

F7



Report of Audit Activities 2004



*Finance and Audit Committee
Board of Regents*

Department of Audits
University of Washington

March 2005



Executive Summary

Internal Audit engages in three primary activities – audits, advisory services, and investigations. Our focus is to proactively work with campus schools and colleges assisting management to understand financial risk and exposures. Rather than duplicate the financial and compliance auditing performed by KPMG and the State Auditor’s Office, Internal Audit concentrates on departmental control systems and processes. We continue to expand our advisory services, enabling management units to develop the tools and implement the systems to find and correct their own errors. In this way, audit resources are maximized.

In 2004 we visited 51 University units: 36 as part of our planned scheduled audits, 7 at the request of management and 8 as part of special investigations.

Overall, our audits found that departments generally had good control systems in place. Exceptions resulted primarily from management oversight rather than from problems systemic at the University level.

The number of information technology audits completed in 2004 increased significantly over 2003. We focused these audits on departmental systems developed and operated to meet specific departmental needs. Most of the systems we examined had not been audited before. Our audits revealed that departments need to improve and strengthen controls related to system access and security, and disaster recovery.

Internal Audit recommendations increased last year although the implementation rate declined to 71%, 7 points below the industry average of 78%. This is not due to an unwillingness to accept findings, but because the complexities of implementing solutions is taking more time. Internal Audit performs follow-up reviews of each audit and audit recommendation approximately 6 months after each audit report is issued. Audit recommendations that have not been implemented continue to be tracked until they are either implemented or alternative solutions are found.

The University of Washington Internal Audit Plan for 2005 is designed to provide comprehensive audit coverage, deploying Internal Audit resources in an effective and efficient manner. As in years past, we will continue to focus on federal regulatory issues and departmental management controls.



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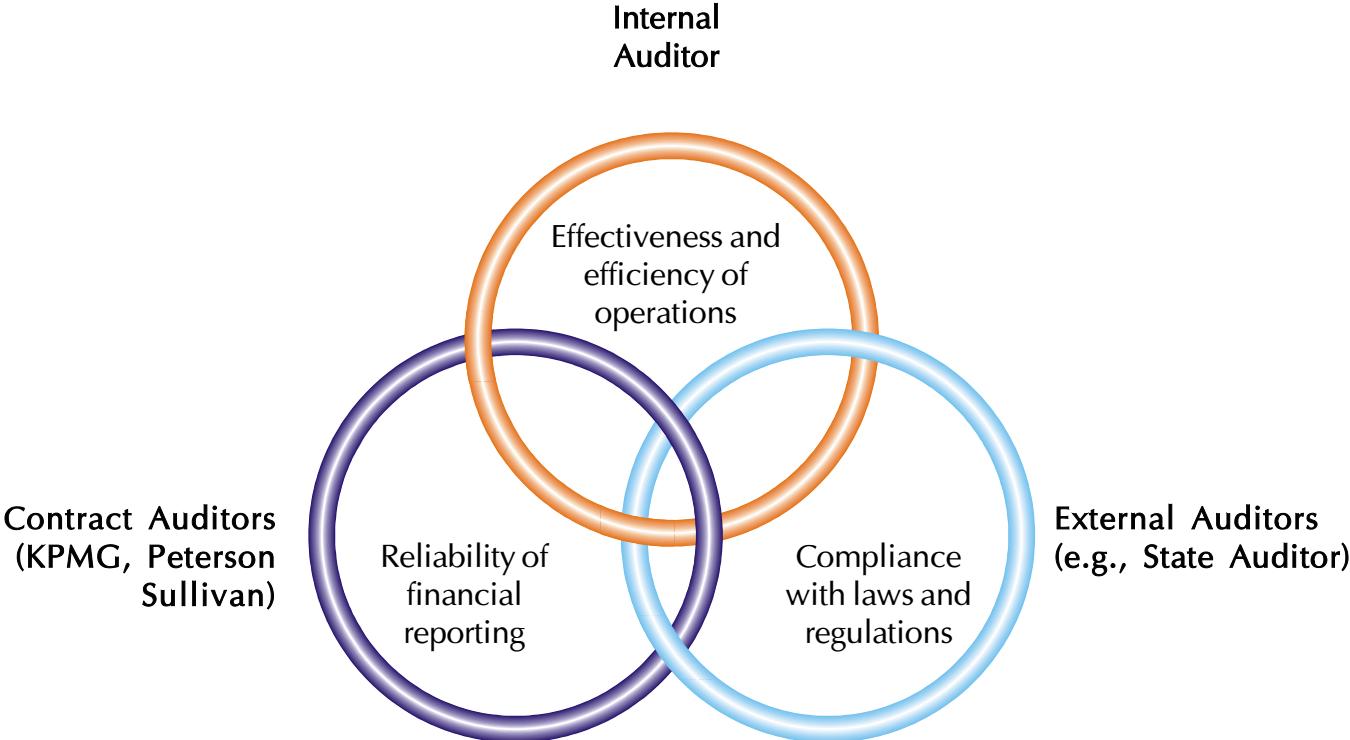
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Results of 2004 Work

Audit Coverage Overview

As part of the coordinated audit approach adopted in 1990, the Department of Audits works closely with contract auditors and external auditors to maximize audit coverage and to avoid duplication of effort. Each audit organization has a specific role:





Results of 2004 Work

Work Accomplished in 2004

Scheduled Department Audits*

Completed

Bioengineering
Office of the Board of Regents
Chemistry
International Faculty, Students and Staff
Office of the President
Payroll
Student Fiscal Services
Audit Follow-ups (26)

In Progress

Capital Projects
College of Forest Resources
Intercollegiate Athletics
Department of Surgery

Management Requests

Center on Human Development and Disability
(cash handling)
Chemistry (use of biochemicals)
General Internal Medicine (CCER grants)
Office of Minority Affairs (GEAR UP program)
Purchasing (policy review)
Regional Primate Center (rate review)
Department of Surgery (hourly payroll)

Special Investigations

Fraud (3)
Ethics/Conflict of Interest (2)
Financial Processes (3)
UWMC/Harborview (6)

Training Provided

University Training & Development

- Faculty Grants Management (4)
- Internal Controls and Fraud Prevention (2)
- Work & Leave Records Maintenance (7)

Departments

- Assess and Reduce Departmental Audit Risk (2)
- Grants Management
- Internal Controls
- State Ethics Law (15)
- Travel

Advisory Services

- Campus Security Advisory Committee
- Effort Reporting Team
- Environmental Health & Safety Committee
- Privacy Assurance & Systems Security Council
- Tax Strategy Team
- User Transitioner's Team

External Relations

External Committees

- Washington State Society of CPAs Governmental Accounting & Audit Committee

Memberships

State Committees

- Interinstitutional Internal Auditors

Professional Organizations

- Association of College & University Auditors
- Association of Governmental Accountants
- Certified Fraud Examiners
- Information Systems Audit and Control Association
- Institute of Internal Auditors
- Washington State Society of CPAs

* See pages 3 & 4 for results of the 2004 scheduled audits



Results of 2004 Work

Results of 2004 Scheduled Audits

In 2004, the Department of Audits continued to emphasize the University's commitment to ensure that departments have solid control systems in place.

Overall, we found that internal controls are sufficient to ensure compliance with applicable regulations and policies, and to ensure that business objectives are achieved. We found no flagrant deficiencies in the course of these scheduled audits. Audit exceptions resulted primarily from lapses in management oversight and not from systemic problems at the University level.

Bioengineering

The department reports to the School of Medicine and the College of Engineering. It is currently housed in ten buildings on campus. A new Bioengineering building is under construction with completion scheduled for late 2005.

Bioengineering research programs receive more National Institutes of Health funding than any other bioengineering department in the country. Annual research funding in FY 2004 totaled more than \$19 million.

The department is to be commended for its orderly and efficient operations.

We recommended the department strengthen controls in the areas of grants management, payroll, purchasing, and information technology.

Office of the Board of Regents

We reviewed the office's system of internal controls relating to purchasing, work and leave records, and compliance with the Open Public Meetings Act. We recommended the office strengthen purchasing controls to ensure that transactions are properly authorized.

Chemistry

We reviewed the department's system of internal controls over payroll, purchasing, cost centers, and gifts and grants management. We recommended the department strengthen controls over travel, cost sharing, salary certification reporting, IT management, and rate setting.

International Faculty, Students and Staff

We reviewed controls that ensure the University remains in compliance with federal regulations regarding enrollment and/or employment of non-US citizens.

At the time of our audit, the University employed more than 5,400 non-US citizens, and approximately 2,500 foreign students were enrolled. Federal law places restrictions on foreign visitors such as how long they can work and stay in the country, how many classes they must take and required documentation.

Overall, we found that University systems ensure compliance with the federal record maintenance and information reporting requirements. We recommended strengthening monitoring procedures to ensure that documentation has been filed to support the continued lawful employment of all non-US citizens employed by the University.



Results of 2004 Work

Results of 2004 Scheduled Audits (cont'd)

Payroll Systems User Access

We reviewed the University's automated payroll, time reporting and leave systems. We recommended strengthening controls over user access.

Office of the President— Residence Inventory

We reviewed the inventory of items housed in the President's residence. We recommended that the office update the inventory records, and also the appraisals for antiques and silver to ensure sufficient insurance coverage.

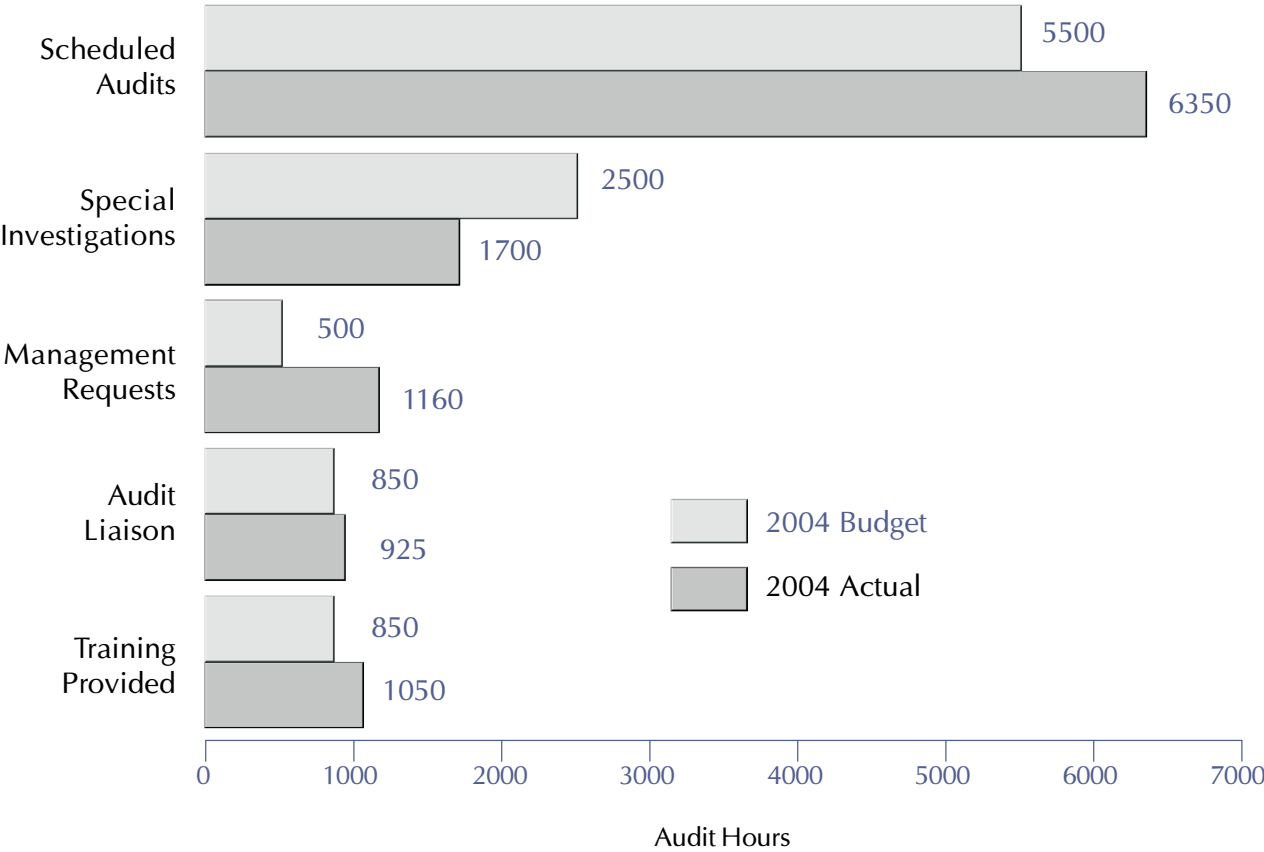
Student Fiscal Services Cash Handling & Scholarship Database

We reviewed Student Fiscal Services (SFS) system of internal controls over cash handling. SFS processed more than \$63 million from September 2003 through February 2004. We found that the department has sufficient controls in place to ensure that cash receipts are recorded and deposited on a timely basis. We recommended the department strengthen procedures to restrict access and improve security over cash.

We also reviewed controls over the scholarship database. We recommended the department strengthen controls over user access, and the completeness and accuracy of transactions.



Audit Hours by Type of Audit—2004 Budget and 2004 Actual



Total actual hours exceeded total budgeted hours by 985 hours. This was a result of reductions in non-audit hours.

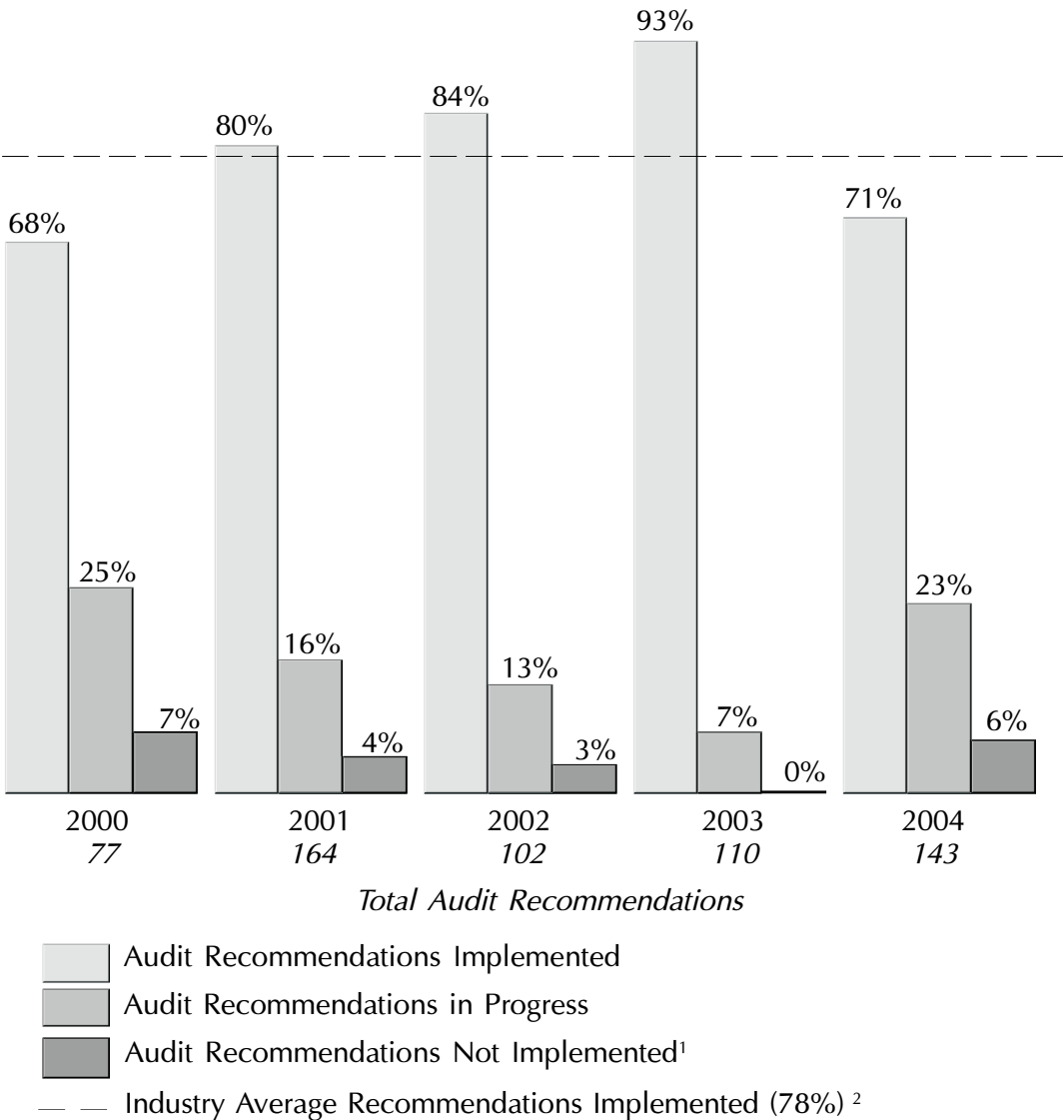


Results of 2004 Work

Implementation of Audit Recommendations 2000–2004

Internal Audit conducts follow-up reviews to determine whether audit recommendations agreed to by management have been implemented. Follow-up reviews generally occur six months after an audit is completed. The following graph compares the percentage of recommendations implemented for the years 2000–2004.

Implementation numbers based on six month follow-up



¹ Management planned to implement the audit recommendations but had not done so at the time of our follow-up review, or management decided to accept the risk of not fully implementing the recommendations.

² Source: *The 1999 Analytical Benchmarking for Auditors in the College and University Sector (ABACUS)*.



2005 Audit Plan

2005 Audit Focus

Federal Regulatory Issues

Faculty Effort Certification Process

Faculty effort on research projects is the subject of increasing scrutiny by federal and state auditors. Faculty effort certification (FEC) reports document effort paid from both federal and non-federal sponsored projects. The FECs also document cost sharing on sponsored projects. As part of our 2005 grants management audits, we will determine whether effort is accurately reported and certified on the FECs. We will also review budgeted and actual salaries charged to grants to determine whether controls are in place to support compliance with award requirements.

Privacy of Medical Records Used in Research

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) mandates privacy standards to protect patients' medical records. We will review departmental policies and procedures for protecting the privacy of medical records of persons participating in National Institutes of Health-funded clinical trials and other research.

Grants Management

We anticipate continued federal interest in research and program accountability. The University can be proud of its award winning grants management program. Internal Audit will continue to identify high risk departments and work with departmental management to ensure full compliance with applicable regulations.

Capital Projects

The need to ensure that ongoing and new capital projects do not expose the University to major financial losses is a continuing internal audit focus. In 2005 we will focus on control systems that ensure construction project costs are accurately tracked, and that projects are completed on time and within budget.

Internal Control Systems

The University continues to move its central systems away from pre-approval controls and toward post audit controls. Internal Audit provides advisory services and training to ensure that departments continue to have a sound basis for establishing and monitoring internal control systems. It is more important than ever that departmental management understand the risks and responsibilities associated with operating in a decentralized post-audit control environment. As more functions are delegated to departments, oversight is required to ensure that controls are in place and serve the intended purpose.

Budget cuts and restraints on departmental and general operating funds force departments to make difficult decisions on resource allocations. As budgets shrink, pressures may result in the elimination of critical system controls. Without system checks and balances, departments have a higher exposure to financial irregularities and noncompliance with policies and regulations.



2005 Audit Plan

2005 Audit Focus *(continued)*

Gifts and Endowments Expenditure Control Systems

During FY 2004 the University received more than \$120 million in gifts and endowments. The University relies on individual departments to ensure that these funds are spent in accordance with donor intentions. In 2005 we plan to review departmental controls designed to ensure gift and endowment funds are expended according to donor intent.

Computing and Networking

Web-Based Transaction Processing

The growth of web-based transaction processing continues. Internal Audit will focus on security measures and controls that are required to ensure data is protected from loss or damage.

Department Computing and Networking

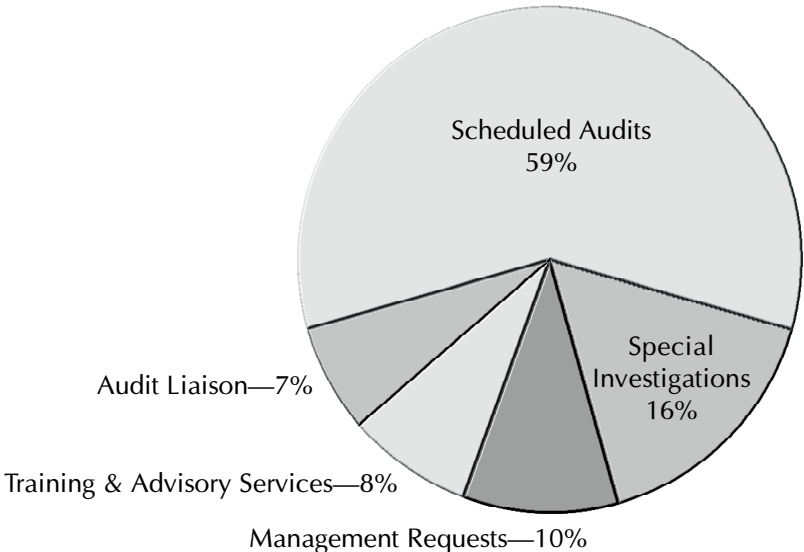
University departments often develop and operate their own computer systems because of special needs. Our focus is on identifying critical systems and networks that are managed at the departmental level so that we can ensure security of the overall University computing environment. Toward this objective, we are working with departmental staff to promote awareness of risks and issues concerning internal security and uninterrupted operations.



2005 Audit Plan

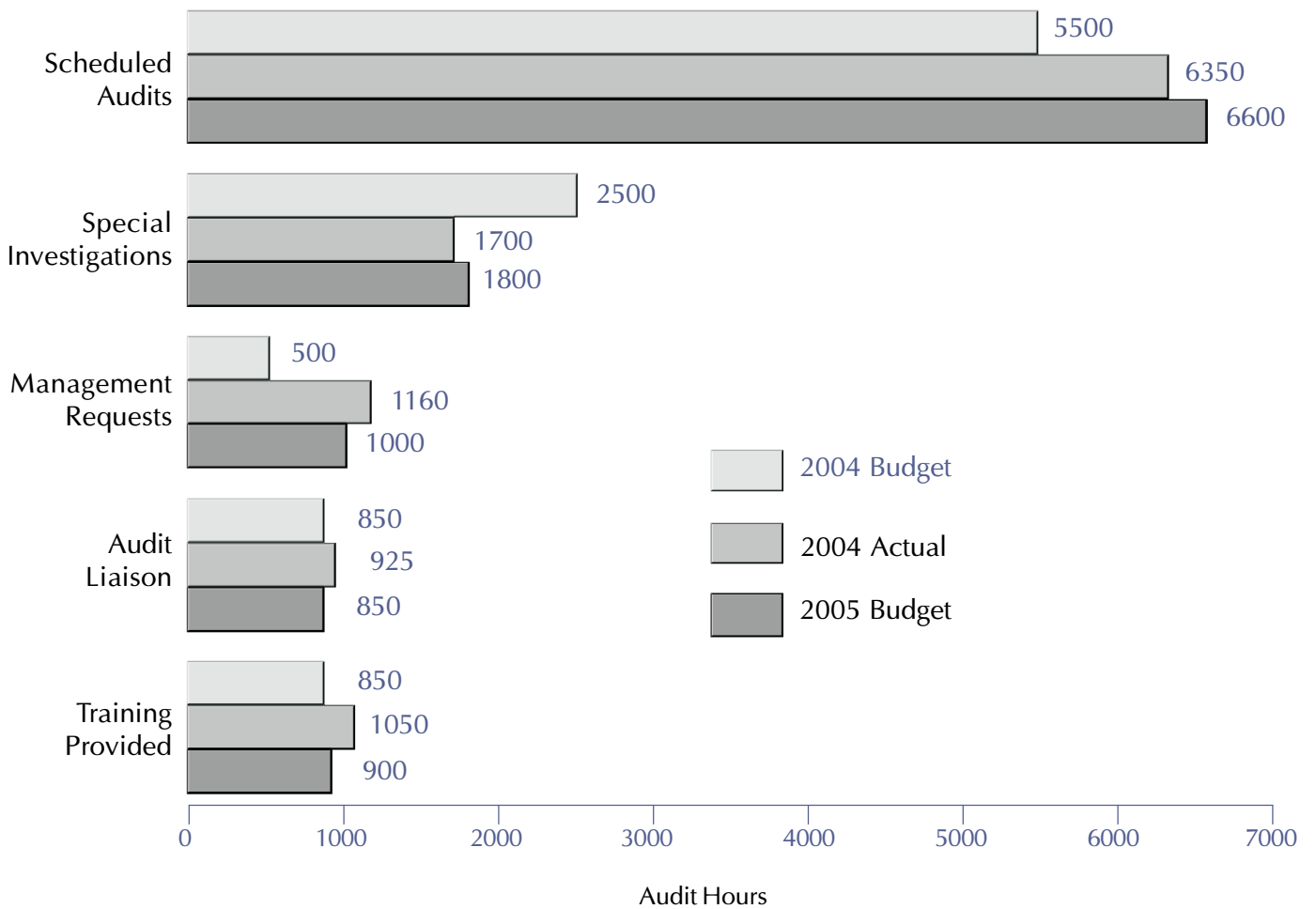
2005 Departments to be Audited

	Internal Controls	Compliance	Business Processes	Information Technology	Follow-Ups
Scheduled Departmental Audits					
Capital Projects Office	•	•	•	•	•
College of Forest Resources	•	•	•	•	•
Health Sciences					
· Regional Primate Center	•	•		•	
Intercollegiate Athletics	•	•	•		•
School of Medicine					
· Dept. of Medicine (Metabolism, Endocrinology and Nutrition)	•	•	•	•	
· Radiology	•	•	•	•	
· Surgery	•	•	•	•	
School of Social Work	•	•			
Various Departments					•
Scheduled University-Wide Audits					
Cash Receipts/Revolving Funds	•		•		
Endowments and Gifts	•	•			
eProcurement				•	
Payroll—Overtime, Hourly	•			•	
Systems Development				•	





2005 Planned Audit Hours





2005 Audit Plan

Summary of Audit Coverage

The University departments listed below are ranked from high to low in terms of the relative risk they represent. A ● in the columns to the right signifies the areas each auditing entity plans to audit in 2005. A ✓ represents the areas audited by other auditors in 2004.

Risk/ Rank	Organization	Internal Audit Dept.	Hospital Internal Auditor	State Auditor's Office	KPMG	Peterson Sullivan	Other Auditors
1.	School of Medicine	●		●			✓
2.	Harborview Medical Center		●	●	●		✓
3.	University Medical Center		●	●	●		✓
4.	Health Sciences	●					✓
5.	Intercollegiate Athletics	●		●	●		
6.	College of Arts & Sciences			●			✓
7.	College of Engineering						✓
8.	Capital Projects	●		●			
9.	Office of Development & Alumni Relations				●		
10.	Payroll			●	●		
11.	University Computing Services						
12.	Purchasing			●	●		✓
13.	School of Public Health & Community Medicine			●			
14.	Treasury Office			●	●		
15.	UW Tech Transfer						
16.	Grant & Contract Accounting			●	●		
17.	Payables Operations			●	●		✓
18.	Financial Accounting			●	●		
19.	Student Fiscal Services				●		
20.	Information Systems						
21.	Student Financial Aid						
22.	Physical Plant				●		
23.	Transportation				●		
24.	School of Dentistry						
25.	Housing & Food Services					●	
26.	Communication Technologies						
27.	Equipment Inventory			●	●		✓
28.	Publications Services						
29.	Office of Sponsored Programs						✓
30.	College of Forest Resources	●					
31.	Graduate School						
32.	University Stores				●		



2005 Audit Plan

Summary of Audit Coverage *(continued)*

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Risk/ Rank	Organization	Internal Audit Dept.	Hospital Internal Auditor	State Auditor's Office	KPMG	Peterson Sullivan	Other Auditors
33.	School of Business Administration						✓
34.	School of Law						
35.	School of Pharmacy						
36.	College of Ocean & Fishery Sciences						
37.	Educational Outreach						
38.	Real Estate/Metropolitan Tract Office					●	
39.	School of Social Work	●					
40.	University Libraries						
41.	School of Nursing						
42.	Human Resources						
43.	Facilities Services				●		
44.	University Police						
45.	College of Education						
46.	Student Activities and Union Facilities					●	
47.	Daniel J. Evans School of Public Affairs						✓
48.	College of Architecture & Urban Planning						✓
49.	Bothell Campus						✓
50.	Admissions & Records						
51.	Tacoma Campus						
52.	Information School						
53.	Risk Management			●	●		✓
54.	Undergraduate Education						
55.	Student Affairs						
56.	Media Relations and Communications						
57.	Planning & Budgeting			●			
58.	ASUW/GPSS					●	
59.	Office of Research						
60.	Student Publications					●	
61.	Minority Affairs						
62.	Provost						

Internal Audit Charter

Mission

The mission of Internal Audit is to actively provide the Board of Regents and the University of Washington community with useful information that improves accountability through independent assurance, consulting and education services. This is accomplished through independent audits and consultations designed to evaluate and promote a strong system of internal controls, including effective and efficient operations.

Authority

The Department of Audits functions under the authority of the Finance and Audit Committee of the Board of Regents of the University of Washington.

The Department of Audits is authorized to have full, free, and unrestricted access to information including records, computer files, property, and personnel of the University. Internal Audit is free to review and evaluate all policies, procedures and practices of any University activity, program, or function.

In performing the audit function, the Department of Audits has no direct responsibility for, nor authority over, any of the activities reviewed. Therefore, the internal audit review and appraisal process does not in any way relieve other persons in the organization of the responsibilities assigned to them.

Scope

The scope of internal audit activity encompasses the examination and evaluation of the adequacy and effectiveness of the University's system of internal control and the quality of performance in carrying out assigned responsibilities including appropriate training and consulting assistance. Internal auditors are concerned with any phase of University activity in which they may be of service to management. This involves going beyond the accounting records to obtain a full understanding of operations under review.

Independence

To permit the rendering of impartial and unbiased judgment essential to the proper conduct of audits, internal auditors will be independent of the activities they au-

dit. This independence is achieved through organizational status and objectivity.

- *Organizational Status:* The Director of Audits is responsible to the Treasurer, Board of Regents, whose scope of responsibility and authority assures that audit findings and recommendations will be afforded adequate consideration and the effectiveness of action will be reviewed at an appropriate level. The Director of Audits has direct access to both the President and the Board of Regents, and may take matters to them that are believed to be of sufficient magnitude and importance to require their immediate attention.
- *Objectivity:* Because objectivity is essential to the audit function, an internal auditor does not develop and install procedures, prepare records, or engage in any other activity which the auditor would normally review and appraise and which could reasonably be construed to compromise the auditor's independence. The auditor's objectivity is not adversely affected, however, by determining and recommending standards of control to be adopted in the development of systems and procedures under review.

Responsibility

The internal audit staff has a responsibility to report to University management on the areas examined and to evaluate management's plans or actions to correct reported findings. In addition, the Director of Audits has a responsibility to report at least annually to the Board of Regents Finance and Audit Committee and to inform the Board of any significant findings that have not been reasonably addressed by University management. The Director of Audits will coordinate internal and independent outside audit activities to ensure adequate coverage and minimize duplicate efforts.

Standards

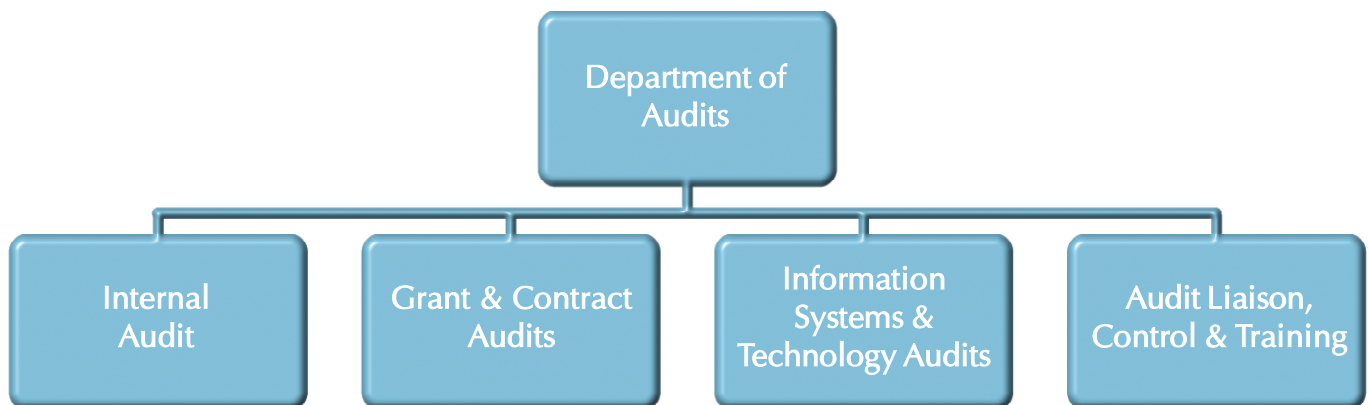
The responsibility of the Department of Audits is to serve the University in a manner that is consistent with the standards established by the internal audit community. At a minimum it shall comply with the relevant professional auditing standards and code of conduct of the Institute of Internal Auditors (IIA) and the Association of College and University Auditors (ACUA).

Audit Services by Function

“The objective of internal auditing is to assist agency staff in the effective discharge of their responsibilities.”

Source: *State Administrative & Accounting Manual, O.F.M., Section 20.40.20, May 1, 1999*

We have changed our focus from a traditional transaction-based auditing model to a proactive risk-based model. We partner with campus management to analyze business processes and identify risk and improvement opportunities. To effectively carry out our responsibilities, the Department of Audits is organized into four functions:



Internal Audit

- Internal Control Systems
- Departmental Support
- Compliance
- Special Investigations

Grant & Contract Audit

- Grant Management Systems
- Special Investigations

Information Systems & Technology Audits

- Internal Control Systems
- Central System Computing Support
- Departmental Computing Support

Audit Liaison, Control and Training

- Management Communications
- External Auditor Liaison
- Audit Resolution
- Audit Contracting
- Training and Development

Risk Assessment

We use a risk assessment model to prioritize audit coverage and ensure timely reviews of high exposure areas. We define risk to include:

- Loss, unauthorized use and misappropriation of University assets
- Violation of laws and regulations
- Adverse publicity involving the University

The risk assessment process includes gathering and evaluating information from senior management and college and department administrators. We use the following risk factors to help identify high risk areas.

- Asset Liquidity
- Nature of Operations
 - Decentralized Operations
 - Sensitive Data
- Internal Control Systems
- External Audit Coverage
- Extent of Outside Regulation
- Financial Impact
 - Grants & Contracts
 - Gifts
 - Total Expenditures
- University Focus
 - Management's Interest
 - Auditor's Interest

We review risk assessment models used by peer institutions and utilize KPMG's experience and knowledge of University operations to ensure our risk assessment model includes factors relevant to the University of Washington.

We develop our annual audit plan based on the results of the risk assessment survey, management input, planned external audit coverage and issues currently affecting universities nationwide.

Elements of the Audit Planning Process

- Interviews of senior University management for key concerns
- University-wide assessment of risk
- Consideration of the changing environment and identification of issues that could affect the University
- Evaluation of issues of concern to other universities

Universities contacted:

University of Arizona
University of California - Berkeley
University of California - San Diego
University of California System
Colorado State University System
Cornell University
University of Florida
University of Georgia
Georgia Institute of Technology
University of Georgia System
University of Illinois - Urbana-Champaign
John Hopkins University
Massachusetts Institute of Technology
University of Michigan
University of Minnesota
University of New Mexico
University of North Carolina - Chapel Hill
Oregon University System
University of Pennsylvania
Stanford University
Texas A&M University Systems
University of Texas System
University of Utah
University of Wisconsin-Madison

- Integrated planning with external auditors
- Assessment of cyclical audit coverage for the high-risk organizational units identified in our risk assessment

Contract Auditors on Campus During 2004

KPMG

Financial statement audits for:

- University of Washington
- Intercollegiate Athletics
- Parking Services
- UW Medical Center
- UW Medical Center Consolidated Laundry
- UW Medical Center Service League
- Harborview Medical Center
- Harborview Sexual Assault Center
- Harborview Eastside Sexual Assault Center for Children

Peterson Sullivan

- Metropolitan Tract Financial Statements Audit
- UNICO Properties—Lease Compliance
- Four Seasons Olympic Hotel—Lease Compliance
- Trammell Crow Company—Operating Agreement

Financial statement audits for:

- Associated Students of the UW
- Graduate & Professional Student Senate
- Student Publications
- Student Union Facilities
- Housing & Dining System
- Retail & Remote Food Services

External Auditors on Campus During 2004

Office of the State Auditor

- Compliance with state and federal regulations
- State of Washington's annual financial statements audit in compliance with the Single Audit Act
- Whistleblower and citizen complaints
- Fraud investigations

U.S. Dept. of Health and Human Services

- Review of Select Agent Program

Office of Naval Research

- Property Control System Analysis

M.D. Oppenheim and Company P.C. (contracted by the National Science Foundation)

Audit of costs claimed of PEER grant subcontractors

- Civil Engineering
- Evans School of Public Affairs
- School of Business Administration
- UW Bothell

National Aeronautics and Space Administration

- Assessment of quality system and compliance to internal quality plans and procedures

Eastern Virginia Medical School — Contraceptive Research and Development Program

- Audit of costs claimed Department of Obstetrics and Gynecology

Washington State Department of Labor and Industries

- Compliance with industrial insurance laws and regulations