Strategic Risk

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Editor
John M. Fuchko, III, MBA, CIA, CCEP
Board of Regents/University System of Georgia
john.fuchko@usg.edu
(404) 656-9439

Deputy Editor
Doug Hawks, MBA, CIA
douglas.hawks@suu.edu
(435) 586-7940

Contributing Editors
ACUA Life: Vacant
Internal Audit Organization:
Claire Sams Milligan,
Alabama Department of Postsecondary Education
Internal Audit Practices:
Amy Hughes,
Michigan Technological University
Higher Education:
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Columns:
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Internal Audit Organization:
David Dixon, Governors State University
Internal Audit Practices:
Vacant
Higher Education:
Mary Ann MacKenzie,
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Columns:
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The University of Montana

ACUA Management
Stephanie Newman, Executive Director
Our Fall 2010 CandU Auditor theme is “Strategic Risk.” Auditors with a strong public accounting background are familiar with the concept of risk of material misstatement and this concept, among others, has traditionally focused our risk assessments on those black and white, debits and credits risk concepts. These “traditional” risks are easier to assess and much easier to audit than this concept of strategic risk. This leads us to the question: How should auditors identify strategic risks and, should/how do we audit against these risks?

Further complicating this concept of strategic risk is the “Black Swan” concept. Nassim Nicholas Taleb is largely credited with developing this “Black Swan” concept. I certainly recommend reading his book, The Black Swan, for a detailed exposition of this idea. However, the overall concept is that hard-to-predict, rare events often have a completely disproportionate impact on life, an organization, etc. Additionally, most individuals are psychologically disinclined to even recognize these events. Conceptually, this suggests that our question to management should not be “What keeps you up at night?” but rather “What should be keeping you up at night that we have not thought of?”

The answers to these questions requires creativity, thoughtfulness, a deep knowledge of our “business,” and the personal courage to share a thought or perspective on risk that no one has heard before – and hence might resist. I recently shared some of these thoughts with an internal audit student group. One of the students told their professor (after the presentation) that they would never think about risk – or about internal auditors – in the same way again … and neither should we!

BRIEF OVERVIEW AND FUTURE ISSUES

Our ACUA Life section includes letters from our new ACUA President Mary Barnett and our Immediate Past President Mark Paganelli. Donna Stapleton provides us a brief personal introduction to ACUA Board member Leigh Goller.

Our remaining articles are detailed and informative. Charlie Hrncir walks us through the history of risk and charts a course for how we might better understand this concept as internal auditors.

Kathy Kapka provides us insightful and needed insights on the new Institute of Internal Auditors’ professional standards. This article is a must-read for all internal auditors and especially for our chief audit executives.

Carolyn Newman provides suggestions on how we can better leverage technology and available data to improve our risk assessment and auditing processes.

John Pittman provides us an up-close and unique perspective on the management of a public-private venture. The concept of strategic risk and capital financing are absolutely intertwined and John’s article helps us to better understand these concepts.

Seth Kornetsky, a former ACUA President, shares with us the Enterprise Risk Management implementation journey from his perspective at Tufts. His is a well-written and even humorous presentation of a topic that has increasingly dominated the attention and efforts of internal auditors.

Finally, ACUA Board member Phil Hurd delivers his much-anticipated “How to Steal with a Purchasing Card – Part Two” column. Internal auditors with an interest in fraud detection and prevention owe it to themselves to read Phil’s work. As a reminder, Part I of this series can be read in the Summer 2009 issue.

I NOW HAVE A LITTLE MORE HELP FROM MY FRIENDS

I am very pleased to announce that Doug Hawks, Southern Utah University Director of Internal Audit, has agreed to serve as the Journal’s Deputy Editor effective this issue. The spirit of volunteerism remains alive and well within ACUA!
Wow – My First “Letter from the President!”

By Mary M. Barnett, President

I hope you all know how flattered and excited I am to serve as ACUA’s President this year; ACUA is the best professional association on the planet, and I am so glad to be associated with it.

Over the past year, I have had the chance to expand my higher education experience from medium-sized private (the University of Richmond), to big public (Virginia Commonwealth University), to a system of 23 two-year institutions (the Virginia Community College System or VCCS); it has been a wonderful opportunity to learn about the variety of institutions that make up ACUA. There are issues which are hugely important to a community college which are not on the radar of a private four-year institution, and things a big public university deals with which neither of the other two care about. The VCCS in some ways may have more in common with the California State System – which also has 23 campuses – than it does with some other community colleges … and yet the internal audit issues that all these institutions face have similarities which make ACUA the tie that binds them all together.

ACUA-L, of course, almost literally ties us all together. I did some contracting work this summer for a Fortune 500 corporation’s internal audit shop, and when I tried to explain ACUA-L to them they looked at me like I had two heads. I have to admit it: I was a little bit smug about us.

As many of you heard during the Business Meeting at the Annual Conference in Baltimore in September, this is the year the Board wants to stand on the great foundation we have built beneath us and reach out for new members. We know ACUA has a lot to offer, and we want to be sure that we have gathered everyone who can benefit from that – auditors, of course, but also compliance officers, risk managers, and others with an interest in risks and in internal controls.

A great deal of behind-the-scenes work is being done by our Membership Committee, chaired by at-large Board member Tom Dwyer, working closely with our management firm and our Executive Director Stephanie Newman. In the coming months, they intend to contact every NACUBO institution that is not already a member of ACUA. They have developed a fantastic member-benefits brochure to share with them. We are going to be sure they know about the Annual Conference and the Midyear, and that ACUA offers benefits even to institutions without a department called “Internal Audit.” ACUA has done membership drives in the past, but our intention now is to create a sustainable process to be sure we are constantly getting the word out about ACUA and reaching out to welcome new members.

ACUA’s membership has stayed strong even in the current economic downturn, but the Board is excited about the opportunities that an influx of new members can provide. More members means more volunteers to provide the services we need, more voices on ACUA-L, more potential speakers at Annual Conferences and Midyears, more input on the Risk Dictionary, and more potential authors for the Journal. Of course, more members also means more revenue to ACUA, which means a stronger financial situation and more resources to support our initiatives, including the Risk Dictionary, outreach to other higher education organizations, the NCAA Audit Manual, and the website. We also want to make sure we are continuing to provide the benefits that ALL of our members need and expect from us.

One of the greatest benefits ACUA offers (that many associations cannot match) is our webinars. ACUA offers free webinars to our members up to eight times a year (thanks to the longstanding generous support of EthicsPoint for four of them, and a new initiative from Baker Tilly for four more). Those webinars give us a great opportunity to target very timely topics. Keep an eye out for announcements about them; they are a great way to get some CPE and learn some important information as well.

We are in the early stages of developing an in-house, ACUA-specific version of a survey like the Institute of Internal Auditor’s GAIN survey. This will address higher education much more specifically so that the results will be more applicable to our members and their departments. It will also be much more cost-effective for our members!

We are going to be sure that ACUA is your (and my) indispensible resource as we serve our institutions – big and small, public and private, stand-alone and system – every day.
It has been a pleasure serving as your president this past year. A lot of hard work by ACUA volunteers came to fruition this year and will hopefully benefit ACUA for several years.

In keeping with past practices, the Board met to update the ACUA strategic plan. To save money, this was done in conjunction with the midyear Board meeting and facilitated by our own Kim Turner, past ACUA president, from Texas Tech University, instead of hiring an outside consultant. The overarching goals of ACUA remain the same: provide a good array of benefits to our members and be an advocate for higher education internal auditing. These goals continue to drive ACUA’s resources and the actions of our volunteers.

The newest member benefit is a new and improved website that was developed under the guidance of Phillip Hurd, Board Member-at-Large from the Georgia Institute of Technology and the Web Services Committee chair, Susan Jago from Ohio University. This was a large project that took a lot of effort by this committee and has resulted in a greatly enhanced website that will enable us to deliver additional member benefits. Included on this site is a news event section that will allow us to provide links to the latest publications, news events and other matters that will be of interest to you as a higher education internal auditor. We also plan on creating a vendor section that will provide links to products used in internal auditing. We hope to negotiate group discounts on your behalf and view this as a win for the vendors and our members. In addition to these new benefits, we continue to emphasize quality education for a reasonable price. The Midyear conference held in Reno was a huge success and the evaluations were very positive for all of the tracks. I want to express my sincere thanks and appreciation to Sandy Jansen, the Midyear Director, from Texas Tech University and all of the volunteers who assisted her for putting together an outstanding conference.

Unfortunately, not all member enhancements go as planned. We thought we had created a cheaper solution to the ACUA-L that would provide the same service. Several quality issues resulted and several solutions were explored until finally we were able to purchase software that resolved all of these issues and will save us money in the long run. Thus, ACUA-L is in a better place than it was a year ago and we greatly appreciate your patience with all of the bumps in the road. Another enhancement that increases member benefits and reduces costs is just distributing the Journal in an electronic format. This is anticipated to save thousands of dollars in printing and mailing costs, enables all members to receive a copy of the Journal versus just mailing it to the institutional representatives and is in response to member requests at last year’s business meeting. Therefore, this appears to be a win-win-win for everyone. The Journal is distributed to more members, at a lower cost and the vendors advertising in it receive more coverage.

Other important goals continue to be a challenge. Increasing our efforts in advocating for internal audit in higher education continues to be limited due to our lack of resources. The larger higher educational associations such as NACUBO and AGB have full-time staffs located in Washington who do this. In attempting to partner with these and other higher educational associations, I have asked, “What assets does ACUA have that would benefit potential partners?” Our biggest asset is our members and their knowledge of higher education, internal controls, risks, governance issues and matters related to compliance. While we have had members publish articles for other associations and serve on committees for other associations, the Board was continually frustrated that other associations were not seeking us out for information on these topics. In an attempt to resolve this and leverage the talents of our members, we have created an ACUA Faculty program. ACUA members who are deemed to be talented presenters by the professional education committee are displayed on our website along with the courses and other material that they present. We are actively promoting this group with other associations and the hope is that they will not only look to ACUA for talented speakers but will also begin to think of us for all matters related to audit, risk, governance and compliance. This is hopefully the start of something that will benefit ACUA for many years.

I greatly appreciate the opportunity to serve as your president and I look forward to remaining active with ACUA for many years. ■
It is time again to meet a member of our Board. In this issue we introduce Leigh Phillips Goller.

Leigh is the Director of Internal Audit at Duke University. She has been married to Jeff Goller for more than eight years and is the proud mother of a four-and-a-half-year-old son (the “half” is very important to him), Slade Goller. Leigh and her family live close to the beaches of North Carolina and her family owns a house at Topsail Beach where they spend their weekends between April and October. This is their place to relax, have some fun, be amazed by the ocean and sea life and thoroughly enjoy the setting of the sun in the evenings.

Leigh has had a very unique travel history in the name of conducting internal audits. She once received her most interesting pre-flight announcement, not from a perky flight attendant for Southwest Airlines, but rather from a United States Air Force Flight Sergeant. She was not directed to return her seat to its upright position, but to be sure to sit on her ceramic flak jacket (the bullets do not come in through the sides of the plane) and to be sure her coat was on and zipped all the way up (no heat in a cargo plane). She was then told to prepare herself for “the best roller coaster ride I would ever get for my tax dollars (a corkscrew or black diamond descent – depending on ground conditions that day in Bagdad).” Upon landing, Leigh donned her flak jacket in the proper manner (as a vest rather than a seat) and embarked upon an audit adventure in Iraq. She spent four nights in “the zookeeper’s” house on Saddam Hussein’s compound. She spent the next three nights at “Chemical Ali’s” house in Basra, where she made friends with the local pool sharks of the Royal Air Force, who were deployed in the adjoining compound. From this experience, she learned to see everything from a different perspective and to allow flexibility to ensure maximum performance and safety. She also learned to “appreciate the human experience of trying new things, however frightening they may be, because the rewards for having the experience far exceed the price of admission.”

When asked what she wished for ACUA, Leigh responded that her passion was creating and cultivating opportunities for professional and leadership development, advancing the visibility of internal audit professionals at all member institutions and linking the ACUA strategy to achieve these goals.
Peddle bank accounts?  
Nope.

Profit from student data?  
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Risk and Auditing – A Backwards Glance

By Charles R. Hrncir, CPA

Wow. Thirty years ago, Risk was just a board game.

Twenty-nine years ago this summer, I was headed east on I-10, leaving Houston on my way to the Golden Triangle of Texas. I was on my way to one of my first audits of a higher education institution, Lamar University in Beaumont. We had our five column pads, our calculators and lots of colored pencils to mark things up and cross reference numbers from one piece of paper to another. If we talked about risk it was about the risk of misstatement, control risk, inherent risk, detection risk, or audit risk. Our basic focus back then was on financial controls.

Roll forward about 10 years. I’m in Austin, Texas, learning about strategic planning, goals, objectives, strategies, and performance measures. Performance-based budgeting has become an important tool of the Texas Legislature and they want the process audited at all the agencies and universities in the state. The Federal Sentencing Guidelines for organizations came out in 1991 and provided a minimum standard for effective compliance programs. In 1992, a new auditing model called the COSO model was out and its five interrelated components included the control environment, risk assessment, control activities, information and communication and monitoring. Our focus was starting to change from just financial controls to including something we started to call management controls.

Roll forward about 10 more years. September 11, 2001. The stock market crashed. Enron, WorldCom, Sarbanes-Oxley. A new set of federal sentencing guidelines defined a stronger set of standards for an effective compliance program and a new COSO Model emphasizing risk management was developed. New internal auditing standards were also issued emphasizing the assessment of risk management, controls and governance.

More recently, publications from oversight bodies and others illustrate the need for a change in internal auditing. Over the past few years, Standard & Poor’s released a number of publications related to its intended analysis of institutions’ Enterprise Risk Management (ERM) processes in determining an institution’s overall credit rating. In 2007, PricewaterhouseCoopers LLP released a publication, Internal Audit 2012, stating that internal auditors need to adopt a “risk centric mindset” – to remain key players in their organizations. In 2009, the IIA released a publication, 10 Risk Management Imperatives for Internal Auditing, which encouraged internal auditors to determine if they had kept up with management’s risk management processes. The publication also provided a list of 10 leading internal audit practices that internal auditors could use to help better serve their institutions.

For internal auditors in higher education to be successful, they must understand how compliance with laws, policies and procedures are managed at their institution. The Federal Sentencing Guidelines provide a standard for organizational diligence related to compliance. Are policies documented? Are employees trained? Is training documented? How are policies, procedures and training monitored? Does management assess the risk of non-compliance? Does management monitor compliance?

For internal auditors to be successful, they must also understand how risk is managed. COSO’s Enterprise Risk Management Integrated Framework provides a standard for organizational diligence related to risk management. Does the institution have a strong strategic planning process? Has management identified the events that could keep the organization from meeting its goals? What has management done to formally mitigate the identified risks? Who is monitoring to make sure the mitigating activities are actually working and does the CEO get regular formal communication on the status of the risk mitigation activities?

As you can see, internal auditing has changed quite a bit in 30 years. From five column pads, land lines and lots of calculator tape, to cell phones, laptops, electronic working papers and the Internet. From reporting to the comptroller or the director of accounting, to reporting to the CEO and the audit committee. From simply counting cash, searching for equipment and testing inventory to audit planning and risk assessment. From being pretty much only worried about financial controls to developing strategies on how to audit such risk areas as deferred maintenance and construction, recruitment and retention of faculty and staff, research compliance, IT security, student safety, environmental health and safety and the recruitment of students.

Some things have not changed for internal auditors. We have to work with limited resources and we have to adapt to changes in business practices and changes in expectations. If we cannot or will not adapt to these changes … we run the risk of becoming irrelevant.
Ever complete an audit and wonder, “What could we have missed?” The question is fair enough, considering the staggering amount of data to be considered and analyzed. Many auditors are taking a risk-based audit approach that begins with a data-driven forensic phase to counter providing false assurances and to meet the audit standards.

Risk-based audits have been recommended since 2002 for financial statement audits. In 2006, the six largest global accounting firms called for a dialogue with policymakers and investors to help close the expectations gap and consider other fraud detection requirements, such as the periodic conduct of forensic audits of all or selected public companies. While these dialogues did not result in any additional changes in auditing standards, they have brought attention to the somewhat overwhelming task of using indirect means to ascertain whether fraud has occurred among numerous transactions.

Use of computer-assisted audit techniques (CAATs) can allow auditors to perform unpredictable procedures on essentially all of an organization’s recorded transactions.

**UNDERSTANDING THE ENVIRONMENT**

The standards require auditors to gain a thorough understanding of the organization’s industry and environment, including its internal controls. This includes management inquiries and analytical procedures. Data analysis may be used to analyze information for comparison and to perform forensic-type analysis on general ledger entries to gain an understanding of transaction flows.

Using data analysis software and an electronic version of the general ledger detail report, auditors can quickly understand their organization’s financial environment by reviewing specific areas such as:

- What types of entries exist
- Whether there are a high number of manual journal entries and what accounts are most often affected
- Volume of activity in loan accounts
- Activity around excessive credits or debits
- Whether the ledger balances and how many transactions are included in each account

This type of report can be used to identify significant recorded activities that might represent risks, gain a better understanding of the organization’s environment and help meet documentation standards. Because data analysis software has no limit in the amount of data that may be imported for review, stratifications or data population profiles can help identify significant items and provide documentation.

**IDENTIFYING FRAUD RISK FACTORS**

Using a risk-based approach, auditors must consider scenarios where fraud might occur. What can go wrong? How could management intentionally cause a material misstatement in the financial statements? Are there indications of the fraud “triangle” of pressures – incentives, opportunities and rationalizations? In addition to inquiries, the auditor must perform specific analyses to help identify potential fraud, or respond to an identified risk factor. Data analysis can assist in performing these procedures, among others:

- Unusual or unexpected relationships identified in earlier analytical procedures
- Disaggregated analysis of revenue (by month/quarter/product line, etc.)
- Identification and testing of journal entries made at the end of reporting periods
- Review accounting estimates – analyze underlying details
- Perform cut-off procedures at period end

**About the Author**

Carolyn J. Newman, CPA and CISA, is the co-founder and president of Audimation Services, Inc.
• Compare inventory quantities using various possible scenarios
• Test the compilation of the physical inventory counts
• Match vendor list with employees to identify address and phone matches
• Search payroll records to identify duplicate addresses, employee IDs, taxing authority numbers or bank accounts
• Review the propriety of large and unusual expenses

DEVELOPING A RISK-BASED AUDIT APPROACH

Standards require auditors to link their audit procedures including the nature, timing and extent of tests they perform to the risk of material misstatement (RMM), which is often viewed as a formula:

\[ \text{RMM} = \text{IR} \times \text{CR} \times \text{DR} \]

(continued from page 8)

If inherent risk and control risk are low, the risk assessment procedures performed to make that determination might be sufficient to lower the auditor's risk. If not, or if fraud risk factors are identified, the auditor must respond with a plan to perform additional procedures.

Materiality is an important concept for financial statement audits given the time and cost required to examine 100% of a population. Data analysis may be used to save time and minimize the risk of material misstatement. For example, using an electronic version of a detailed accounts receivable report, an auditor could achieve the following in approximately 20 minutes:

• Gain a better understanding of the monitoring systems for accounts receivable
• Review the file and determine whether the organization's monitoring report and general ledger balance
• Check and re-perform calculations on the aging report by using the due date field
• Isolate past due balances, summarize them and compare them to other locations
• Determine the most effective strategy to respond to the high inherent and control risk assessments

Further tests, based on the determination of materiality, may require the auditor to select accounts from the entire population. With large populations, data extraction is the only efficient way to ensure all individually significant items are identified.

Audit program steps should reflect the auditor's risk assessment, noting how the test or further audit procedures will be used to lower the risk of material misstatement. These must be defined by the relevant assertion for the account balance. Since tests of details or substantive tests in response to RMM are generally conducted by junior-level staff, it is important that the audit program clearly define not only the tests to be performed, but the process for obtaining and importing the data and the output which will become part of the work papers. While organizations rely on IT specialists to acquire, import and analyze data during an audit, this practice hinders the internal auditor's ability to review the results of the test and determine what to do next. Using data analysis software, an auditor can drill down on a questionable summarized amount and see the necessary evidence to clear or isolate the exception.

Add-on components for data analysis software are available to help test for common indicators, such as negative amounts, duplicates, rounded amounts and unusual descriptions on accounts receivable, general ledger, accounts payable, inventory and fixed assets. Because the tests are pre-developed, they may be used by junior-level staff with minimal training time.

APPLYING ANALYTICAL PROCEDURES

From simple financial statement balances and ratio comparisons to complex correlations, time series and trend analyses, the objective for analytical procedures is the same – set an expectation, then perform the test or other procedure and compare the results to the initial expectation. This may include visually scanning records to identify large or unusual items. Data analysis is highly effective when scanning the general ledger or subsidiary accounts looking for unusual items. It provides the ability to summarize the details then allows the user to drill down into specific areas that require further investigation. Following are two examples of how data analysis may be used to achieve audit effectiveness:

Analytical Procedure: Summarize the entire year of cash disbursements by payee and compare with a similar summary from a prior year.

Audit Impact: Allows auditor to note excessive payments and payments to new payees. Auditing by exception is effective for fraud detection.

Value: Efficiencies for check processing can be recommended in cases where excessive payments are appropriate, but wasteful for the organization.

Analytical Procedure: Compare inventory unit costs between years.

Audit Impact: Lowers the cost to perform inventory testing in second and third years of an audit. Increases can be compared with expectations based on auditor's knowledge of economic trends and other factors for prices.

Value: By analyzing all inventory items, special reports can be provided to management that will help it see anomalies or errors in its inventory data that might not be material, but would still provide valuable action items.
Using analytical procedures can help reduce the risk of an auditor missing a material error. Performed during the risk assessment, analytical procedures result in a more complete understanding of the organization and the work can be used as audit evidence. Performed as further audit procedures, in response to identified risks, the same data can be disaggregated into smaller amounts to see relationships and isolate the cause for anomalies that need to be explained.

**TESTING INTERNAL CONTROLS**

Internal controls over the major transaction classes include manual or automated control activities that assure management’s directives are achieved. In most cases, IT affects control activities, especially those areas of authorization and segregation of duties, such as passwords and other access controls and accuracy and completeness. Tests of controls to determine reliability of details will be necessary if the information system data is to be used for these kinds of analytical procedures.

Data analysis software can assist in internal control testing by calculating sample sizes based on the desired confidence level and precision and compute achieved confidence to help the auditor document conclusions. For instance, an auditor can enter actual test results using an evaluation feature, such as the number of errors found and then print a report with an appropriate conclusion.

Sampling is another area of testing internal controls where data analysis software can be helpful. Using a systematic method, the data analysis software would extract a number of records from a database at equal intervals by entering the required number of records or specifying the selection interval. Stratified random is useful if the auditor is designing a dual purpose test because the sample will randomly select items from each strata per the auditor's judgment as to how many items to select from each group.

In conclusion, auditing is an iterative process, which requires the auditor’s judgment to constantly evaluate the evidence obtained and make determinations as to when the procedures are sufficient to minimize risk of material misstatement. Data analysis tools help reduce risk by reducing the amount of manual work and decreasing human error. For more than 25 years, auditors have used data analysis tools to obtain a greater understanding of their organization’s systems and reporting environment, identify anomalies, errors and potential fraud. Properly implemented and integrated into the audit, data analysis can help solve the auditor’s dilemma of closing the expectations gap and responsibility to detect material misstatements in the financial statements, and most importantly, gain confidence in their findings.

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*Information for this article was developed from the CaseWare IDEA Research Report, “Using Data Analysis to Meet the Requirements of the New Auditing Standards.” The complete report may be downloaded by visiting [www.caseware-idea.com](http://www.caseware-idea.com) and click on the “Research Reports” tab.*
The New IIA Standards – What Do They Mean for Your Audit Shop?

By Kathryn W. Kapka, CPA, CIA, CGAP

Just when you thought you had a firm grasp of reality…it shifts again. Such is the life of a Chief Audit Executive when coping with changes to internal audit standards. The Institute of Internal Auditors (IIA) reviews all guidance at least once every three years “to ensure that it remains current, relevant, and timely” (www.theiia.org/guidance). The IIA recently issued new standards with several changes that may affect the way audit departments function. President Mark Paganelli and Chair of the Accounting Principles Committee Kathryn Kapka responded to The IIA exposure draft on behalf of ACUA members in a letter dated May 1, 2010. In the letter, concern was expressed about several of the proposed changes/additions to the standards. This article will briefly summarize those concerns, the substantive changes in the standards and how we can comply with these revisions.

THREE NEW STANDARDS – ONE NEW CONCEPT: “STAKEHOLDER EXPECTATIONS”

Standard 2010.A2 – “The chief audit executive must determine stakeholder expectations for internal audit opinions and other conclusions, including the levels of assurance required, through discussion with senior management and the board.” On the surface, this new planning standard appears to indicate that the auditor “must,” not “shall,” determine what conclusion the stakeholder is expecting prior to the execution of the audit. After viewing The IIA’s October webcast, it is now understood that the intent of this standard was for the Chief Audit Executive (CAE) to have discussions with senior management and the board to determine the type of opinion the constituents would like to receive (i.e., quantitative, qualitative, scaled, etc). The IIA did not mean to imply that the stakeholder expectation of audit results should be pre-determined. Determining stakeholder’s level of assurance required might mean ascertaining senior management’s risk appetite, which would affect the amount of testing performed. This would be understandable, as long as the relationship between the level of assurance desired by the stakeholder(s) and/or management and the amount of audit testing required to support the desired level of assurance is understood…and documented in the planning memo. With this clarification, ACUA’s concerns over the impact of this new standard on auditor objectivity have been addressed. Compliance with this standard can be achieved by expanding the planning memo to document the auditee’s requested opinion format and desired level of assurance.

Standard 2410.A1 – “When an opinion and/or conclusion is issued it must address the expectations as agreed with the board, senior management, and other stakeholders and must be supported by sufficient reliable, relevant, and useful information.” In their letter to The IIA, ACUA expressed concern about this standard because it appears to require auditors to include expected results in the audit report. Were we expected to add a sentence to the conclusion that states results of the audit were “as expected” or “not as expected”? The main contention with the proposed standard, as stated in ACUA’s response to The IIA, is that “expected” results are not the same as “audited” results and have no place in the audit conclusion and/or opinion. When The IIA clarified that the “expectation” wording in the standard referred to the opinion type and not its substance, ACUA’s concerns for auditor objectivity were alleviated. Auditors may comply with this new standard by including in our opinions that the type of audit opinion stated was requested by management. Exactly how the audit function reports the type of opinion desired by executive management is left up to the CAE and/or the audit committee. Possible scenarios are varied, but, for example: “Management requested that we determine whether or not the Department of Biology generally complies, partially complies, or does not comply with the grant requirements. The Department of Biology generally complies with grant requirements.” Another approach could be “At the request of executive management, our opinion is expressed as a percentage of overall compliance. The Department of Biology is compliant with 85% of the grant restrictions.”

Standard 2450: Overall Opinions – “When an overall opinion is issued it must cover an appropriate time period and it must address the expectations as agreed with the board, senior management, and other stakeholders and must be supported by sufficient reliable, relevant and useful information.” The concept of expected results is covered in Standard 2410.A1 above. While the concept of an appropriate time period is not defined by The IIA, it is generally understood to be at least six months or the previous fiscal year. However, each audit function and audit committee may define what is appropriate for their organization, or for each individual engagement.
OTHER IMPORTANT ADDITIONS AND INTERPRETATIONS TO NOTE

Standard 1110: Organizational Independence – Additional interpretation was provided in the form of a list of board activities that constitute “functional reporting” of the CAE to the board. In the case of a university system environment, the individual audit committees of each campus or institution would perform these activities in lieu of a “board.” Activities defined as “functional reporting” include:

- Approving the internal audit charter;
- Approving the internal audit plan;
- Receiving audit plan status reports from the CAE;
- Approving appointment and removal of the CAE; and
- Inquiring of the CAE and management to determine if there are inappropriate scope limitations or resource limitations.

Standard 1312: External Assessments – Additional interpretation provided indicates it is not necessary for every member of a peer review team to have all competencies required to perform the review, as long as the team as a whole is qualified. This guidance should make it easier to have at least one inexperienced member on a peer review team, as long as the other members have sufficient experience to lead and manage the team. Hopefully, this will result in making it easier to find peer review team members.

Standard 1321: Internal Assessments – Additional interpretation reinforces the requirement for internal assessments to be performed annually and communicated to the board (i.e., documented in the board [or audit committee] meeting minutes). The external review, required every five years, will include all internal assessments performed in the interim between external assessments.

Standard 2070: External Service Provider – A new standard that states external service providers of internal audit services must conform to the same internal and external assessments as “in-house” internal audit functions. Therefore, CPA firms that perform internal audit services must also comply with the quality assessment standard.

CHANGES TO DEFINITIONS OF KEY TERMS

Add Value: The old definition of “improving opportunities to achieve organizational objectives” is replaced with “provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes.” Therefore, according to The IIA, value is now added by “providing assurance” rather than “improving opportunities.” Neither concept is a measurable performance measure.

While we know our institutions have stronger internal controls because of our constructive recommendations and participation in risk management, the challenge continues to be determining how to provide a quantitative measure of our value.

Adequate Control: Without providing an explanation, The IIA proposed deleting this term from the glossary. This terminology is part of an auditor’s everyday vernacular to express the audited level of control. ACUA suggested that the definition remain in the glossary. The IIA agreed and the term will remain in the glossary.

CAE: The IIA altered the definition to state that “normally, the chief audit executive would be a Certified Internal Auditor or have Certified Internal Auditors reporting to them.” On behalf of our members who hold a professional certification other than the CIA, ACUA protested the proposed verbiage and suggested “or other appropriate professional designation” be added to the definition. The IIA agreed with ACUA and other professional organizations and changed the definition to state that the CAE should have a professional designation, but does not specify a particular one.

Independence: The IIA proposed omitting the phrase “or appearance of objectivity” from the definition. An appearance of a lack of objectivity can be as damaging to an auditor’s credibility as an actual lack of independence, therefore ACUA suggested that the phrase remain in the definition.

WHAT NOW?
The addition of “stakeholder expectations” to The IIA standards may be a confusing concept for many internal auditors. As a result of the standard revisions, conversations will occur between the audit function and executive management to determine what types of opinions they would like to receive for the various types of audits performed. Additionally, auditor objectivity has been preserved in the new standards. The challenge will be in documenting stakeholder expectations … either in each individual engagement, or with a more general approach, such as amending the Audit Charter. It is expected that many audit functions will discover that their executive management decides to leave the decision on opinion type to the CAE. In this case, auditors will need to document the executive decision either in audit committee minutes, or in the audit charter. Just remember… if it isn’t written, it didn’t happen! Your next peer-review team will be asking for this documentation. As always, the ACUA listserv provides a wonderful sounding board for questions on the new standards and ideas/suggestions for compliance. Auditors with a suggestion on how to comply should share their suggestion with their peers. We will appreciate it!
Auditing Success in a Complex Public/Private Partnership Venture

By John C. Pittman

The University of Central Florida (UCF) is a state-funded university with a fall 2009 enrollment of more than 53,000 students. To accommodate student demand, enhance UCF’s main campus and serve area residents, UCF began developing plans in 2002 for an on-campus housing and retail project with a new sports and events arena at its center.

This multi-year project involved many private and public partnerships, multiple financing arrangements and on-the-fly changes to manage unforeseen issues from an economic downturn to three hurricanes within six weeks. The project has been a success for UCF and we hope it can serve as a roadmap for how other universities can balance innovation with strict accountability standards in their construction projects.

HOW TO GET STARTED

Colleges and universities seeking to build capital facilities have a few options for funding. We can attract donors to pay for all or part of a new building. Governmental appropriations sometimes completely build and furnish facilities or match donations that we have received. Most of the time, however, colleges and universities issue debt to finance a new building.

There are two major types of debt issued for capital projects. A loan, usually from a bank, is a promise to pay both principal and interest over a certain period of time. With bonds, the principal is paid at the end of the debt period while the interest is paid over the life of the debt. Bonds are usually sold to multiple investors, whereas loans are usually from one bank. Bonds are sold in increments of $1,000 and packaged in bundles to equal the total amount of funds needed.

UCF commissioned two feasibility studies to determine the appropriate size and costs for the facility. After review and discussion of the results of the studies, the university issued a request for proposal seeking partners that could design, construct, finance and operate an arena on UCF’s campus. UCF reserved the right to have the first opportunity to reserve dates for events. The winning proposal identified a need for additional student housing along with additional retail space on campus to accommodate a growing university. The private sector saw how combining various operations together with the new facility could help UCF achieve its goals.

The UCF Board of Trustees voted to obtain the financing needed to complete the project for two primary reasons. First, if the project produced extra revenues, this could support the university. Second, if the project failed, a private company obtaining the bonds could walk away, allowing the bond insurer to take control of the facility.

FINANCING AND CONSTRUCTION

UCF began working with the financing team organized by the private partners and obtained a financial advisor who specialized in debt issuances to serve as a consultant for the largest construction project UCF had ever undertaken. Under the advisement of the project team, the $242 million in debt was issued through three separate Certificates of Participation over two years. The first debt issuance for $68.8 million was in October 2004. This segment involved the construction of two 500-bed student towers along with a 700-space parking garage for the students in the towers. In June 2005, the second issuance of $67.4 million financed two additional student towers, a second 700-space parking garage and 21,800 square feet of retail space attached to one of the towers. In September 2005, the last component of debt was issued for $107.4 million, which primarily included the new 10,000-seat arena, a renovation of the existing arena and additional retail space. The first student tower opened in fall 2005 and two additional towers opened in fall 2006. The first retail spaces were ready in January 2007. In fall 2007, the final tower opened, the remaining retail spaces were completed and the university celebrated the grand opening of the new arena.

(continued on page 14)
Because UCF had no prior history of completing a project similar to this one, it was considered risky by the rating agencies and bond insurers. The combined experience of the financing team working with UCF was extremely valuable in helping the university succeed at every stage.

**MANAGEMENT STRUCTURE AND OPERATIONS**

UCF’s approach differs from the usual model, which involves a university leasing the land and/or constructing a building and then contracting with a private entity to manage it. A Direct Support Organization (DSO) of the university, a subsidiary corporation known as the UCF Convocation Corporation (UCFCC), was created to finance and own the project. UCFCC contracted with one of the private companies comprising the project team to manage all of the revenue-producing aspects of the project. The project consisted of three major revenue-producing entities: 1) student housing and parking rentals, 2) retail leases and 3) arena operations. The private company, in turn, subcontracted the management of specific parts of the project to other entities. The university became the subcontractor managing the student residential and parking facilities, using the software infrastructure and management systems already in place, and ensuring that the management of all housing and parking on campus would be uniform. The management of the new and existing arenas was subcontracted to a facility management company. The original private company managed the retail leasing component. UCFCC had no employees of its own. All operations were contractual in nature. The Office of the Vice President for Administration and Finance for the university oversaw the accounting and corporate records of the DSO. The private management company reported to a Board of Directors of UCFCC and members were appointed by the university and its Board of Trustees.

**LESSONS LEARNED**

The private partners responsible for the design and construction of the project did an outstanding job. Construction on the first housing tower began in 2004, when three hurricanes passed through Central Florida. By constructing the project in phases, the contractors took advantage of lessons learned during the first phase and applied them to the remaining structures. This resulted in the final tower being available for occupancy ahead of schedule with a significant cost-savings.

By working with a financial consultant, UCFCC used cash reserves funded with debt proceeds to build the event parking facility instead of issuing additional debt.

The project has faced some unforeseen financial challenges. Following the 2004 hurricane season, property insurance rates in Florida skyrocketed. The project in its earlier years faced insurance rates three times greater than the amount forecasted and utility costs also have been much higher than expected. In 2007, the year of the project’s grand opening, the U.S. economy began to slump.

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A significant amount of operating revenues was expected to come from selling naming rights for the new arena, along with leasing suites and club and loge seats. The down economy made it difficult to attract companies interested in partnering with the university and has delayed securing a naming rights partner as well as leasing all of the suites and other premium seating. This reduction in revenue has stressed the overall financial performance of the project. Because of this, the Office of the Vice President for Administration and Finance frequently monitors and updates its financial forecasts to ensure all covenants and contractual obligations continue to be met and to make recommendations to steer the project toward success.

MOVING FORWARD
From UCF’s perspective, this is one project with revenues flowing together for a common purpose. However, the project was funded through three debt issuances resulting in three separate debt covenants, flows of cash and many contractual requirements that must be monitored. The office of the Vice President for Administration and Finance works with the internal audit staff of the university and the audit staff of the state and has an external audit performed for the corporation annually.

The most significant risk in the project from an audit perspective is in the areas where cash is handled and controlled by private entities. All project revenues are transferred to the trustee for the different bonds, except for those generated by the arena during its events. Those funds are kept within the operation to pay for expenses related to the events and other operational costs. Funds for housing and operational expenses drawn from the trust are kept in an institutional account managed by the Office of the Vice President for Administration and Finance on behalf of the DSO. All expenses are monitored and paid from this office. The private partner also received funds to pay for the Common Area Maintenance expenses related to retail. To prevent unauthorized expenditures of funds by the private partner, the DSO transferred the responsibility of managing these funds. The DSO is currently working with the university to evaluate the best management structure for the continuation of the project.

Outside of the uncontrollable effects of the economy, the project has been successful and has more than met the intended needs of the university.
It was at a May 2001 audit committee meeting when I first heard Tufts’ external auditor mention Enterprise Risk Management (ERM). I remember the perplexed look on the faces of the senior managers and audit committee members as the audit partner valiantly tried to extol ERM’s virtues, walking us through a 20-page handout which explained the theory behind it. According to the partner, ERM was the wave of the future; a systematic, focused approach to anticipating and managing the operating, compliance, reputational and strategic risks that our university would likely face in the years ahead. Perhaps the timing was bad (we were still battle-fatigued from our university-wide effort to avert “Y2K” disaster on January 1, 2000), but the concept of ERM was not a big sell among the group. By the end of the meeting, and based on comments afterward, it was evident senior management and the audit committee members had concluded that ERM was yet another attempt by the external auditor to increase consulting income by promoting the latest management improvement technique (TQM was not yet a distant memory). It was enough of a challenge to provide the required administrative resources to support the academic enterprise and research; there was no time to assess probabilities and impacts and contemplate risk appetites! Besides, when necessary, a committee or task force could be easily convened to address any significant challenge or crisis.

Fast forward almost a decade to a cultural shift. Slowly, risk assessment is becoming part of Tufts management’s lexicon as ERM is becoming more prevalent among institutions of higher education. How did the university get to this point? Several years ago, realizing that a top-down directive to incorporate a structured risk assessment process with the university’s strategic and operational planning was unlikely any time soon, we decided that Internal Audit would at least plant the seed by becoming an early adopter of ERM in terms of our auditing approach. If we were successful, we could lead the way for others within the university community to adopt concepts of ERM as part of their management activities. First, we had to get our own house in order by implementing a more formal risk-based approach to our audit planning process.

First, we had to get our own house in order by implementing a more formal risk-based approach to our audit planning process.

The following risk drivers are used to assess the degree of residual risk within a particular area or activity:

1. The quality of controls based on the results of the last audit
2. The date of the last audit (areas not audited for some time are assumed to have a potentially higher risk profile; accounting for this as an assumption, this risk driver is weighted only 50%)

Using a ranking formula, the impact of the above-mentioned criteria results in an audit plan score that falls into a risk range of ‘high,’ ‘medium’ or ‘low.’ The higher the score, the greater the risk noted. Areas that score in the high and medium range are prioritized for internal audits.
BABY STEPS TO ERM

Subsequent to improving our approach to risk-based audit planning, we embarked on a dual strategy to promote the practice of risk assessment throughout the university. Given the existing complex, decentralized culture, we deliberately chose an incremental approach. We sensed that the executive management in place at the time was not yet persuaded of the need to participate in a structured forum where higher level operating and strategic risks might be discussed. Instead, on a one-to-one basis, we informally engaged Tufts vice presidents, senior managers and executive deans of administration in what the consultants refer to as a “risk conversation.” We used these meetings as an opportunity to describe the risk model we were using and within this context, sought their input concerning the areas they perceived as at risk and “audit-worthy.” We continue to use these annual meetings to educate our colleagues about the components of risk and prompt them to express any concerns about their schools or divisions in terms of strategic, operational and reputational risk probability and impact.

Concurrent with this strategy we developed an approach to promoting ERM on a local level by offering to facilitate risk assessment forums for clusters of academic department administrators at each of Tufts’ schools. Department chairpersons were also encouraged to participate in the risk assessment forums. We realized that the majority of our clients would more easily identify with the concepts of ERM by applying them to their daily administrative responsibilities such as grants administration, regulatory compliance oversight, budget monitoring and reporting, personnel management, information security, records retention, etc. We still offer this option; each risk assessment forum is broken into two sessions of no more than 2-3 hours each. The first session is used to identify the top 5-10 inherent risks which the participating departments commonly share that could have a negative impact on successfully managing operations, regulatory compliance obligations, funding streams, environmental safety and other administrative activities. After identifying these risks, the participants are asked about the policies, procedures and other internal controls they currently employ in their departments to effectively manage or eliminate the identified risks. At the second session, weaknesses identified in current administrative practices pertaining to the identified risks lead to discussions and brainstorming concerning recommendations to address the issues. The recommendations are summarized in a report to senior school management as collectively addressed from the group. The risk assessment process is periodically offered as an alternative to a traditional audit; thereby leveraging resources and allowing for a more collective assessment by the individuals whose administrative practices are being reviewed.

TAKING ERM TO THE NEXT LEVEL

With the two strategies taking hold in modeling the concepts of ERM, it was time to take it up a notch by taking advantage of an established meeting structure that included all Tufts vice presidents, members of the Office of the Provost and the executive administrative deans from each of the schools. Known as the Administrative Council, the group meets monthly to discuss topics of interest and exchange information to promote administrative excellence and academic support. The Council represented an excellent opportunity to promote ERM at a higher administrative level to identify certain strategic and key operating risks and evoke discussion on how they might be managed. However, to obtain buy-in among the members, we needed a “champion” and found it in our executive vice president who chairs the Council. Having conducted a similar exercise with her previous employer, the executive vice president appreciated the value of risk assessment and was willing to place it on the agenda of a planned retreat and encourage participation. It was also critical to have a good facilitator available; one participant
on the Council serves as Tufts’ director of Organizational Development and Training and she fit the bill.

In advance of the session, a memorandum which contained a primer on concepts of ERM was sent to all Council members. Association of Governing Boards (AGB) recommendations for improving risk management at colleges and universities and examples of strategic, financial, operational, compliance and reputational risks at a hypothetical university were also provided. Council members were then asked to complete a Risk Reporting Form to identify higher level risks pertinent to their individual divisions and schools. The survey results were used to identify several risk “themes” for discussion and ranking at the Council retreat.

THE MOMENT OF TRUTH

At the retreat, I was tasked with introducing the risk assessment exercise. Admittedly, I was a little nervous and sensed a bit of skepticism amongst the group. I began my introductory remarks by stating that “for me, convening the Council for a discussion about enterprise risks was a dream-come-true.” My comment elicited laughter and a few auditor wise cracks, but the ice was broken and what followed was a lively discussion about Tufts’ more prevalent risks. By the end of the session, we agreed on four particular risks which were deemed relevant and impactful. The risks pertained to continuing to attract a high caliber of students and faculty, enhancing diversity, increasing collaboration among our schools and administrative divisions and maintaining good regulatory compliance. Within this context, we assessed the Council’s current and future leadership ability to effectively address each of the identified risk areas.

THE FUTURE OF ERM AT TUFTS

Enterprise risk management at Tufts continues to evolve. Admittedly, not every step was followed at the Administrative Council retreat that a true ERM process might dictate; however, the process used was appropriate to engaging the Council and introducing them to a more formal risk assessment than they were accustomed to. Based on this experience, for any ERM activity to be successful, you must remain flexible. An early and integral step to success is to evaluate your management’s comfort level about actively participating in a structured discussion about financial, operational, compliance and reputational risks and adjust your approach accordingly. For certain ACUA members, rolling out an ERM process will be relatively easy if the directive comes from an influential board member or senior executive. For other member institutions, it may require a more patient and methodical approach, similar to the process we deemed appropriate for Tufts.

JOB ANNOUNCEMENT

Director of Internal Audit, Mississippi State University

Mississippi State University, located in Starkville, MS invites nominations and applications for the position of Director of Internal Audit. The Director reports to the Institutions of Higher Learning’s Director of Internal Audit and the President of Mississippi State University. The Director directs the advisory function on internal auditing and systems accounts, which serves as an independent review and appraisal for the fiscal and administrative operations of the institution.

The Director is responsible for planning, developing and directing the institutional internal audit functions which serves as an independent assurance and advisory activity of the University’s risk, governance and control processes. In addition, the Director will design, develop, and implement internal auditing policy and procedures within the University to ensure compliance with identified objectives, standards, and laws; provide shared audit services to other Universities and/or locations, and manage professional and administrative staff.

This is a non-tenure-track, professional position. The successful candidate will hold a bachelor or master’s degree in business, management, finance, accounting, or related field; have experience in higher education preferably at a land grant institution, and have seven years experience in policies, laws, and practices of internal auditing. The following certification and/or licensures are required: Certified Public Accountant (CPA), Certified Internal Auditor, or Certified Fraud Examiner. The successful candidate must demonstrate personal integrity and honesty.

All applicants must apply online at http://www.jobs.msstate.edu. Questions concerning applying for this position should be addressed to: Dr. Teresa Gamill, Assistant Vice President for Research and Chair of the Search Committee, Office of the Vice President for Research and Economic Development, tgamill@research.msstate.edu, (662) 325-3570.
How to Steal Using a Purchasing Card (Part Two)

By Phillip Hurd, CISSP, CISA, CBM, Guest Columnist

Part one of this two-part series appeared in the Summer 2009 CandU Auditor and discussed how con artists use social engineering techniques to gain access to sensitive information, such as credit card numbers and passwords. As explained, con artists would buy gifts (for birthdays, holidays, anniversaries, etc.) to create a perception of friendship, all the while enabling them to get closer to information needed to commit crimes. Also discussed was how fraudulent documentation could be used to cover up real purchase information.

In this article, two fraud schemes will be discussed that have been facilitated by the information age. Both are modified versions of older schemes, but information technology and e-commerce have made the schemes, in some cases, nearly impossible to detect. The first scheme converts credit to cash, and the second creates a nearly untraceable personal company using the infrastructure of a major e-commerce provider.

SCHEME ONE: CONVERTING CREDIT TO CASH

Most of us think the only way to get cash from a credit card or debit card is to go to the ATM and use our PIN. However, for the devious mind, there are other ways. Take the example of a recent fraud case in which the individual purchased items using PayPal. The items were fictitious, and the PayPal account was hers, but under an assumed name that allowed her to funnel cash to her own personal bank account. Once the money was transferred to her personal account, she was free to withdraw it in any amount she needed, thus her credit was converted to cash. The receipts created by the transaction were forged to appear to be for hard-to-trace items. Thanks to the ever-increasing number of sites that allow individuals to take credit cards and transfer funds between accounts, this type of scheme is becoming more commonplace. Usually verification requires only e-mail addresses, which are easily ghosted.

SCHEME TWO: CREATING A PERSONAL COMPANY

While creating a shell company is nothing new, today's e-commerce markets make it exceptionally easy to do and adds new dimensions of protection and anonymity. During the last few years, more and more examples have surfaced of individuals who have created their own companies using an online service, such as Amazon.com, eBay, or PayPal. Moreover, e-commerce sites that allow you to drop ship items provide a fraudster a virtually turnkey base of operations. In any of these instances, the fraud scheme is extraordinarily difficult to detect. These are the steps:

1. The individual maneuvers into a position of purchasing authority. In many modern organizations, this can simply mean having a purchasing card or corporate credit card.
2. The individual sets up an online store, a personal company if you will, under an assumed name. On eBay, Amazon.com, and numerous other sites, this takes less than 10 minutes. Because such stores are separate legal entities, law enforcement officials must issue a separate subpoena for each entity as they try to track money through the maze of e-commerce payment systems, making the investigative process that much more difficult.
3. The individual identifies a legitimate item for purchase.
4. The individual goes to a retail store and purchases the item with personal funds. We will use the example of a computer monitor and assume the individual goes to Best Buy and purchases the monitor for $200.
5. The individual puts the monitor up for sale on his or her online store, on eBay for example, for $250 plus $50 shipping. Since tracking shipments depends almost entirely on the type of delivery, fraudsters will almost always choose untraceable methods. If the individual is going to forge documents, this will be where they are most likely to be forged.
6. The individual purchases the item from that online store. Because the store is under an assumed name, the purchase won’t be directly traceable to the individual. Because the margin is so close to the price variation for that particular object in the market, it is very difficult to detect the purchase as fraudulent. Because the individual is likely to bring the monitor to his or her workplace, the shipping cost becomes part of the heist too.
Once the item is ordered and appears to be delivered, PayPal, Amazon.com, or other e-commerce sites may automatically generate what appear to be shipping documents that can be given as supporting documentation. Electronic systems that track purchases will show a valid purchase. An auditor verifying the existence of an asset will be able to see the asset, the shipping documents, and trace the purchase to available electronic records.

Without a subpoena to trace the money through the accounts to the individual, it becomes nearly impossible to determine fraudulent from real purchases. The only real difference is the higher price being paid for the item. However, electronic items and numerous other categories of goods fluctuate with the market, so small differences, such as $100 or less, are not likely to be viewed as a discrepancy. An individual using this fraud scheme can go undetected for an indefinite period of time if he or she doesn’t get too greedy.

The graphic illustrates the online store/personal company scheme.

The above fraud schemes can be very damaging to any organization, so this begs the question: How do you thwart schemes such as these that are almost impossible to detect? There are several things that an organization can do. The remainder of this article touches on some of them that involve elements of fundamental control and detailed analysis.

**MERCHANT CATEGORY CODES**

Merchant Category Codes (MCCs) refer to the codes given to vendors based on the type(s) of goods and services they sell. Every vendor has an MCC. An MCC will fall within a specific range. For example, airlines have a range of 3000 – 3299 for MCCs. In theory, you simply block the use of your purchasing cards for particular MCCs to provide appropriate control. It should be noted that some merchants give rise to multiple MCCs. For example, while an airline ticket may be purchased under a certain MCC, that does not mean that an alcohol purchase on the airplane will show the same code. Likewise, a hotel may have a certain MCC, but its gift shop may have a different one. Purchases from large vendors, such as Wal-Mart, may have multiple MCCs because Wal-Marts have multiple stores within them, such as gas stations, food stores, other retail
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**COMPARATIVE ANALYSIS**

Many data mining tools, such as IDEA, allow for comparative analysis within their protocols. What this means is that comparisons can be made between individual purchasers, the items purchased, the frequency of discrepancies in price, and variations in shipping details. This assumes that an organization has the appropriate data available. To obtain them, organizations should request Level III data from their banks.

Levels I and II data might include little more than the name, MCC, and address information. Level III data would typically also include line item descriptions of what was purchased, prices, taxes paid, shipping details, discounts given, etc. Level III data are essential for doing comparative analysis and spotting fraud schemes. Most major banks have some type of mechanism in place to give you this information. Most large vendors will provide Level III data. For example, Amazon.com provides Level III data for purchases made from its sites, but not for purchases made from individuals using its site to market individual goods and services. Major retail stores such as Office Depot, Staples, OfficeMax, etc., will also provide Level III data.

To fully understand credit cards and the controls associated with them, I recommend visiting the following sites:

- [www.creditcards.com](http://www.creditcards.com)
- [www.pcisecuritystandards.org](http://www.pcisecuritystandards.org)

Cred card fraud is among the fastest-growing sectors of crime in our country. Organizations struggle with controls on these cards because too much control might defeat one of their primary purposes, which is to make commerce more efficient. Visa’s global transaction volume alone is commonly measured in trillions of dollars. With fraud rates approaching 3% to 4%, the resulting amount of lost or stolen dollars is staggering. Your institution’s purchasing card risk, while perhaps not staggering, is undoubtedly consequential in terms of dollars and reputation. Constant vigilance over purchasing card transactions is thus essential to avoid becoming a victim of con artists, fraud schemes, and the costs they inflict.
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