Midyear Conference in Charlotte, you missed out on a great conference! The turnout was one of the best in recent years, thanks to a great program directed by Jana Briley from Georgia Southern University and the Professional Education Committee. I attended Phil Hurd’s class on IT Risk Assessment, and I’m eager to use the materials he provided. I also heard lots of great feedback on the Compliance, Fraud, IDEA, and Basic Auditor Training courses. Mark your calendars for next April as ACUA Midyear moves to the west coast in Seattle, Washington!

Enjoy this issue – thanks to our great authors, you’ll learn more about counting (Institutional Compliance Survey), sharing and getting along with others (Workplace Conflict), decision-making (Sourcing Models and ERM) and planning (The Future of Internal Auditing). And by the way, survey results indicate that 45.5% of Board members would be Cookie Monster if they were a Muppet. Luckily – there were no Oscar the Grouch lovers! What Muppet would YOU want to be? See y’all September 9-13, 2012, on the River Walk in San Antonio, Texas! This issue of the President’s Letter is sponsored by the Letters A, C, U, and A.

Toni Messer
President
Internal auditors live by the credo of providing value through independent, objective and informed assessment of risks, controls, processes and outcomes. Knowing that the evaluations we perform are fuel for the fire of improving organizational effectiveness and efficiency, why do we instinctively fear borrowing a match or a bellows from third-party resource providers? We manifest this fear with logical resistances such as we'll lose control of our internal audit function, successful co-sourcing will lead to full outsourcing, they will not understand our organization or culture, they may do a better job and it will cost too much.

Our institutions expect and depend upon internal audit to keep pace with the evolving strategic and operational risks, business process changes, information technology advancements and the effects of increasing financial pressures. As executive leadership and the audit committee elevate the expectations of internal audit’s role in the institution’s mission and objectives, we may need to bring specialized knowledge to bear. Or, we may need to supplement full-time audit staff with temporary resources to effectively deliver on the audit plan. Knowing when and how to leverage third-party resources will help you stoke the flames to a warm glow of success.

WHAT ARE THE THIRD-PARTY RELATIONSHIP OPTIONS?

**Insource** is the in-house, hands-on, do-it-yourself approach. Your internal audit department provides all the services, takes responsibility for oversight and quality assurance, and reports the findings to management and the audit committee. The internal audit department selects the audit, establishes the engagement, prepares the audit program, conducts the audit, retrieves and analyzes data, reviews the work, issues the report and conducts any follow-up procedures. Insourcing doesn’t necessarily mean that internal auditors have to do everything. For instance, an audit shop might utilize assistance from the organization’s information technology staff to retrieve data for analysis. The key is that everything is within your organization; you aren’t relying on resources outside your system.

**Outsource** is the hands-off, rely entirely upon a third-party resource approach. The institution purchases the services and depends on the external provider to manage delivery and report results to management and the audit committee. Outsourcing can include a) a specific audit project (partial outsource), or b) the entire audit department (full outsource).

The institution can also choose to outsource the internal audit department, hiring an external firm to provide the entire audit function. This doesn't, however, totally eliminate institutional participation as IIA Standard 2070 requires that, “when an external service provider serves as the internal audit activity, the provider must make the organization aware that the organization has the responsibility for maintaining an effective internal audit activity.”
OUTSOURCING

Duke University relies on a few general contractors to execute significant capital construction projects and historical renovations. While we leverage a competitive bidding process, we also place great value on the trusted relationships that have developed over time. During a period of significant capital expansion, Internal Audit identified an opportunity to leverage audit expertise as a tool for ensuring the cost of our construction is in line with the contract and its change orders.

After considering the depth of expertise necessary to effectively conduct the audits and the fluctuating nature of long-term construction activity, we determined that partial outsourcing represented the best option to achieve the agreed-upon institutional objectives. Together with facilities leadership and the project management office, we defined our needs and researched potential vendors that would be able to deliver high-quality and timely audit services. Following a request for proposal and vendor interviews, we selected three preferred vendors: two boutique audit firms with deep construction audit expertise and one national accounting firm with a well-developed construction internal audit practice.

Together with management, we defined the thresholds for obtaining the desired level of contract review and cost verification procedures. We tasked our preferred vendors with designing audit programs to meet the defined requirements, to coordinate with the general contractors to conduct the audits, report findings to management and participate in negotiations with vendors for any disputed costs. With this outsourced arrangement, Internal Audit does not direct or oversee the work of our preferred vendors. Instead, we participate alongside management to understand the nature of the findings and identify opportunities to improve internal business processes for project management. If the construction audits identify a material issue, we include a brief summary of the findings as a supplement to our ongoing audit committee communications.

The choice to outsource a specific audit project can originate from an internal audit recommendation, management request or an audit committee request. It should also be noted that if the entire department is outsourced, IIA Standard 2070 still applies. This requires that, “when an external service provider serves as the internal audit activity, the provider must make the organization aware the organization has the responsibility for maintaining an effective internal audit activity.”

Co-source is a hybrid of insource and outsource. It means internal audit works with external resources to achieve the audit plan. Co-sourcing can take many forms, including staff auditors, validators and partners. The common denominator is that the institution has a director of internal audits, chief audit executive, chief internal auditor or similar position.

When you co-source auditors or audit projects, the institution obtains some or all of the audit staff from an external audit firm. The director is the conduit between internal audit and management and the audit committee.

As a validator, the external audit firm serves as subject matter experts for specific risks or projects, supplementing your knowledge of the organization with topical expertise you don’t have in-house. Audits are conducted by in-house staff, with expert advice and results validation from the external firm.

In a partnership, internal audits and an external resource jointly complete the audit activity. In-house and external staff work side-by-side to conduct the audit and report results with the oversight of the director of internal audits.

Temporary staffing is a form of insourcing. Firms that have specialty internal audit support practices sometimes alternatively call this co-sourcing. An internal audit department may obtain temporary staffing resources from professional services firms, staffing agencies or independent contractor relationships.

WHICH MODEL IS RIGHT FOR YOU?

There is a seemingly endless array of options for resourcing audit activity. To complicate matters, building an audit plan that is responsive to emerging risks, operational trends and advancing technologies requires annual consideration of the resources and unique skills necessary to meet stakeholder expectations. Leveraging resource partnerships, in addition to vigilant recruiting and staff development, can be a valuable way to create and maintain flexibility. To deliver the right value at the right time, consider if and when each model may be appropriate.

INSOURCING

Insourcing is a good choice when your department has all the necessary skills or can obtain them within your time and cost frames. You might choose to insource when you are dealing with ongoing issues, your regular business or audits that occur regularly or repeat with some frequency. Insourcing is also appropriate when institutional knowledge or relationships are critical or when maximum institutional control is desired. If you determine you need to periodically supplement resources or skills, you can consider partial outsourcing, co-sourcing, or temporary staffing options to successfully achieve your audit plan.

OUTSOURCING

Outsourcing can be a good option for certain types of audits. Some institutions may choose to outsource audits that require a highly specialized skill set or knowledge, when it doesn’t make sense to have internal audits’ staff obtain the necessary skills or knowledge. In addition, it might be too costly to obtain the skill set.

The expense – both time and money – to acquire the skills and knowledge in-house may simply be too great for the return. Examples include construction audits, complex regulatory compliance audits and network penetration vulnerability audits. These audits can be arranged and funded by management and may not appear on your annual audit plan. In
CO-SOURCING

Oklahoma State University’s Department of Internal Audits has been successfully co-sourcing selected internal audit activities for more than ten years. The original need was in the area of information technology. The first step was defining requirements and inviting proposals for an IT risk assessment. That was followed by purchase of supplemental information systems/technology audit services on an hourly basis for projects where in-house skills were not sufficient.

The initial co-source agreement was approved by OSU’s Board of Regents in January 2000 and has been renewed annually with new proposals considered at about five-year intervals. Co-sourcing combined the experience and system familiarity of in-house auditors with specific, highly technical skills of outside staff brought in for selected projects. Co-sourcing has also been used to help with construction and medical audits.

MANAGING THE RELATIONSHIP

When Oklahoma State University started co-sourcing over ten years ago, it was difficult for firms to provide any related experience. There’s been some change over the years but it’s still an area where we have to consider similar but not necessarily direct co-source experience. It’s still a little difficult to distinguish co-sourcing from outsourcing in discussions with potential service providers. Over the years, we have developed a method of selecting service providers that works well for us.

Criteria we’ve used for selecting a co-sourced firm include the firm’s history of competency and successful experience with similar engagements. Past performance is the best indicator of future performance. We want to make sure that the firm is compatible with internal audit’s current and anticipated needs. We also want the firm to have proven experience in the content areas we’re interested in. We ask proposers to provide team member credentials and information about their staff. We’re particularly interested in management experience as staff may change over time. Another important measure for us is the firm’s responsiveness to the proposal requirements we outlined in the RFP. We look for a response tailored to our proposal. If we just get boilerplate responses, that’s an indicator that the audit work we get may not be up to our expectations.

Our ideal co-source relationship brings depth and breadth of experience. While it is necessary to focus on the areas where we expect near-term assistance, we value the flexibility of knowing we can go to our partner for other future needs. The final considerations are the fee structure and the firm’s ability to meet our timelines. If the firm can’t perform on our schedule for a price that is fair, they won’t be of much value.

CO-SOURCING

Co-sourcing may be a good choice when you have too many projects on your audit plan to complete with the resources at hand. Alternatively, you can shorten the delivery timeline on a substantial audit project by supplementing internal staff with co-source staff. In some cases, the cost of obtaining or maintaining a particular skill is disproportional to the organizational need. Using a co-source partner can reduce these costs because the co-source partner can spread the acquisition and maintenance costs over multiple audits.

As an example, technology infrastructure and information technology risks change quickly and a limited staff can’t keep up with everything. Co-source expertise can help conduct these projects. In addition, working side by side with a co-sourced expert can help your staff increase skills in specific operational areas, audit engagement management and client communications. It can also serve to train your staff to perform the same or a similar audit the next time without co-sourced assistance.

Bringing in a co-source validator can increase credibility with subject matter expertise and may help shift the risk tolerance threshold with targeted consultation. A validator may offer unique perspective, knowledge of global benchmarking or depth of knowledge to areas such as regulatory compliance, narrowly-focused business lines and investigative services.

• Additional examples of successful co-source projects:
• Vendor contract price compliance and cost recovery
• New system post-implementation testing
• Regulatory compliance verification (sponsored program activities, employment actions, import and export controls, Americans with Disabilities Act, anti-corruption, etc.)
• Fraud, waste or resource abuse investigations
• Foreign business unit or regional office controls assessment
• PCI compliance
• Medical billing documentation and coding

TEMPORARY STAFFING

Temporary staffing may be used to bridge extended absences in key positions or to initiate an internal audit transformation, a redesign of the internal audit risk assessment, engagement execution and reporting model. The institution retains an internal audit staff and hires the third-party resource to provide departmental leadership.

MANAGING THE RELATIONSHIP

External firms often have a co-source definition that differs somewhat from how in-source internal auditors might understand the relationship. Depending upon the accountability structure and the strength of leadership, a firm hired for specific expertise could ultimately gain more influence with institutional leadership and
the audit committee, resulting in more of an outsource relationship model. Consider these practices for effectively managing the co-source relationship:

Clearly define your needs and request proposals from multiple firms. Consider proposals carefully: Firms may try to sell you what they know they do best; it isn’t necessarily what you need. You, not the external firm, are responsible for meeting your organization’s needs. External providers may try to get you into their model rather than fitting themselves to your model. They may have some very good ideas but what is important is that you meet the needs of your audit committee.

Establish performance expectations in the professional services contract or engagement letter. Define the work product and who is responsible for what part of the audit. Provide clear procedures for feedback, issue escalation and reporting. Clearly state limitations on hiring away talent from one another. Document requirements for receiving and approving assigned resource credentials and a mechanism to dismiss resources that are not performing or do not adhere to organizational values.

Manage engagement staff and provider relationships. Design and consistently execute thorough engagement coordination, planning and supervision. Establish the appropriate fee structure that matches the type of work. Co-source staff should be retained based on a per hour fee; with a “not to exceed” amount.

Ensure co-source staff has a dual reporting relationship to the firm’s engagement partner and to the CAE (or audit supervisor). Partner firms need your supervision to keep them on track to meet your needs. While they may have technical expertise, they may not understand organizational requirements or culture. A co-source partner works for the internal audit department. They do not work for the Board or audit committee. While situations may arise where the co-source partner may be invited to present their work to the audit committee, typically internal audit leadership retains responsibility for providing the committee with results of audits and updates on the audit plan.

Take responsibility for adherence to professional standards and institutional or departmental policies and procedures. Internal audit departments are required to adhere to the IIA Standards. Co-source partners should also operate in conformance with the Standards as well as institutional and departmental procedures, such as reviewing work, formatting reports and maintaining confidentiality.

Retain all work papers. Your institution should have standards related to retention of work product and they should apply to the co-source partner. Ownership of work product should remain with the institution, not the external firm.

Evaluate the service provider’s performance. Every external person who participates in an audit should be evaluated. This doesn’t need to be a complex process but should allow internal audit to identify and eliminate poor performers. Criteria should be established for measuring the service provider’s performance. Among other things consider timely performance, accuracy and completeness of documentation, effective communication and contribution to the total audit effort.

**CONCLUSION**

Co-sourcing and partial outsourcing take some time and effort to coordinate. The resources can be more costly than internal staff; however, the external partners bring valuable expertise and provide you with scalable flexibility. Good up-front coordination will result in better, more efficient and more timely audits. Recognize that the right co-source partner can help you deliver better results on well-defined portions of your audit plan. Co-sourcing is intended to be a truly cooperative effort between the department and the external partner. By emphasizing the expectation that you’re working in concert with one another, you can ensure that you’re playing from the same score.

What is the most critical factor to consider when evaluating sourcing options? Determine which arrangement allows your department to best meet the expectations of your stakeholders including your audit committee. The choice is up to you for how to fan the flames higher!
The Importance of Workplace Conflict in an Investigation: It’s Just not about the Technical

By Anne McSorely and Kate Bothwell-Wendel, WorkBest Consulting

We all encounter and work through various conflicts and stressors in our work and personal life on a regular basis. We may start our day with an internal conflict regarding our breakfast choice; oatmeal is good for the heart but bacon, eggs and hash browns may sound much more appetizing. A child does not get up in time and misses the school bus and our day is starting early with a critical meeting. We arrive at work and find out the critical meeting has been postponed to later in the day due to a scheduling conflict and is now at the same time as another meeting we must attend.

Internal conflict arises when there is an inconsistency between our beliefs and the actions we choose. Interpersonal conflict develops when there are incompatible ideas, goals and interests. Conflict is frequently a request for clear communication. Conflict motivates us towards some type of action. Constructively resolved conflict provides opportunities for change and growth. Unresolved and/or poorly managed conflict can have a profoundly destructive impact on organizations and employees.

Consider the five scenarios below which are all composites of real life workplace situations.

**Scene 1)** A manager is discussing his concerns about an employee with a human resource representative. The employee is described as exhibiting erratic behavior, including inappropriate outbursts, vague threats to no one in particular and a hostile physical demeanor. However, no documentation is noted in the personnel record nor has there been an official reprimand or an employee assistance referral. Both the supervisor and HR decide to “wait and see” what develops.

**Scene 2)** The highly visible academic chair is holding a faculty meeting with three of his chairpersons. He begins by inviting discussion about how to cut 10% from their budgets – outlined with precision in his presentation. As each colleague presents their version of the proposed cuts, he systemically points out the flaws in each of their thinking. The meeting comes to a close with budget decisions that mirror the academic chair’s.

**Scene 3)** Two teams are merging into one team in the workplace. Team A has prided itself on the value of all team members’ input in decision making. Team B has focused on seniority and rank as the indicators for making decisions. Team A expresses a need for the new team to quickly be effective in meeting increased work demands. The group votes on a new decision-making format that closely mirrors Team B’s.

**Scene 4)** A work group has just realized there is a possibility of a significant safety concern with a time-sensitive project it has put an extensive amount of time and energy into and are close to completing. The group is divided on next steps, some want to notify senior management of their dilemma and others want to keep moving forward. The group decides upon a solution that will minimize, but not eliminate, the risk.

**Scene 5)** An auditing group has been working on a very complex audit with many technical, financial and interpersonal concerns. The group believes it has a good perspective; however, it is not 100% comfortable with it. The group has a deadline and after an open, frank discussion decide to move it back to further research its concerns.
Work place statistics reflect that 60-80% of all difficulties in the organizations stem from strained relationships between employees and not from deficits in skill or motivation. In fact, destructive workplace conflict (gossip, drama, rigid positioning, frustration, anger and resentment) leads to all kinds of risks, including the behavioral kind. Productivity is wasted, grievances are lodged and as conflict escalates, retaliation frequently occurs.

Organizations and individuals respond to conflict in various ways dependent upon numerous variables. There are five behavioral approaches that are most commonly utilized. Avoiding and Directing are the two approaches most often seen in the work place. Directing allows for decisive solutions that provide the decision makers an opportunity to quickly move onto the next concern. Avoiding allows for energies to be focused on other concerns with the hope that the situation will improve on its own. Both are very reflective of time-pressured workplaces that are being asked to do more with less and reactivity has become the norm. The other three behavioral approaches are: Accommodating, Collaborating and Compromising. The scenarios above reflect all five approaches.

In the first scenario, avoiding may give the troubled employee time to reach out to her Employee Assistance Program and ask for help. Avoiding can also have devastating outcomes, especially if the employee’s behavior escalates and there are no formal policies in place to frame her behavior.

The directing style in scenario two, may move process forward and make the hierarchy happy—after all, he’s been successful with that style in the past. On the other hand, the ill will he may have created by not listening or incorporating his colleagues’ idea with his own may create resentment and a toxic work environment.

Team A in scenario three exemplifies accommodating. It allows for the team to move forward in a timely manner, yet there is a strong possibility that creativity and differing perspectives, both of which may encourage positive change within the work group and organization will no longer be accepted. There is also a high probability that internal team resentments will grow.

In scenario four, compromising ensures the group will meet its deadline and the safety risk has been lessened, yet it has not been eliminated. There is still the possibility of a very destructive outcome.

Scene five reflects collaboration and is one many of us strive for. It allows for the best possibility of all being heard and concerns being attended to, however it can also be time consuming and potentially costly.

Why is this relative to auditors? Auditors are often brought into projects that are not just about the technical. Auditors are responsible for identifying organizational risks and assisting with potential solutions. Organizational conflicts are frequently messy and fraught with emotional undertones that the participants are not necessarily aware of. Decision making has a strong emotional component to it that can have more weight than the “objective” perspective. Unresolved conflicts escalate emotions and move from being about a situation to becoming personal. As the participants become fixed in their perspective and position, believing there is no other option, risk escalates. Participants then justify their actions based upon their belief that they are not being heard and valued in the conflict.

This is an opportunity for auditors to include an assessment that is systemic in its view of the problem and objective and neutral in focus. Messy conflicts are frequently responded to reactively and there is a significant risk of the real problems being overlooked when the focus is on the most recent, urgent dilemma.

A seasoned professional knows when to expand his or her auditing repertoire and look beyond the numbers. Hidden, unresolved conflicts can be brought out into the open for both clarity and positive resolution when individuals and organizations understand the potential risks of ignoring them.
The Future of Auditing

By Phillip W. Hurd, CISA, CISSP

For years, Hollywood has made motion pictures depicting time travel. A favorite source of speculation and conceptualization is the future. It seems that mankind as a whole has a fixation with what the future may hold. Auditors aren’t much different with the exception that we use facts about past events to determine a perspective on future risk.

An auditor I once worked with was fond of saying, “an optimist is just a pessimist with less data.” That may not always be the case but it certainly seems that auditors are stereotyped that way. However, by examining current trends, extrapolating out likely paths of career motion, a prediction of the future for an internal auditing professional’s needs and concepts can be made.

The foundations of a good control structure are found in the underlying concepts of control. Those concepts of control haven’t changed very much over the past couple hundred years. For example, it was not a good idea to have the same person taking the money, counting the money, depositing the money, and reconciling the accounts, in the 1800s just as it is a poor idea to do so now – at least if any expectation of control is necessary.

The difference, largely due to the ever-increasing influence of technology, is that business happens much faster and is even easier to manipulate. I am certain that some of my IT colleagues will have issue with the previous statement, but I have found in most instances it is accurate. Here is an example: in 1970 only 15 percent of Americans had credit cards. By the year 2007, 93 percent of the population of the United States carried credit cards and 96 percent had some form or method of electronic payment.

As such, to the current generation, the idea of having a big pile of cash somewhere that you take out to pay your power bill, phone bill, food bill, etc. is becoming, if it isn’t already, very foreign. By taking the trends of the past 30 years and drawing conclusions from them about the reduction in the use of cash to purchase goods and services and following through the timeline to the future, it is likely that one day cash will simply not be used. There are large segments of trade industries that currently do not take or deal with cash. Examples of this practice are Internet shopping, Sam’s Club gas stations, and many mail-order facilities that no longer accept cash as a form of payment, and some will not take any form of non-electronic payment. If we follow that path out another 20 years, it’s likely that only the smallest of trade services will still accept cash.

This perspective on the future is offered as it relates to internal auditing in higher education with a brief explanation of the trends that will likely indicate the coming change. The fundamental concepts of control will not change, but I do believe that information technology, the quest for new and additional knowledge, and the desire for many organizations to have a competitive advantage against their peers will drive change.

There are four primary areas in which the future appears to already be changing and will be very different for internal auditing. The four areas are: data analysis, training, reporting, and workflow. Each area has shown tremendous change in the past five years and the continued impact of those changes will be far-reaching. Most of us do not possess the vision of a Hollywood director, but do have an understanding that tremendous changes are coming to our profession. So it is worthwhile to put some thought and articulation into what that change may be so that we as the current generation and leadership of internal auditing can ensure that we embrace it and continue to excel.

DATA ANALYSIS

There is an old saying that finance is the language of business. If that’s true, then information systems are the vocal cords and data analysis is the volume. Data analyses and the tools to support it are maturing and excelling in the marketplace. Data analytics, a skill set once reserved only for the most technically savvy information systems auditor, will (and is) become a commonplace in every auditor’s portfolio of skills. Affordable software that allows business intelligence and data analytics, once only reserved for super-funded organizations such as Fortune 500 companies, is now available to even the smallest of audit shops. Skills in programming are no longer necessary while skills in math and statistics are becoming more of a necessity.
IDEA, software specifically designed for data analysis, allows the assessment of extraordinarily large sets of data in very little time. The audit shop at Georgia Tech was able to deploy IDEA on a vendor audit and in a matter of hours identify several instances of “inappropriate” vendor relationships. Continuous control monitoring, a concept of real-time data analytics, offers the potential to identify issues as they happen rather than after the fact. By performing continuous control monitoring, the audit shop has the potential to promote progressive business intelligence and increase driven assets to the organization; while maintaining control, compliance, and financial issues.

**TRAINING**

In any field that is driven by change, leadership must understand the need for training. Enhanced skill sets are necessary to accomplish tasks in the ever-increasing dynamic complexity of compliance, auditing, investigation, and forensic accounting. However, training, especially as a vision of the future is accentuated, will take a different perspective for most folks from what it is now. As travel costs continue to increase, less travel to large-scale convention type training is likely with an increase in more localized regional training, as well as computer-based training. For example, when the Association of College and University Auditors first offered webinars less than 100 people attended the first one and there were only four per year. Now, there are eight per year and attendance for most tops 300.

Envisioning the training space of the future tends to call for an increase in modular-based skill sets, individualized training, and the increased emphasis on information technology related skills over the coming decade that will allow individuals, on an as needed basis, to access the enhanced skill sets necessary to the job. Training typically yields a large budget and can be a resource issue and therefore, concentrated efforts will have to be practiced by internal auditing leadership to ensure that quality employees are produced, retained, and enhanced.

**REPORTING**

An area that has seen a great deal of change over the last decade is reporting. In the late 1990s, when I first started in auditing, reports with card stock covers and wire bindings was the norm for reports received from the state, Board of Regents, our external audit firms, and a variety of other sources. As the years progressed, the reports changed forms and became “saddle stitched.” More recently automated work papers systems such as TeamMate have given us the ability to interactively present reports. Conclusions can be reached that in the next five years many audit shops may be providing only electronic data versions of reports. In turn, the reports themselves will become data driven and in-depth as the ability to compartmentalize and present the information in modular and varying forms increases.

**WORKFLOW**

The coming changes in multiple areas will likely face difficulty in staff adaptation, but perhaps none so much as the workflow of the internal auditing office. In the last generation white-collar jobs, such as auditing, have seen a dramatic decrease in the number of people who are required to be at a centralized location for an entire workday. White-collar jobs, such as auditing, have seen a dramatic decrease in the number of people who are required to be at a centralized location for an entire workday.

The benefits of the advancements in all of these areas are fairly self-evident: reduced commute times, increased productivity, better work-life balance, and access to the workforce of an entire nation rather than a localized region or area. All of this sounds wonderful, and certainly will be; however, there are some challenges. Technicial skills and the ability to self-motivate will be necessary components of the internal auditing profession. Oversight and supervision will become more difficult and require greater quantification and analytical skill.

As this new paradigm integrates itself into our culture, the current “mature” generation will likely have the hardest time living in it. It will happen. Just 20 years ago it was common place to go to the library to read an encyclopedia; now, as of earlier this year, World Books ceased production of printed encyclopedias in favor of an interactive, online, multimedia-driven knowledge experience. The generation just born will never know what a “volume of encyclopedias” is because they will not have existed as a necessary component of learning. These patterns of culture are happening in every field and internal auditing is no different. Current leadership must embrace the future, control the present, and develop a path to assure the continued sustainability of our profession.
ACUA’s Institutional Compliance Survey, Part I: How is Higher Ed Doing?

By Ann Hough

The Best Practices Committee conducted its first Institutional Compliance Survey in January with the goal of gauging the trends in organizational awareness, organizational structures, and operational methods of institutional compliance within our member institutions. The article below summarizes the results. Thank you to all who participated.

RESPONDENT BACKGROUND
A total of 23 members responded to the survey; 83 percent of which were from public institutions. The largest portion of the respondents, 41 percent, worked for larger institutions (defined as having more than 20,000 FTEs) and another 27 percent reported working for institutions with FTEs of between 10,000 and 20,000. Most of the responses, both numeric and commentary, indicated that compliance oversight was fairly self-contained within the institution’s boundaries. At least two (one state and one international university), however, indicated they were subject to relatively rigorous monitoring by governmental agencies.

ORGANIZATIONAL AWARENESS AND STRUCTURE
It is no secret that institutional compliance is gaining more attention as an area that warrants accountability at high levels within the organization. In her article Building a Compliance Program in Higher Education Institutions Without Compliance Officers (College and University Auditor, Spring 2009, page 7), Susan Keller highlights the challenges presented by the inherent diversity of activities conducted in higher education. She writes: “Colleges and universities have been struggling to find the most cost-effective and comprehensive means to tackle diverse sets of compliance requirements at a time when Boards of Directors, management and stakeholders are demanding transparency and accountability and pointedly asking what is being done about compliance.”

Ms. Keller continues, “Regardless of the complexity involved in managing compliance, a breach in any of these areas can have serious consequences, including fines, penalties and reputation damage.” An institution accustomed to decentralized accountability for compliance activities could find the task of formalizing a more centralized institutional compliance function the practical equivalent of, say, herding cats.

Member institutions’ responses to this challenge are evidenced in how long their compliance functions have been in place. In response to the question, “How long has institutional compliance been identified as a separate and distinct function at your institution, with responsibilities identified and assigned to specific individuals/departments/committees?” a full 81 percent of the respondents indicated that their institutions had realized a need for a more defined compliance function more than five years ago. Only 18 percent indicated that the idea of compliance as a function had taken hold in their institutions less than two years ago.

However, there appears to be a difference between realization of compliance as a distinct business objective and implementation of an organizational structure that reflects this. When asked: “Does your institution have a dedicated institutional compliance function? (Dedicated is defined as a function whose sole responsibility is compliance),” only 13 percent of the respondents indicated they had a stand-alone institutional compliance department and another 35 percent indicated that com-
Compliance was defined, but embedded in another area (such as audit or legal). The remaining 52 percent indicated that their institutions did not have the dedicated compliance function.

Furthermore, 59 percent of the respondents indicated that staffing dedicated solely to institutional compliance was less than five individuals, and a full 18 percent indicated their institutions had no dedicated staff at all.

**Organizational Accountability**

Given that few institutions disclosed a dedicated compliance function, the question arose as to what other responsibilities the compliance officer or department performs. In response to the question, “Does your institution have a Chief Compliance Officer?” exactly half of the respondents answered yes. But when asked what other positions the designated CCO holds, all respondents indicated that their CCO wears another hat at their institution, the most common being that of Chief Audit Executive.

While the other half of the respondents, those without designated CCOs, had similar results, their responses were also revealing.

<table>
<thead>
<tr>
<th>Absent a designated Chief Compliance Officer, which executive level individual(s) is/are responsible for institutional compliance? Please select all that apply.</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
</tr>
<tr>
<td>General Counsel</td>
</tr>
<tr>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>Chief Internal Auditor</td>
</tr>
<tr>
<td>Chief Risk Officer</td>
</tr>
<tr>
<td>Chief Financial Officer</td>
</tr>
<tr>
<td>Chief Operating Officer</td>
</tr>
<tr>
<td>Other, please specify</td>
</tr>
</tbody>
</table>

Aside from the obvious eyebrow-raising percentage of those that indicated they had no executive accountability for institutional compliance, the percentages above indicate that the perception of where compliance reasonably fits into the governance structure varies widely within the industry.

Meanwhile, the “Other” category in the table above yielded some interesting results: roughly half of these respondents indicated that the accountability for institutional compliance had been delegated to the academic, rather than administrative, side of the institution – an option not even offered in the survey. Of these, most indicated these individuals on the academic side were also responsible for research, a figure which may be explained by the fact that 52% of the overall survey respondents indicated that their institutions were research intensive, and the exact same number indicated they had medical facilities.

Regardless of the placement of institutional compliance within organizational charts of the institutions, it appears that those held directly accountable are afforded access to the highest levels of governance. Responses indicated that of those executives responsible for compliance, 43 percent reported directly to the Board of Directors or equivalent governing body, and 52 percent reported to the president. A full 74 percent of the respondents reported that their compliance executives have some degree of access to the Board, even if it is not direct reporting.

**Compliance Operations: Centralized Versus Matrixed**

Regardless of where the ultimate accountability for institutional compliance resides, this individual or department must decide how to distribute some of the operational responsibilities that support the compliance mission, such as the policy setting, monitoring, testing and training. Most auditors would be familiar with the centralized approach, in which staff within a common department venture into the various departments within the university and conduct the test work and reporting necessary to support the mission.

However, given the extremely broad scope of activities taking place as part of university operations, it is not unusual to see a matrix approach, in which each distinct compliance area, or “silo,” has its own assigned accountabilities for compliance operational tasks, using an individual within their own area. The role of institutional compliance in this model is to standardize the operational processes across all department lines and to compile results for analysis and reporting.

Only 35 percent of respondents indicated that the operational aspects of institutional compliance are centralized under one compliance department. The remaining 65 percent, who indicated their compliance function was matrixed, were asked to select a statement which best described the relationship between the compliance silos and the CCO or equivalent executive. The results are below:
If matrixed, which best describes the interaction between the distributed compliance "silos" and the Chief Compliance Officer/responsible executive?

<table>
<thead>
<tr>
<th>Option</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal, representative committee with defined accountability, responsibilities and authority</td>
<td>13%</td>
</tr>
<tr>
<td>Formal, representative committee acting mostly as an advisor to the Chief Compliance Officer/responsible executive</td>
<td>20%</td>
</tr>
<tr>
<td>Informal advisory/informational committee made up of representatives from functional areas</td>
<td>7%</td>
</tr>
<tr>
<td>Dotted line from a compliance delegate in each area to the Chief Compliance Officer</td>
<td>0%</td>
</tr>
<tr>
<td>Authority and responsibilities of the Chief Compliance Officer and owner departments not clearly defined</td>
<td>40%</td>
</tr>
<tr>
<td>Other, please specify</td>
<td>20%</td>
</tr>
</tbody>
</table>

While the percentages in the first two responses in the chart above are encouraging, there remains the 40 percent who indicated that the authority and responsibilities of the CCO and owner departments are not clearly defined. These results are consistent with that of the follow up question: “Whether matrixed or centralized: has the Chief Compliance Officer been delegated the appropriate authority to enforce operational functions that affect the compliance program?” Fifty-nine percent answered yes to that question.

The survey results indicate that while the status of institutional compliance has been elevated to at least the level of consideration at executive levels in higher education, the degree of organizational structure and resource allocation still varies to some degree. There are, however, many subject- and method-specific topics upon which most compliance professionals agree are contemporary to their mission. In fact, this is one of the primary purposes of the Federal Sentencing Guidelines (FSG). A better understanding of FSG will help auditors assess the quality of their compliance function. For a discussion of the Federal Sentencing Guidelines and how they related to higher education, and the survey responses related to the guidelines, see part two of this article on page 17.
Seton Hall is a private university founded in 1856, located in South Orange, New Jersey, 14 miles west of New York City. The university is home to nine colleges, more than 60 majors and approximately 10,000 students, with a student to faculty ratio of 14:1.

Lori Brown, Esq. is the Director of Compliance & Risk Management at Seton Hall. The university is progressing toward an enterprise-wide program designed to coordinate, manage and monitor internal and external risks associated with regulatory compliance. She, other members of Seton Hall’s senior leadership and the Audit Committee of the Board played an integral role in developing an Enterprise Risk Management (ERM) model that was approved by the Audit Committee and the full Board in late 2011. Brown has agreed to share some of her insight into achieving a collaborative and comprehensive plan that assigns accountability for institutional compliance at the very top of management.

1. Tell us about the ERM plan your institution came up with, and how it evolved.

Historically, Seton Hall has managed risk under a traditional risk management and insurance program, including a committee of mid-level to lower-level managers. The Risk Management Committee met on a quarterly basis to discuss current/new risks and loss control for the campus. Some areas within the University, however, have been managed more aggressively using risk assessment tools. For example, the university’s Critical Incident Response Plan was developed using a risk assessment framework.

In late 2010, the Audit Committee of the Board asked university leadership to develop a more comprehensive approach to managing risk. As the Director of Risk management, I was charged with the task of developing and recommending an ERM and compliance model appropriate for Seton Hall. Thus, I researched the different ERM models (COSO, ISO-31000) and spoke with my colleagues in higher education to obtain a sense of what other colleges and universities were doing in this area. Also, I conducted a survey through the University Risk Management and Insurance Association (URMIA) list-serv.

Many of the existing ERM frameworks were designed primarily for financial institutions, health care and other specialized areas. There was not a model specifically designed for higher education institutions.

On the basis of my research and in consultation with university leadership, it was determined that an ERM and compliance program would be an effective way to capture and manage risk across campus. Given the institutional structure and organization at Seton Hall, it was recommended that risk be identified and managed divisionally at the vice presidential level. The four divisions within the University are, Academic Affairs, Advancement, Student Affairs and Finance/Technology. The Audit, Risk Management and Compliance Departments report to the Office of General Counsel and the Office of General Counsel reports directly to the President.

The development and implementation of an ERM and compliance program at Seton Hall is a stated goal of the University’s new strategic plan, “From Strength to Strength.” ERM is also a standing agenda item for the Audit Committee. University leadership also report annually to the Audit Committee and the Board on the top university risks.

SETON HALL’S ERM MODEL

Our model has combined attributes of the different frameworks. It is comprised of a Five-Step Process across our five divisional areas with five categories of risk.
### Seton Hall’s ERM Model

<table>
<thead>
<tr>
<th>5-Step Process</th>
<th>5 Divisional Areas</th>
<th>5 Types of Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifying the Risks</td>
<td>Office of the President</td>
<td>Strategic</td>
</tr>
<tr>
<td>Assessing the Risks</td>
<td>Finance and Technology</td>
<td>Operational</td>
</tr>
<tr>
<td>Evaluating the Risks</td>
<td>Student Services</td>
<td>Financial</td>
</tr>
<tr>
<td>Mitigating the Risks</td>
<td>Academic Affairs</td>
<td>Compliance</td>
</tr>
<tr>
<td>Monitoring the Risks</td>
<td>University Advancement</td>
<td>Reputational</td>
</tr>
</tbody>
</table>

### RISK ASSESSMENT

Seton Hall conducted four pilot risk assessments in four different divisions this past year. We used the Risk Dictionary developed by ACUA and the University of Texas System as a tool in creating a standard risk survey for each of the piloted areas. The risk survey was provided to the participating vice presidents using Survey Monkey. Embedded in the survey were the five steps of our risk assessment process.

Survey participants were asked to identify, assess and evaluate the risks. As a result of the assessment, a particularized risk inventory for each of the piloted areas was developed. The risk inventory led to a selection of the top five risks from each piloted area according to type of risk (i.e., strategic, operational, etc.). We also had an opportunity to review the internal controls currently in place for mitigating the risk. The divisional vice presidents are ultimately responsible for managing and monitoring all risks in their respective areas.

Seton Hall’s reasons for a transition from traditional risk management to ERM include: 1) risk management became a part of Seton Hall’s new strategic plan; 2) fiduciary responsibilities; 3) federal financial reporting and internal control standards (Sarbanes-Oxley Act of 2002); 4) the Federal Sentencing Guidelines; 5) financial rating agencies; 6) emerging accreditation requirements; and 7) best practices.

2. What kind of challenges did Seton Hall face in gaining stakeholder buy-in for the plan?

The transition from traditional risk management to ERM required a major culture change for Seton Hall. The tasks of performing risk assessments and assigning risk ownership are new undertakings for the University. They involve a tremendous amount of time, training, increased workloads, more accountability and enhanced oversight by the Audit Committee. At times, the vetting process of ERM was met with challenges in terms of creating additional work, consuming time and dividing resources among senior leadership. Initially, ERM was viewed as added work instead of added value. I conducted presentations for an ERM/Compliance Program for our Executive Cabinet and Audit Committee to gain support from both groups and to provide a contextual approach as to what ERM is and how it would work for Seton Hall. Through these challenges eventually the value of ERM was realized and risk management became a part of Seton Hall’s new strategic plan.

3. Under the new program, how does institutional compliance collaborate with internal audit?

There is an increased awareness of campus-wide risks that is shared between departments. Our internal auditors share with me an inventory of the audits to be conducted in a given academic year to provide me with insight into specific areas of focus. From a compliance perspective and with my addition to the Audit Committee there has been more communication regarding legal and regulatory compliance as well as ensuring that we share information as it pertains to risk assessments. The risk assessment process is also designed to help inform the development of Seton Hall’s internal audit calendar. ■
ACUA’s Institutional Compliance Survey, Part II: Federal Sentencing Guidelines

By Ann Hough

It’s hard to imagine that the judges, lawyers and law enforcement officials who made up the U.S. Sentencing Commission over the years might have foreseen the small piece of irony their assignments eventually yielded. After all, they were charged with the grim task of standardizing punishments for organizational misconduct under provisions of the Sentencing Reform Act of 1984 and later, the Sarbannes-Oxley Act; the results of which should have appealed to, hopefully, only a few.

Yet today we find that these very guidelines on punitive measures have become the cornerstone reference for businesses wishing to avoid the provisions of the act altogether. For when the commission provided interested parties a small ray of hope, in the form of sentencing grace for certain mitigating circumstances, they found themselves obligated to define the elements of one of those mitigating circumstances: an effective compliance and ethics program.

Today, Chapter 8 of the Federal Sentencing Guidelines (FSG) has become the gold standard by which most industries measure their own compliance oversight programs. As noted by Mary Lee Brown, in her article Federal Sentencing Guidelines – Requirements for Corporate Compliance and Ethics Programs (College and University Auditor, Summer 2004), higher education falls under the umbrella of the commission. She writes, “The FSG have a broad reach, in that organizations are defined to include, among others, non-profits. This category encompasses colleges and universities.” And indeed some major universities, such as Stanford and Princeton, openly reference the FSG as the basis by which they create their institutional compliance programs.

Our survey attempted to glean from the respondents some detail as to the extent universities are aware of and have adopted the elements of the FSG. Yet today we find that these very guidelines on punitive measures have become the cornerstone reference for businesses wishing to avoid the provisions of the act altogether. For when the commission provided interested parties a small ray of hope, in the form of sentencing grace for certain mitigating circumstances, they found themselves obligated to define the elements of one of those mitigating circumstances: an effective compliance and ethics program.

Our survey attempted to glean from the respondents some detail as to the extent universities are aware of and have adopted the elements of the FSG. Below is a summary of the FSG’s seven elements of an effective compliance program and some of feedback generated from the survey.

1. Standards and procedures to prevent and detect criminal activity.

Programs are expected to be “reasonably designed, implemented and enforced so that the program is generally effective in preventing and detecting criminal conduct.” It is interesting to note that the guidelines also state that a failure to detect an instant offense isn’t necessarily a sign that the program is NOT generally effective. On its face, that sounds like a loophole, but rather it appears to be a segue into another section of the guidelines that state “The organization shall periodically assess the risk of criminal conduct and shall take the appropriate steps to reduce the risk of criminal conduct identified through this process.”

Comments provided in the survey indicate that institutions understand the importance of establishing policies and procedures affecting compliance. Most indicated there was a process in place for policy establishment, such as with this response: “We have a formal process for developing institutional policies and procedures. Regulatory requirements are one of the criteria considered when determining the need for policies. Policies undergo review on a set cycle to evaluate continued need.”

2. Effective Governance

While this one may seem like a no-brainer, the guidelines are pretty clear that accountability starts at the top, as in the Board of Directors or the equivalent governing body. The guidelines further
state that “high level personnel” shall be assigned responsibility for the compliance and ethics program, and that
“specific individuals” shall be delegated with day-to-day operating responsibility.

Some institutions appear to have effectively achieved this. In the comments section for this topic, one survey respondent wrote: “The Audit Committee is formally charged with oversight of the institutional compliance program. The Institutional Compliance Officer reports semi-annually to the committee on the status of the program. The Audit Committee is informed if significant changes in the program itself occur, or of external compliance expectations. An ad hoc group of the Board discusses the specifics of compliance failures when they occur.”

However, one respondent wrote, “Although there are various policies and procedures throughout the organization, there is no system-wide code of conduct (tone at the top).” Another reported that its institution had “no designated compliance officer, centralized plan, compliance committee of the board, or reporting to the board.” Given that the survey results, as outlined in the main article, indicate some blurry lines for compliance accountability on some institutions’ organization charts, the guidelines might provide some incentive to bring those into focus.

3. Employee Conduct

The drafters of the guidelines wisely declined to provide detail on how to accomplish a workforce free of a criminal past, but they made it clear that the employer must have some sort of screening or monitoring technique in place. The standard states that the organization shall use “reasonable efforts” to ensure that they do not designate leadership personnel “whom the organization knew, or should have known through exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.”

4. Communication and Training

This too may seem obvious. But note that this particular guideline aims right at the top and moves down through the pyramid. It describes the required recipients of the communication and training as “members of the governing authority, high level personnel, substantial authority personnel, the organization’s employees, and, as appropriate, the organization’s agents.”

The survey indicated that training appears to be a component of most compliance programs, as only 10 percent of the respondents indicated their plans did not offer training. However, the frequency of training varies greatly from institution to institution. Only 29 percent of the respondents indicated that training is provided at or near the hire date. Routine re-training is offered at least once per year by 24 percent of the respondents, and on a more infrequent basis (less often than once per year) for 38 percent. Of note also is the fact that most respondents, 78 percent, are making use of technology and offering online training.

5. Monitoring and Auditing

There are actually three parts to this section of the Federal Sentencing Guidelines. The first is that the there should be monitoring and auditing in place to address the compliance risks identified in each area of the institution, and that these methods should be defined in the institutional compliance plan. The second is a periodic evaluation of the effectiveness of the compliance and ethics program itself. Once the appropriate governance structure is in place, this individual/group must have a method or manner by which they determine their overall plan is performing as intended.

Surprisingly, there were very few comments on the requirement that a compliance program include monitoring and testing within the areas deemed to have compliance risk. Perhaps that is because we, as auditors, believe this is obvious. However, the survey provided more feedback on the respondent’s assessment of the compliance program as a whole. For example:

<table>
<thead>
<tr>
<th>How would you rate your institution’s ability to describe and quantify the effectiveness of the institutional compliance and ethics programs?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor – the institution has not defined effectiveness for its program</td>
</tr>
<tr>
<td>Fair – the institution has defined effectiveness for its program but does not have a process in place to evaluate the program</td>
</tr>
<tr>
<td>Good – the institution has defined effectiveness for its program and has a methodology to measure effectiveness but does not consistently perform evaluations</td>
</tr>
<tr>
<td>Excellent – the institution has defined effectiveness for its program, has a methodology to measure effectiveness, assesses the program on a consistent basis, and makes any modifications necessary</td>
</tr>
</tbody>
</table>
The near bell-shaped response distribution is heartening, and is consistent with a survey question regarding methods used by institutions to assess the effectiveness of their compliance programs. Sixty-four percent of the respondents said their institutions were using monitoring, auditing or a combination of the two to assess compliance program effectiveness. However, 27 percent of the respondents indicated that their institution had not yet formally established metrics and methods by which to gauge the effectiveness.

The third part of this section of the guidelines addresses the need for a “hotline” or other independent and anonymous method for employees to report suspected criminal conduct. Although the survey did not capture the number of respondent institutions that actually had hotlines, it did make an inquiry as to how hotline information is used, and only nine percent of the respondent’s indicated that information garnered from “hotline” or other self-reporting mechanisms was analyzed for implications for the compliance program.

6. Enforcement

Many compliance programs have clearly defined consequences for bad behavior, but how many include incentives for good behavior? The guidelines specify that both are necessary. It should be noted that the guidelines state that the program should have “appropriate disciplinary measure for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.” The highlighted section is another example of the commission clarifying that accountability lies within the leadership in compliance.

In a question specifically aimed at this portion of the guidelines, only one respondent indicated that his or her institution provided “incentives for compliance.” Only 30 percent of the respondents indicated their compliance programs had “clearly defined disciplinary measures for non-compliance,” with one commenter making the distinction between having the enforcement measures, and having them “clearly defined.”

7. Response

After criminal conduct has been detected, the guidelines state that the organization shall take reasonable steps to respond appropriately to prevent further similar conduct. The guidelines then go on to specify that this means a reassessment and revision to an organizations compliance and ethics program.

CONCLUSION

While the survey indicated that many institutions still struggle with governance and accountability issues for institutional compliance, many institutions appear to already have at least a footing in each of the seven elements of an effective compliance program as defined by the FSG. ■
As early as 700 BCE a giant University at Takshashila in northwest India had 10,500 students and offered advanced education on 68 disciplines by recognized masters in their fields. More than 2,700 years later, are we entering the most dynamic period of change higher education has ever seen?

Many of America’s colleges and universities are in crisis—or on the verge of it. Tightening budgets and a rising chorus of calls for a stop to rapidly escalating tuition prices are plunging many into financial jeopardy. Colleges and universities are doing everything from trying to slim down and become more efficient to cutting back on the number of students enrolled.

On top of that, people are questioning the sector’s academic quality and calling for it to increase dramatically the numbers of students it serves.

An increasing number of people are speculating that several of these institutions may collapse in the years to come.

Paradoxically and simultaneously, a smaller section of America’s higher education system has been nearly giddy with glee. Financing has been plentiful. Their budgets are not strained. Growth is on the horizon. They see rich opportunities to increase access and improve student outcomes. The common thread holding these institutions together is that they are powered in some way by online learning.

How can we explain this? The answer is that we are now witnessing the power of disruptive innovation starting to materially affect and transform the higher education sector.

Disruptive innovation is the process by which a sector that has previously served only a limited few because its products and services were complicated, expensive, and inaccessible, is transformed into one whose products and services are simple, affordable, and convenient and serves many, no matter their wealth or expertise.

It is the process that has transformed everything from computing—where $2 million mainframe computers used to dominate the world and now laptops, tablets, and smartphones do—to taxes—where today many use inexpensive and simple software to do their taxes instead of bringing it to an accountant. In this process, upstart competitors have historically toppled the leading institutions, and in so doing, they often look different and use different metrics to measure quality.

As a result, disruptive innovations tend to look unattractive to the mainstream and therefore start by serving the “low-end” of the market where the users are often non-consumers (i.e., people who literally cannot access or use the dominant products and services of the time). The products then improve so that they can solve more demanding problems and, over time, people from the mainstream flock to the disruptive innovation, which is how the transformation occurs.

For the first time, this process is playing itself out in higher education.

Although community colleges and land grant universities before them had many of the characteristics of disruption in that they decentralized higher education and made it accessible to many more students, what they didn’t have was a technology enabler that allowed them to stretch an affordable model up-market to serve increasingly demanding students. Instead, to move up the Carnegie classification system, these institutions had to put in place all of the trappings of the most prestigious institutions, which had real costs.

ABOUT THE AUTHOR

Michael B. Horn is the co-founder and executive director of the education practice of Innosight Institute, a non-profit think tank devoted to applying the theories of disruptive innovation to solve problems in the social sector. In 2008, Horn co-authored the book Disrupting Class: How Disruptive Innovation Will Change the Way the World Learns (McGraw-Hill) with Harvard Business School Professor Clayton M. Christensen, the father of disruptive innovation theory, and Curtis W. Johnson, president of the Citistates Group. BusinessWeek named the book one of the 10 Best Innovation & Design Books of 2008 and Newsweek named it as the 14th book on its list of “Fifty Books for Our Times.” Horn holds an MBA from the Harvard Business School and a BA in history from Yale University.
Higher Education

Online learning, on the other hand, appears to have given upstart institutions of higher education this technology enabler. It is for the first time disrupting higher education—and helps to explain much of the rapid growth in the up-start for-profit higher education sector over the past 10 years, even as many colleges and universities have struggled financially and had to cut back. Roughly 10% of students in 2003 took at least one online course. That fraction grew to 25% in 2008, topped 30% in the fall of 2010, and we project it will be 50% in 2014.1 New start-ups are now emerging in the space with big visions to disrupt the online universities that have preceded them. The pace of change is accelerating.

Although many traditional universities have implemented online learning options in response, they have tended to price this option in a manner similar to their traditional offerings. Because the marginal cost of online learning is much lower than that of enrolling a student in a traditional campus, this practice has allowed them to sustain their business model, but not disrupt it.

Meanwhile, many of the pure online universities with which they are competing have priced their offerings at a similar price point, but rather than use online learning to try and offset budget crunches, they are running operations with margins of around 30%. This gives them a significant potential advantage; in the future, governments are likely to cut back on some of their financing and subsidization of higher education given their own budget woes, which will mean price competition begins to be more important.

One of the main reasons for the significant budget troubles many traditional universities are experiencing today—and one of the reasons many of them will struggle to compete in a price sensitive world—is high overhead costs. These overhead costs aren’t because the universities are inefficient per se, however, as many charge. In essence, many traditional institutions of higher education offer multiple value propositions around knowledge creation (research), knowledge proliferation and learning (teaching), and preparation for life and careers. As such, they have become confluence of the three generic types of business models—what we call solution shops, value-adding process businesses, and facilitated user networks. This has resulted in extraordinarily complex—some might say confused—institutions where there are significant coordinative overhead costs that take resources away from research and teaching.

A typical state university today is the equivalent of having merged consulting firm McKinsey with Whirlpool’s manufacturing operations and Northwestern Mutual Life Insurance Company: three fundamentally different and incompatible business models all housed within the same organization. Using online learning in a new business model focused exclusively on teaching and learning, not research—and focused on highly structured programs targeted at preparation for careers—has meanwhile given several organizations a significant cost advantage and allowed them to grow rapidly.

One of the more interesting developments as of late has been that several traditional institutions—from Arizona State University to the University of Southern California—have entered into partnerships with for-profit entities to create online offerings. One of the things these online offerings appear to do is to solve this problem of business model conflation.

By setting up an online division exclusively focused on teaching and learning, the partnership allows universities to have a focused value-adding process business model separate in many ways from the other conflated business models inside the institution. Given that these entities have priced their tuition at similar rates as the traditional institution, they have turned a profit quickly and are then able to spin off some of the free cash into the existing institution to support the traditional model with its significant overhead burden.

This outsourcing of pieces so close to the university’s academic core is one step in a broader trend toward the modularization of the university, which will likely have significant implications down the road for the future of higher education.

Historically, the university has been made up of a set of proprietary and interdependent parts. Each was unique in some sense as a result.

But over the past 40 years, this has been changing. In the 1970s and 1980s, universities began to outsource their IT operations to suppliers like Infosys. Over time, they found partners for their finance and accounting and human resource systems, as well as to handle more things that directly interfaced with students on the front end, such as food service and financial aid and student loans. More recently, in the 1990s through today, universities have outsourced some of their enrollment management functions like marketing and recruitment and student coaching. With the rise of these partnerships in online education to offer an online platform and help with course development, the modularization is approaching closer to the academic core.

This trend toward modularization and away from interdependence is not unique to higher education. In the initial stages of an industry when a product or service’s performance is not yet good enough for the majority of customers, to be successful, institutions must control all aspects of the product in order to make the experience good enough for the early customers. Over time, the service improves and becomes better understood such that it’s possible to create standards between different interfaces and outsource different components to different suppliers.

As the product or service begins to overshoot what its least-demanding customers need, however, people become less willing to pay for price increases for incremental improvements they don’t value. Instead they want offerings that are more customized to their individual needs at affordable prices. As a result, modular offerings—in which you can plug and play and mix and match best-of-breed components—become the norm.

With a population that is less able and willing to afford colleges’ consistent price hikes and, in many ways, have had their needs overshot by many of the amenities on campuses, it appears as though we are witnessing the beginnings of this shift to true modularity in higher education.

This shift will likely have profound implications for the ways in which higher education institutions of the future are built. In the past, if someone was starting a university, he or she would have to put in place all the different component parts, including building curriculum, finding faculty to teach courses and so forth.

But with the rise of the modular university, the barriers to entry in the industry are dropping precipitously. New institutions can assemble the best courses from a variety of sources—MITx, Udacity, and Udemy present three exciting options, for example. In essence, the unit of accreditation is shifting from the whole institution to the unit of the individual course itself.

The notion of accreditation is shifting fundamentally as well. In the past, accreditors have only accredited the fully integrated institution; determining the value of an institution’s component parts was not possible. But who is to say that a credit from a MITx course isn’t valuable or real? Employers are likely to give it a seal of approval in the market, which will certainly make it valuable to students.

Ultimately this emerging disruptive innovation of online learning presents an opportunity to rethink many of the age-old assumptions about higher education—its processes, where it happens, and what its goals are—and to use the disruptive start-up organizations to create institutions that operate very differently and more appropriately to address the country’s challenges.

As a result, it also allows for an escape from policies that focus on credit hours and seat time to one that ties progression to competency and mastery. Online learning courses can easily embed actionable assessments and allow students to accelerate past concepts and skills they understand and have mastered and instead focus their time where they most need help at the level most appropriate for them. Time is naturally a variable in online learning, so these courses can instead hold outcomes constant—and outcomes will be a more appropriate measure for judging students and institutions. Shifting policy to focus on outcomes rather than the build up of ancillary services for their own sake will encourage these services to wrap around and support each institution’s core value proposition and its students’ core jobs to be done.

Higher education is on the verge of rapid change. Many traditional institutions will come under significant pressures in the years ahead. And many new institutions will arise disruptively, unencumbered with their pasts, and intensely focused on serving students well and at a low price. How this will play out is anyone’s guess, but the pace of change is likely to be more rapid than we might imagine.
The More Things Change, the More They Stay the Same

By Donald Holdegraver, CIA, CFE, Future-Retiree

As I contemplated my recent retirement, I looked back at nearly 37 years of auditing. Change has come fast and furious over the past nearly four decades: from typewriter to word processing; from green flowchart templates to flowchart software; from 14-column paper to spreadsheets. But the phrase, “the more things change, the more they stay the same!” comes to mind, even considering the technological revolution we have experienced.

What has nearly 37 years taught me? When I joined the auditing profession in January 1976, we were on the verge of the passage of the Foreign Corrupt Practices Act – the ‘solution’ to foreign bribes, and implementation of management controls monitoring. Yep, those problems were certainly solved once and for all, weren’t they?! Then the 1980s came with the savings and loan scandals. More controls and the COSO frameworks. Yep, that solved those problems alright!

Then came the 1990s and the dot-com bubble that crashed the market. Once more the auditing world shook!

Need I even mention the first decade of the 21st century? Enron, WorldCom, derivatives, housing bubble, sub-prime loans, robo-signing, and on and on.

The common denominator? People will always be the same and those disposed to not do the right thing will always do the wrong thing. The way we as auditors have evolved over the years as new technology and new approaches came along has never altered the fact that the role of the auditor has really not changed at all. At least, not in my view.

Our role as auditors has and will always be to seek out the truth, the facts, the needs, and present them in a way that will encourage management to make changes to improve operations or controls. We may even get management to make all the changes we suggest, but in the immortal words of Ronald Reagan, “Trust but verify!” No matter how good a job we as auditors do, or management does, internal auditors will always have to be on guard, monitoring for failures and people who don’t have the best interests of the organization at heart. It will often mean that we repeat, and repeat, and repeat what we say, but our satisfaction must always be that we are doing the job we were hired to do in bringing these issues to management. There will be times when you will say, “Why do I even try?” But it is exactly those times when you will know that, despite everything, what you do is critically important even if not always recognized.

My favorite internal audit quote of all time came from none other than Larry Sawyer, the ‘guru’ of modern internal auditing. In the third edition of his internationally known text, “The Practice of Modern Internal Auditing,” he said:

“It is axiomatic that internal auditing is not bought by management, it must be sold to management. It is also axiomatic that the auditor cannot ask management what it expects of him. Management usually does not really know. The experienced auditor must tell management what he has to offer. And then be must sell his product with every audit project he completes. He must produce a product that is professional, useful, and technically correct. And he will be allowed few mistakes.”

More timeless and truer words were never spoken, in my view.

Rely on your fellow auditors out there. There is an immense body of knowledge available, and it’s always free for the asking through ACUA. Take advantage — learn, grow, share — and in the end, though you may see history repeat itself, you will know that you are leaving a legacy to continue the battle to make your organizations the best they can be!