
SECTION B-5.4

RISK METHODOLOGY

Each year, the Internal Auditing Department prepares a risk analysis, as required by The Standards for the Professional Practice of Internal Auditing which states that its plan of engagements should be based on a risk assessment, undertaken at least annually, and that the input of senior management and the board should be considered in this process. Risk is defined as the probability that an event or action may adversely affect the organization or activity under audit.

The purpose of our risk analysis is to develop an audit plan for performing audit projects in risk areas over a specified time to minimize the risk of losses to the University; to prioritize audit projects by the level of risk; to use our audit staff and time in an effective and efficient manner; and to determine the nature, timing, and extent of audit steps and procedures in direct relation to the amount and nature of the risk.

The risk methodology we use consists of three phases: (1) identification of auditable areas; (2) input from management; and (3) a risk analysis. We also considered an auditable area's impact on the accomplishment of the University's goals and objectives during our risk analysis. Matters that we consider in establishing audit work schedule priorities include: (a) the date and results of the last audit; (b) financial exposure; (c) potential loss and risk; (d) requests by management; (e) major changes in operations, programs, systems, and controls and (f) opportunities to achieve operating benefits.

The auditable areas audit cycle is as follows: Dean's Reviews (see 7-3-6) – every 5 years; UH Research Centers (see 7-3-5) – every 4 years; SACS Accreditation Reviews (see 7-3-1) – every 10 years; and NCAA Rules-Compliance (see 7-3-2) and Financial Aid (see 7-3-3 & 4) receive an annual audit for a portion of the coverage areas.

In addition to the auditable areas cycle, each department is scheduled for a departmental compliance review at least once every 5 years (see 7-4). These reviews test compliance with the universities' policies and procedures for the following eleven areas: 1) departmental policies and procedures / baseline standards, 2) reconciliation of account balances, 3) payroll / human resources, 4) cash handling, 5) petty cash, 6) long distance / cell phone charges, 7) contract administration, 8) property management, 9) conflict of interest / related-party disclosure, 10) accounts receivable, and 11) negative fund balances.

RISK ANALYSIS:

In the attached Risk Analysis, we assigned levels of risk by use of a number rating system. The first step was to define the risk factors. We decided on the following risk factors: (1) reason for the audit, (2) administrative oversight, and (3) date last audited. These risk factors were assessed as follows:

- (1) Reason for the Audit: Each auditable area was assigned a value of 5 for one of the following reasons: auditor preference (the complexity of information systems, the impact of compliance issues, knowledge of management practices, results of last audit, and public relations exposure) or management request.
- (2) Administrative Oversight: We decided on the following factors to assess oversight risk: (1) budgeted sources of funds, (2) budgeted uses of funds, (3) total expenditures, (4) total income, and (5) total asset values. Values were assigned from 0 to 10 (0 - < \$10,000,000; 1 to 9 – increments of \$10,000,000; 10 - > \$100,000,000).
- (3) Date Last Audited: Values assigned for date last audited were from 0 to 10. A value of 10 was assigned for an auditable area that has not been audited or was audited 10 or more years ago. Values below 10 were assigned based on how many years since the last audit.

All risk factors for each auditable area were combined resulting in a total risk factor. All auditable areas with a total risk factor of greater than 20 were included in the three-year audit schedule in the Long-Range Internal Audit Plan.