



## INTERNAL AUDIT MANUAL

### Purpose of the Internal Audit Manual

This manual summarizes the operations of the internal audit function at the University of San Francisco and delineates the policies, standards, and procedures which will generally govern the internal audit function. Notwithstanding the foregoing, these policies, standards, and procedures may not be followed for certain special projects requested by the Audit Committee of the Board of Trustees and/or the President, fraud or financial irregularity audits, and under other special circumstances.

### Job Description

In discharging his job responsibilities the Director of Internal Audit and Tax Compliance will:

- Develop, document, implement, test, and maintain a comprehensive internal audit plan and system of internal controls to help provide assurance that applicable laws, regulations, and University policies and procedures are complied with judiciously;
- Examine financial transactions for accuracy and compliance with institutional policies and applicable laws and regulations;
- Evaluate financial and operational procedures to assure adequate internal controls are present;
- Identify, assess, and evaluate the University's risk areas; make appropriate recommendations for improved internal controls and accounting procedures; and research and adopt industry best practices where appropriate;
- Work with the President and senior leadership of the University to identify key business risks, assess those risks, and establish risk management procedures and practices based on industry best practices;
- Identify pertinent portions of the Sarbanes-Oxley Act of 2002 and best practices emerging within the higher education industry which can assist the University in producing accurate and reliable financial reporting information;
- Oversee the administration of the University's Whistleblower Hotline;
- Oversee the preparation and timely filing of the University's primary state, local, and federal tax returns;
- Direct research and strategic planning efforts related to tax issues;
- Act as a resource to the University community for tax issues;
- Advise the University's senior management on policy and procedure developments with respect to tax issues;
- Provide expert knowledge with respect to maintaining the University's tax-exempt status Maintain a current knowledge of legislative and regulatory proposals which have the ability to effect the University's tax-exempt status;
- Monitor current tax law developments which could potentially adversely impact the University's operations;
- Oversee and negotiate federal, state, and local tax audits and inquiries;

# **Types of Audits**

## **Departmental Audits**

Departmental audits are designed to review and evaluate the activities and operations of a particular University function, activity, department, or unit under review. Departmental audits will evaluate accounting controls, ensure compliance with University policies and procedures, applicable laws and regulations, and validate the records and account balances of the auditee. Departmental audits may utilize a complete battery of audit tests and procedures, including, but not limited to, functional tests, transaction reviews, substantive tests, and analytical reviews.

## **Financial Audits**

Financial audits are designed to validate the accuracy and completeness of records and account balances. Financial audits may utilize substantive tests, analytical reviews, and other validation procedures which may or may not include functional tests or transaction reviews. Financial audits determine whether the financial information of the University function, activity, department, or unit under audit fairly represents the financial position, results of operations, and cash flows or changes in financial position of the auditee in accordance with Generally Accepted Accounting Principles.

## **Operational Audits**

Operational audits are designed to evaluate procedures and controls which impact the attainment of the University's organizational goals and objectives. Operational audits also measure compliance with University policies and procedures as well as applicable laws and regulations. During operational audits, functional tests and transaction reviews may be utilized.

## **Grant and Contract Audits**

Grant and contract audits are designed to evaluate the contracting process, compliance with the provisions of grants and contracts, and third-party contractual performance. These audits may be performed with respect to any function, activity, department, or unit of the University and may include all types of contracts; e.g., federal and private grants and contracts, construction contracts, and professional service contracts.

## **Fraud and Financial Irregularity Audits**

Fraud and financial irregularity audits are designed to verify the existence and magnitude of suspected fraud and financial irregularities. Fraud and financial irregularity audits may be conducted at the request of the Audit Committee of the Board of Trustees, the President, or other senior members of University management; as a result of a tip from the University's whistleblower hotline; or at the discretion of the Director. The Director shall utilize the highest level of discretion when undertaking a fraud or financial irregularity audit. The Director shall promptly notify the Audit Committee of the Board of Trustees (including the Chair of the Audit Committee), the President, and any other member of senior management which may be appropriate, of any significant findings which result from a fraud or financial irregularity audit.

## **Follow-up Audits**

Follow-up audits are designed to determine whether corrective action has been taken on previous audit recommendations. These audits may be conducted at the direction of the Audit Committee of the Board of Trustees six months after a Final Audit Report was issued and usually include only the deficiencies reported in the Final Audit Report. The follow-up audit may include such functional or substantive tests that are necessary to verify that logical and appropriate corrective actions have been taken.

# **Overview of the Internal Audit Function**

## **A. Introduction**

This section describes the organization of the internal audit function, outlines the Director's responsibilities with respect to the internal audit function, describes audit planning and scheduling, and discusses the scope and types of internal audits generally performed at the University of San Francisco.

## **B. Scope of Internal Audits**

The internal audit function's scope of operations is by its very nature quite expansive. The internal audit function assists the University in fulfilling its vision, mission, strategic initiatives, and objectives, while adhering to its core values, by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of enterprise-wide risk management, internal control systems, and governance processes.

Ultimately, the internal audit function helps ensure:

- Risks are appropriately identified and managed.
- Significant financial, managerial, and operating information is accurate, reliable, and timely.
- University resources are used efficiently and adequately safeguarded.
- University operations are transacted in accordance with sufficient internal controls, good business judgment, and high ethical standards.
- Quality and continuous improvement are fostered in the University's internal control processes.
- Opportunities for improving the University's internal controls may be identified during internal audits; these opportunities will be communicated to the Audit Committee of the Board of Trustees, the President, and other appropriate members of University management.

## **C. Types of Audits**

In preparing the Annual Internal Audit Plan, the Director shall determine the type of audit to be performed for each auditee. The following is a summary of the various types of audits which will generally be conducted:

## **D. The Phased Audit Approach**

A phased audit approach will generally be used to conduct, monitor, and complete internal audits in a timely and professional manner. Notwithstanding the foregoing, this approach may not be followed for certain special projects

requested by the Audit Committee of the Board of Trustees and/or senior management, during fraud or financial irregularity audits, and under other special circumstances.

This phased audit approach allows the Director to:

- Establish guidelines for completing internal audits;
- Identify the entire internal audit process, rather than emphasizing the fieldwork component as the extent of the internal audit process;
- Establish responsibilities and outputs for each phase of the internal audit process; and
- Provide regular communication that serves to document the internal audit progress.

As discussed below in more detail, the phased audit approach consists of five phases:

- The planning phase;
- The organizing phase;
- The preliminary phase;
- The conducting phase; and
- The reporting phase.

Each phase of the internal audit process has definite requirements and produces specific deliverables.

## **E. Internal Audit Procedures and Techniques**

During the internal audit process, the Director may employ one or more audit techniques. Such techniques include, but are not limited to:

### **Observation and Inquiry**

The Director may observe the operation of any University function, activity, department, or unit. The Director may also make reasonable inquiries of any University employee in attempting to carry out the internal audit process.

### **Analysis and Review**

A principal means by which the Director administers the University's internal audit function is through careful analysis and critical review of both financial and operating data. In some cases this will be accomplished through the comparison of current balances with those from prior periods. Another common technique which may be utilized while performing analysis and review activities is the breakdown of individual accounts into their most refined detail so that unusual or significant items are more likely to be highlighted and thus selected for further review. Other techniques may be used as necessary to accomplish an appropriate level of analytical review during the internal audit process.

### **Inspection**

At his discretion, the Director shall have the authority to inspect physical assets, documents, and other evidence supporting relevant data of the auditee under review. This process is usually accomplished by verification of transactions employing the following basic audit techniques:

- **Vouching**—This is the verification of entries by comparing them to the original documents on which they are based. This technique helps ensure the accuracy, genuineness, validity, or truth of the entries under review.
- **Recomputation**—This is the process of recalculating selected calculations to determine their accuracy. In applying this technique an auditee’s footings, adding machine tapes, and spreadsheets shall never be assumed to be correct.
- **Retracing of Bookkeeping Procedures**—This includes tracing postings from original books of entry to ledgers and vice-versa.
- **Physical Examination and Count**—This technique may be used to substantiate the reliability of the records under examination. In applying this technique, the Director shall: (i) identify what is being examined; (ii) determine the existence of the items being examined; (iii) determine the condition of the items being examined; and (iv) verify the quantity of the items being examined.

## **Confirming**

The validity of items shown on University records may be established by receiving confirmation directly from a third-party in a position to verify the validity of a given item. Requests for such confirmations must be mailed by the Director and are to be accompanied by a return envelope addressed to:

**Dominic L. Daher**  
 Office of Internal Audit and Tax Compliance  
 University of San Francisco  
 2130 Fulton Street  
 San Francisco, CA 94117

## **Scanning**

This is the process of quickly but carefully scrutinizing a ledger account, document, or any other record for questionable, unusual, or improper items. Scanning will be used in the internal audit process whenever it is determined that this process has a reasonable chance of adding value.

## **F. Internal Control**

### **What is internal control?**

Internal control is a process which is ultimately implemented by University management; it is designed to provide reasonable assurances regarding the achievement of University objectives in the following categories:

- **Operations**—relating to effective and efficient use of University resources;
- **Financial Reporting**—relating to the preparation of reliable published financial statements; and
- **Compliance**—relating to University compliance with applicable laws, regulations, and policies.

Internal control consists of five interrelated components which are as follows:

- **Control Environment**—These factors include the integrity, ethical values, and competence of University personnel; management’s philosophy and operating style; the manner in which University management assigns authority and responsibility; and the attention and direction provided by University management.
- **Risk Assessment**—A prerequisite to risk assessment is the establishment of objectives which are internally consistent. Risk assessment is the identification, analysis, and management of relevant risks which may impede the attainment of the University’s goals and objectives.
- **Control Activities**—These are the policies and procedures which help ensure management directives are carried out. Control activities help ensure that necessary actions are taken to address risks which may impede the attainment of the University’s goals and objectives. Ultimately, control activities include a broad range of activities including, but not limited to: approvals, authorizations, verifications, reconciliations, reviews of operating performance, and segregation of duties.
- **Information and Communication**—Pertinent information must be identified, captured, and communicated in a form and time frame that enables people to effectively carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance-related information that makes it possible to manage and control the University’s operations.
- **Monitoring**—Internal control systems need to be monitored; this means that over time University management must assess the quality of the internal control system’s performance.

### **When is internal control effective?**

A system of internal control can be judged effective if University management has reasonable assurance that it understands the extent to which:

- The University’s operational objectives and goals are being achieved;
- The University’s financial, managerial, and operational information is accurate, reliable, and timely; and
- The University is complying with applicable laws and regulations.

## **The Planning Phase**

The planning phase begins when the Director begins an internal audit engagement. During this phase, audit objectives and scope are developed, and appropriate members of management are notified of the planned audit. The deliverables of the planning phase include the initial audit objectives and notification of appropriate members of management.

### **A. Phase Objectives and Procedures**

#### **Phase Objectives**

- The planning phase will develop the initial audit objectives and the requisite audit methodology to satisfy those objectives.
- Appropriate members of management will be notified that their function, activity, department, or unit has been selected for audit.

## **Phase Procedures**

- The Director will develop the initial audit objectives with consideration for any concerns expressed by the Audit Committee of the Board of Trustees, the President, and other relevant members of management.
- The Director will notify the auditee of the pending audit in a timely manner.

## **B. Development of Audit Objectives**

The first step in the planning phase is the development of the initial audit objectives which are as precise as possible and clearly articulate what the audit is expected to accomplish. The audit objectives will define the audit purpose, establish the direction for detailed audit work, and provide the focus for formulating subsequent findings. All planning, evidence gathering, and data evaluation begins with the audit objectives, and the audit ends when the Director has enough competent and relevant evidence to write a report which satisfies the audit objectives.

## **C. Auditee Notification**

After the initial audit objectives are developed by the Director, the next step in the planning phase is to notify the auditee of the audit, except in circumstances where fraud and/or irregularities may be suspected.

In notifying the auditee of a pending audit, the Director will generally communicate the following information:

- The activity name or a brief description of the function, activity, department, or unit of the University to be audited;
- The type of audit to be conducted and the audit objectives and scope;
- The dates of the planned audit;
- A request of any required documentation;
- A link to the University's Internal Audit website which contains helpful information on the internal audit process and various documents such as: (i) the Charge of the Director with Respect to the Internal Audit Function; (ii) the Internal Audit Charter; (iii) Internal Audit Standard Operating Procedures; (iv) the Internal Audit Manual; and (v) a link to the University's Whistleblower Hotline.

## **D. Phase Conclusion**

The planning phase will conclude the Director's notification of the auditee of the pending audit.

## **The Organizing Phase**

The organizing phase begins when the audit notification letter is issued and ends when the Opening Conference is held. During the organizing phase, the Director organizes the audit and prepares detailed audit plans. Moreover, during this phase the Director will develop a preliminary audit program, prepare any necessary administrative documentation, prepare an agenda for the Opening Conference, and conduct the Opening Conference, where appropriate.

This phase includes the process of the Director identifying the various types of information and documentation needed from the auditee. This information and documentation will generally include items such as: organizational charts, job descriptions, department manuals, and relevant reports.

## **A. Phase Objectives and Procedures**

### **Phase Objectives**

During the organizing phase the Director will develop the preliminary audit program and conduct the Opening Conference, where appropriate.

### **Phase Procedures**

- During the organizing phase the Director will review appropriate data and request copies of pertinent information. Common examples of data which will likely be requested include:
  1. Accounting information not available from the University's accounting system;
  2. Pertinent contracts and agreements;
  3. Established policies, procedures, and accounting processes;
  4. Minutes of pertinent senior management meetings; and
  5. Pertinent correspondence and other relevant information.
- During the organizing phase the Director will obtain a copy of the appropriate organizational chart and confirm its accuracy during the Opening Conference, if applicable. If there is no organizational chart of the function, activity, department, or unit of the University under review, the Director may facilitate the development of one.
- During the organizing phase an agenda for the Opening Conference will be prepared, and the Opening Conference will be scheduled and conducted, where appropriate.
- The major output of this phase is the preliminary audit program.

## **B. Preliminary Audit Program**

The Director will develop the preliminary audit program during the organizing phase and thereafter make modifications as necessary.

## **C. Opening Conference**

The purpose of the Opening Conference, where applicable, is to discuss the plans for the overall conduct of the audit.

During the Opening Conference, if applicable, the Director will:

- Explain the type of audit being undertaken, the scope of the planned audit, the audit objectives, the period to be audited, and the general approach to the audit;
- Verify that the auditee understands the role of the Director and the commitment needed from the auditee to support the audit and respond to audit requests;
- Ask the appropriate members of management if they have any particular areas of risk or concern which they would like reviewed;



- Request management plans, objectives, or other documents that may have a material impact on the audit outcome;
- Review audit findings from previous internal audits, if applicable;
- Develop a list of key personnel in the auditee department to be contacted for meetings or information;
- Discuss the procedure for preparing and reviewing the formal audit report, which is a compilation of reportable findings and auditee responses;
- Inquire about current developments relating to the University function, activity, department, or unit under audit;
- Confirm the location of documents and records needed during the audit;
- Explain the preliminary audit program in general terms and establish priorities for the audit;
- Prepare a workpaper memo which summarizes the date, time, location, and persons in attendance at the Opening Conference, if applicable; and
- Discuss any other applicable topics.

## **D. Phase Conclusion**

This phase will be concluded upon the close of the Opening Conference, if applicable. Audit work will not begin, nor will meetings with the auditee be held, until the preliminary audit program has been prepared, the auditee has been properly advised of the planned audit, and the Opening Conference has been held, if applicable. Notwithstanding the foregoing, these procedures may not be followed in cases of suspected financial irregularities, fraud, or other special circumstances.

## **The Preliminary Phase**

The preliminary phase begins upon the conclusion of the Opening Conference, if applicable, and ends with the preparation of the audit program.

### **Phase Objectives and Procedures**

#### **Phase Objectives**

- The objective of the preliminary phase is to gain a basic understanding of the University function, activity, department or unit which is under audit, including the accounts available for its use, the types and volumes of transactions processed, and the systems and processes used in its operations.
- The preliminary phase will allow the Director to develop a clear understanding of the events and practices which may have a significant impact on the operation of the University function, activity, department, or unit under audit.
- The preliminary phase ultimately allows the Director to obtain a broad overview of the internal controls in place in the University function, activity, department, or unit which is under audit. The preliminary phase also allows the Director to identify any areas of the auditee's operations which may require special attention or consideration.

#### **Phase Procedures**

During the preliminary phase the Director will:

- Review correspondence files, prior workpapers (if applicable), and other relevant information; Identify significant changes in account balances over time or large variances from expectation or budget and perform an analytical review to determine the significance of these variances;
- Review organizational charts and job descriptions and the nature of the auditee's activities and functions;
- Evaluate the auditee's internal controls;
- Discuss relevant matters with the auditee;
- Inquire about problem areas which the auditee would like the Director to review;
- Make arrangements with the auditee for the preparation of the data which will be needed during the audit; and
- Develop preliminary estimates of materiality levels and acceptable error rates.

## **Phase Conclusion**

This phase concludes with the preparation of the audit program.

# **The Conducting Phase**

The conducting phase of the audit begins with the finalization of the audit program and ends with the Closing Conference.

The extent of the tests performed during this phase is heavily dependent upon the discretion and judgment of the Director. The materiality of the amounts involved and the relative risk of the existence of errors or other irregularities will be weighed heavily when considering and planning audit tests.

## **A. Phase Objectives and Procedures**

### **Phase Objectives**

During the conducting phase the Director will:

- Execute the audit program;
- Prepare audit workpapers which detail the necessary audit work accomplished to satisfy each step of the audit program;
- Prepare a Draft Final Audit Report;
- Obtain management responses to preliminary findings, where appropriate; and
- Hold the Closing Conference.

### **Phase Procedures**

Procedures utilized for the accomplishment of the audit program will vary based on the scope and objectives of the audit. Some procedures that will regularly be employed during this phase include a review of internal controls and the tracing of transactions through the University function, activity, department, or unit under audit.

## **B. Preliminary Audit Findings**

Preliminary audit findings are written statements of conditions noted during the audit.

### **Types of Findings**

Deficiencies and findings noted during the audit will be classified as reportable or non-reportable. Reportable findings will be included in the Final Audit Report. Non-reportable findings will not be included in the Final Audit Report, but may be discussed briefly during the Closing Conference. It is important to note that the category of any deficiency or finding may change as additional information becomes available.

### **Processing of Findings**

If deficiencies are identified during the audit, they will be discussed with the auditee to verify the facts before any audit reports are drafted. If these discussions confirm that a deficiency exists, the Director will draft a preliminary finding. All findings will be considered preliminary unless (and until) they are included in the Final Audit Report.

## **C. The Closing Conference**

The Closing Conference of each audit will be scheduled as close as practical to the last day of fieldwork; i.e., the last day of the conducting phase. During the Closing Conference the Director will present his preliminary findings to the auditee, and he will seek the auditee's input where appropriate.

## **D. Phase Conclusion**

This phase will conclude upon conclusion of the Closing Conference.

## **The Reporting Phase**

The reporting phase begins upon completion of the Closing Conference and ends when the Final Audit Report is issued. The activities completed during this phase include: preparing a Draft Audit Report; discussing proposed changes with the appropriate level of management; preparing a Final Audit Report; and distributing the Final Audit Report to the Audit Committee of the Board of Trustees, the President, and other appropriate members of senior management and/or department management.

## **Internal Audit Workpapers**

In the performance of audit work, the Standards for the Professional Practice of Internal Auditing state that "Internal auditors should collect, analyze, interpret, and document information to support audit results." The Director's workpapers will provide the principal evidence that these standards were met, and the audit was performed professionally.

The term "workpapers" includes all documents and papers collected or prepared during a given audit. Workpapers provide the basis and support for the conclusions reached by the Director. All relevant workpapers prepared during a review will be preserved and included in the workpaper files maintained by the Director.

## **A. Characteristics of Workpapers**

Workpapers include the evidential matter that links fieldwork and the Final Audit Report. Workpapers will contain the necessary evidence to support the findings, judgments, and conclusions in the Final Audit Report.

### **Sufficiency**

Workpapers will always be complete and accurate, and include adequate data to precisely indicate the audit work performed. Workpapers will also provide support for findings, judgments, and the conclusions reached by the Director as a result of the internal audit process. Workpapers will delineate sufficient data so that the Audit Committee of the Board of Trustees can easily verify that:

- The audit assignment has been properly planned;
- The auditee's system of internal control has been reviewed and evaluated in determining the extent of the audit tests undertaken; and
- Appropriate audit tests were performed, and the appropriate auditing procedures were followed.

### **Competency**

Workpapers will include only high quality information and evidence. Accordingly, the Director will take all necessary steps to help ensure that the information contained therein is reliable.

### **Relevance**

The information contained in the workpapers will be restricted to matters that are materially important and relevant to the audit objectives.

### **Clarity and Understandability**

Workpapers will be understandable without detailed supplementary oral explanations. Workpapers will also be complete and concise.

### **Principles of Documentation**

- Workpapers will substantiate everything included in the Final Audit Report.
- Workpapers will clearly identify the documents or series of documents examined. It is not necessary to include a copy of each document examined, although in some cases, efficiency may result by utilizing copies of documents.

## **B. Indexing and Cross-Referencing Workpapers**

The Director may use a standard numbering and indexing system for all workpapers; it is specifically noted that this standard numbering and indexing system may change from time to time.

## **C. Standards for Workpapers**

All workpapers prepared by the Director shall be prepared in good form with proper attention to layout, design, and legibility, with complete headings, explanations of sources, and verification of work performed. The Director will generally observe the following rules when preparing workpapers:

- Every workpaper will be properly identified. The workpaper heading may include the name of the auditee, a description of the information presented, and the period covered or applicable date.
- Workpapers may be linked to the audit program.
- The source of the data presented on each workpaper will be clearly stated so as to leave no doubt as to the source of the information.
- The nature of verification work performed by the Director will be indicated on each workpaper.

## **D. Audit Evidence**

In performing internal audits the Director generally gathers evidence from internal sources, which may require verification from external sources. Some of the internal sources of audit evidence include books of account, ledgers and records, memoranda, minutes of meetings, documents that support transactions, and management letters. Information gathered from these sources may be verified from external sources that include confirmations of bank balances, accounts receivable, investment balances, asset held by third-parties, long-term debt, and other assets and liabilities.

All of the information gathered to support the internal audit effort, and the conclusions drawn therefrom, should be considered audit evidence which may be categorized as analytical, documentary, physical, or testimonial.

### **Analytical Evidence**

Analytical evidence includes computations, comparisons, reasoning, and the separation of information into components.

### **Documentary Evidence**

Documentary evidence consists of letters, contracts, accounting records, invoices, etc.

### **Physical Evidence**

Physical evidence is obtained by direct inspection or observation of (a) activities, (b) property, or (c) events. It may take the form of memoranda, photographs, charts, or other summary documentation which recapitulates the subject matter of the inspection.

### **Testimonial Evidence**

Testimonial evidence is obtained from others through statements received in response to inquiries or through interviews. The statements critical to the audit will be corroborated through independent verification when feasible.

# **Audit Communications**

The Final Audit Report is designed to assist University management in measuring its own performance, particularly with respect to the reliability of established internal controls.

## **A. General Standards of Report Writing**

- Findings, recommendations, and opinions will be expressed objectively.
- Final Audit Reports will be organized so as to clearly and concisely disclose relevant, timely, and important information that can be used to enhance or improve relevant aspects of University operations.
- Findings, recommendations, and comments will contain all relevant information necessary for the auditee to fully understand the reported conditions. All Final Audit reports will present factual matters accurately and completely.
- The Final Audit Report will identify the most significant conditions requiring management's attention.

## **B. Final Audit Reports**

### **Report Preparation Procedures and Content**

The Director will prepare a Draft Final Audit Report prior to the Closing Conference. The Draft Final Audit Report may include (among others) sections dealing with the following: background, scope, audit objectives, audit findings, and recommendations. At the Closing Conference, the Director will request a formal response to all reportable findings from management. Management will be requested to respond in a timely manner.

After reviewing management's responses to the Draft Final Audit Report, the Director shall make any changes he deems necessary. After processing any necessary changes, a Final Audit Report will be distributed to the Audit Committee of the Board of Trustees the President, and other members of senior management and/or department management that may be appropriate.

Because of the many and varied activities at the University, and the various reporting relationships, the addressees and distribution list of each Final Audit Report will be determined on a case-by-case basis. All Draft Final Audit Reports and Final Audit Reports shall be deemed "confidential," and the Director shall take appropriate measures to ensure their limited distribution to those individuals with a legitimate business need for possessing the information contained therein.

## **Purpose of Sampling**

Sampling will be used by the Director. Samples are portions of a population that are used to represent the population. Samples are very useful in obtaining information about a population.

There are many types of samples; however, samples can be grouped into two main categories, judgmental samples and statistical samples

## **A. Judgmental Sampling**

Judgmental sampling may be used to select examples of deficiencies to support a hypothesis that a given system of internal controls is weak.

Judgmental sampling will in some cases be used to provide the Director with clues as to whether to proceed with a statistical sample. If the Director encounters a well-designed and well-executed internal control system, good management, well-trained employees, and a feedback mechanism that highlights errors, it may be unnecessary to spend a great deal of time performing extensive transaction tests. A small sample selected at random to obtain some reasonable representation of the population may suffice. If no errors are found, the Director may reasonably determine that he sees no basis for examining the population further or for suspecting any material error.

## **B. Statistical Sampling**

The main advantages of statistical (probability) sampling over judgmental sampling are based on the fact that there is a significant body of accepted theory to support and explain statistical sampling.

One of the attractive aspects of probability sampling is that it is possible to measure the reliability of the estimates computed from the sample results. The ability to measure reliability furnishes additional desirable features for statistical sampling. There are several types of statistical sampling.

### **Random Number Sampling**

Random number sampling is generally considered the most likely to result in a random sample. It makes use of a computerized random number generator to select items to be sampled.

### **Interval Sampling**

Interval sampling simply means selecting items at intervals. When using interval sampling, every item must have an equal chance of being selected. Interval sampling is particularly useful when the records are in manual form, the items are unnumbered, or the population contains some items that are not applicable to the audit purpose.

### **Stratified Sampling**

In stratified sampling the Director will separate the population into two or more strata; i.e., separate populations, and then takes samples from each. Typically significant or expensive items will be set aside in one strata for complete examination, and sampling will generally be used for the remaining strata.

In every population, the Director will look for wide variations in size, amount, and characteristics of the items making up the population. When such wide variations are found, the Director will consider stratification. Stratified sampling arranges the population so as to provide greater sampling efficiency. Properly used, stratified sampling will result in a smaller variance within a given sample size than simple random sampling.

## **Cluster Sampling**

When documents and records are so scattered or dispersed that it is too time consuming and costly to use simple random number sampling, the Director may use the technique of cluster sampling. Cluster sampling is what the name implies; clusters of items are selected at random, then the clusters are either examined in their entirety or are themselves sampled.

Clusters may be based on natural separations; e.g., all documents in a file cabinet drawer may be examined. Clusters may also be artificial.

## **Dollar Unit Sampling**

The dollar unit sampling technique selects records according to monetary units rather than physical attributes. The advantages of dollar unit sampling are smaller sample sizes, an almost infinite degree of stratification and the greatly increased likelihood of finding large but infrequent errors.

## **The Sample Size**

Sample sizes can be determined judgmentally or statistically. The decision will be made based on the audit objectives. In many audit situations a large audit sample or a statistically determined sample size is unnecessary. Where the Director has determined the system of internal control to be strong, it may be appropriate to sample only a few handpicked items to determine that the system is actually functioning properly.

Assuming the system functions as planned, it can then be declared that the system does indeed have the purported control points, and they are in fact working. If a particular system is found satisfactory from an internal control standpoint further sampling may not be necessary or appropriate.

# **Investigating Suspected Fraudulent Activities or Financial Irregularities**

There are three phases in the fraud program: prevention, detection, and investigation. The Director and the University's operating management are responsible for recognizing the exposures, control weaknesses, and situations which foster fraudulent activity.

The Director may learn of known or suspected fraudulent activities from many sources, including routine audits. Also, the Director may be called upon by the Audit Committee of the Board of Trustees, the President, or other members of senior management to conduct investigations of known or suspected fraudulent activities.

Because of the sensitivity and the potential litigation exposure for the University, all investigations of known or suspected fraudulent activities shall be conducted carefully and thoroughly.

The purpose of these audit procedures is to establish a standardized methodology for the Director to follow when investigating, processing, and reporting findings of known or suspected misappropriation and similar irregularities. These procedures may be used in the investigation of fraudulent activities or financial irregularities at the University.



## A. Objectives

The objectives of investigations conducted by the Director are to determine whether the suspected irregularity occurred, to determine and document the source and amount of funds involved, to identify the individuals responsible for the loss, and to provide recommendations for corrective actions to improve prevention and detection procedures.

As delineated in Section 4 of the Internal Audit Charter, the Director, and anyone engaged or acting on his behalf, is duly authorized without limitation by the Audit Committee of the Board of Trustees to:

- Have free, full, unrestricted, and unfettered access to all University functions, records, property, activities, manual and automated systems, and personnel.
- Have free, full, unrestricted, and unfettered access to all third-party institutions, organizations, and individuals who have business dealings with the University.
- Have free, full, unrestricted, and unfettered access to the Audit Committee of the Board of Trustees and the President.
- Allocate resources, set frequencies, select subjects, determine scopes of work, and apply appropriate techniques required to accomplish the internal audit function's objectives.
- Obtain the necessary assistance of personnel in functions, departments, and/or units of the University where audits are performed, as well as other specialized services from within or outside the University.

## B. Responsibilities

The Director may consult and coordinate any investigation activities with the Audit Committee of the Board of Trustees, the President, and other members of senior management, as appropriate.

## C. Definitions

The subject of these procedures is known or suspected losses resulting from misappropriation or misuse of University assets entrusted to employees as part of their job responsibilities. The terms used throughout these procedures are:

- **Assets:** Money, negotiable securities, data and physical property of the University, whether owned or leased.
- **Conflict of Interest:** When University resources, including staff time, funds, University reputation, or other assets are diverted from, or made less effective in their intended purposes by virtue of an individual's activities, association, or interests outside his or her primary University affiliation.
- **Defalcation:** To appropriate University assets fraudulently to one's own uses; defalcation is synonymous with misappropriation.
- **Error:** Unintentional mistakes in financial or accounting data. An error may include:
  1. Mathematical or clerical mistakes in the underlying records and accounting data;
  2. Oversight or misinterpretation of facts; or
  3. Misapplication of accounting policy.
- **Fraud:** The intentional misrepresentation of facts undertaken to mislead management, auditors, or other users of financial statements; i.e., the misappropriation or misuse of University assets, and other similar irregularities. Fraud may involve:

1. Manipulation, falsification, or alteration of records, or documents;
  2. Misappropriation of University assets;
  3. Suppression or omission of transactions or the effects of transactions from University records or documents;
  4. Recording transactions without substance;
  5. Manipulation of accounting policies; or
  6. Any other act or series of acts intended to defraud the University.
- **Irregularity:** Intentional mistakes or distortions of financial statements, such as misrepresentation or misappropriation of assets.
  - **Misappropriation:** Any dishonest or fraudulent act which includes such things as:
    1. Unauthorized use, taking, or destruction of University property for personal gain, or to purposely deprive the University of its use;
    2. Forgery or alteration of checks, drafts, promissory notes, and securities;
    3. Any taking or unauthorized use of University funds, securities, supplies, or any other asset;
    4. Forgery or alteration of policy-related items, such as loans, assignments, changes in beneficiaries, etc.;
    5. Any irregularity in the handling or reporting of cash transactions;
    6. Fraudulent or conflict of interest decisions which result in financial loss to the University; or
    7. Any similar or related irregularity.

## D. Preliminary Investigations

The Director shall initiate a preliminary investigation of any reported or suspected misconduct to verify that there is substance in fact to the suspected irregularity and whether the University has sustained any actual losses. In conducting this preliminary investigation, the Director shall gather sufficient information to identify the University function, activity, department, or unit involved; the individual(s) involved; and the estimated magnitude of any loss.

During the course of the preliminary investigation the Director of Internal Audit may, where appropriate:

- Identify each account or set of related accounts that were, or could be used in or affected by the defalcation, and determine the purpose of each account and how it can be used;
- Identify the types of transactions/documents used to make entries, adjustments, and/or inquiries against each account and who may initiate and authorize such transactions/documents;
- Determine the source of funds involved in the fraudulent activity;
- Determine whether the University function, activity, department, or unit involved has experienced unusual or unexplained losses in the recent past;
- Determine the types of questionable activities that have occurred, may be occurring, or could occur, how the possible irregularities were committed, all likely means of conducting the alleged activities, and the personnel potentially involved;
- Determine the types of questionable activities that have occurred, may be occurring, or could occur, how the possible irregularities were committed, all likely means of conducting the alleged activities, and the personnel potentially involved;
- Determine the degree of reliance which should be placed on existing internal controls, and the extent of testing required;
- Conduct a preliminary meeting with the Audit Committee of the Board of Trustees, the President, and other members of senior management, as appropriate.

If the preliminary findings indicate that the available evidence has no substance in fact, the investigation shall be terminated, and the appropriate members of University management will be notified.

If the preliminary findings show the evidence to be of sufficient strength to justify continued investigation or immediate action, a complete audit or investigation shall be conducted by the Director.

## **E. Investigation**

The investigation may be continued to further substantiate the size and type of loss and/or to identify the responsible individuals.

During this phase, the Director must select the specific auditing procedures that in his judgment are necessary to successfully complete the investigation. To facilitate a successful result, the Director may, among other things:

- Chart the flow of transactions and documents identified during the preliminary investigation and identify key basic control points throughout the flow;
- Collect all the necessary documents, records, files, and correspondence that will be examined; Copy and catalogue all documents to develop audit workpapers on which to make notations and cross-references;
- Examine and evaluate the documentation collected, looking specifically for errors, irregularities, alterations, missing documents, and how the documents were processed;
- Review the budgetary control system in place for developing the budget and assurance of budget compliance; or
- Evaluate the effectiveness of existing internal controls.

The final responsibility for matters involving a misappropriation of University assets rests with University management. Upon completion of the investigation and/or audit, a written report may be submitted to the Audit Committee of the Board of Trustees and the President. Copies of all such investigation and/or audit reports may also be sent to other members of senior management if appropriate; these reports shall be deemed “confidential,” and the Director shall take appropriate measures to ensure their limited distribution to those individuals with a legitimate business need for possessing the information contained therein.