**Linking Performance Measurement, Management, Audit, and Fraud--Handout for 02/10/2010**

# Appendix A

Glossary of Terms

|  |  |
| --- | --- |
| **TERM/PHRASE** | **DEFINITION** |
| **Audit ability** | Audit job factors that the auditor considers after assessing inherent risk and control risk and before finalizing audit objectives, scope, and methodology. These factors include circumstances, policy, or other concerns that could prevent an audit team from meeting audit time and cost estimates and/or producing a quality product. |
| **Control risk** | The risk that the internal or management control system will not detect or prevent material (i.e. significant or sensitive) errors and irregularities in achieving the results, goals, or objectives of operations. |
| **Inherent risk** | The susceptibility of a government program or system to a significant or sensitive deficiency without taking into consideration internal or management controls. |
| **Internal control** | A process within an organization designed to provide reasonable assurance regarding the achievement of the following primary objectives:   * The reliability and integrity of information * Compliance with policies, plans, procedures, laws, regulations, and contracts * The safeguarding of assets * The economical and efficient use of resources * The accomplishment of established objectives and goals for operations or programs. |
| **Program** | A set of government activities with a common purpose that produces results or outcomes for citizens. |
| **Risk** | The probability that something will adversely affect the achievement of expected results or objectives. |
| **Risk assessment** | The identification of risk, the measurement of risk, and the process of prioritizing risk. |
| **Risk factors** | Measurable or observable manifestations or characteristics of a process that either indicates the presence of risk or tends to increase exposure to risk |
| **Key accountability control systems** | The State Auditor’s model which divides risk into five categories. |

# Appendix B

Selecting Risk Factors

Internal auditors use risk factors to identify the inherent risks associated with auditable activities. Generally, any inherent risk can be used as a risk factor.

From the Red Book:

**Risk Factors May Include**

* + 1. Ethical climate and pressure on management to meet objectives.
    2. Competence, adequacy, and integrity of personnel.
    3. Asset size, liquidity, or transaction volume.
    4. Financial and economic conditions.
    5. Competitive conditions.
    6. Complexity of volatility of activities.
    7. Impact of customers, suppliers, and government regulation.
    8. Degree of computerized information systems.
    9. Geographical dispersion of operations.
    10. Adequacy and effectiveness of the system of internal controls.
    11. Organizational, operational, technological, or economic changes.
    12. Management judgments and accounting estimates.
    13. Acceptance of audit findings and corrective action taken.
    14. Date and results of previous audits.

Source: Institute of Internal Auditors, Standards for the Professional Practice of Internal Auditing

**Tips: In general, select risk factors that:**

* Represent the inherent risk factors of the organization
* Help prioritize auditable activities or issues for fieldwork
* Can be measured for each auditable activity

**Tips: To identify risk factors:**

* Management’s input
* Input from other stakeholders, such as governing board or elected officials
* Advice from investigators, lawyers, and criminal justice officials
  + Performance measures

# **Examples of Risk Factors for Assessing Inherent Risk:**

# **Sensitivity Examples:** (1) Embarrassment or (2) Extensive Media Coverage

**Significance Examples:** (1) Total investment or (2) Potential loss of human life or serious injury

**Susceptibility Examples:** (1) Lots of cash or (2) lack of cause/effect relationships between IPPO (experimental government program or private sector activity)

# **New IIA Practice Guide on “Internal Auditing and Fraud” lists 12 factors to consider when prioritizing fraud risks including monetary impact, potential criminal/civil actions, and loss of productivity.**

**Appendix C**

**EXAMPLES OF SPECIFIC CRITERIA FOR ASSESSING INHERENT RISK AND CONROL RISK (VULNERABILITY)**

**RISK RATING CRITERIA**

|  |  |  |
| --- | --- | --- |
| **HIGH** | **MEDIUM** | **LOW** |
| Potential for relatively rapid large financial loss ($500,000 and over) | Potential for midrange rapid financial loss (between $100,000 and $500,000) | Potential dollar loss less than small (less than $100,000) |
| Potential for smaller financial loss ($5000 or less) repeated frequently | Potential for smaller financial loss ($5000 or less) repeated with moderate frequency |  |
| Serious consequences such as loss of life or limb | Inconvenience as opposed to health impact |  |
| Noncompliance with laws and regulations | Equity issue but not required by law |  |

**VULNERABILITY RATING CRITERIA**

|  |  |  |
| --- | --- | --- |
| **HIGH** | **MEDIUM** | **LOW** |
| Several or significant weaknesses in internal controls exist | Some weaknesses in controls exist | Good management controls are in place |
| Management is not monitoring controls | Management is not acting on control information. | Management is using/acting on controls. |

# Appendix D (Exercise #15)

Child Care Licensing Program Audit

Audit Team Risk Assessment

**Which system is most vulnerable to fraud?**

**Which system is most vulnerable to performance deficiencies?**

Fraud Risk Assessment Risk Factors:

Inherent Risk: Management Controls Control Risk:

Performance Risk Assessment Risk Factors:

Inherent Risk: Management Controls Control Risk:

## Appendix E (for Exercise #15)

CCLP — RCCL — CPAs

CASE STUDY SCENARIO

**BACKGROUND**

The State’s Child Care Licensing Program (CCLP) works to safeguard the basic health, safety, and well being of children by developing and enforcing minimum standards for facilities that care for or place children.

It is the human services’ department’s program for licensing group daycare homes, daycare centers, registered family homes, child placement agencies, and publicly and privately owned residential child-care facilities. The program is also charged with investigating complaints and serious incidents involving daycare and residential-care facilities and, if necessary, taking corrective action.

The number of Child Placement Agencies (CPAs) regulated by the CCLP has tripled in the past 10 years, from 67 in 1999 primarily placing children for adoption to 194 agencies in 2009 primarily providing foster care.

With the emphasis on placing children in smaller, more homelike settings and the practice that the money follows the child, there has been a substantive increase in the number of children requiring specialized care and services within the foster care system.

In FY 04 the number of placements by CCLP and CPAs was 7522 and 1818 respectively. By FY 09 the placements by CCLP had dropped to 5331 and CPAs placed 2584.

RCCLs (Residential Child Care Facilities Regulators), CCLP employees, are responsible for regulating and monitoring CPAs (child care placement agencies.) Child Care Placement Agencies in turn place children in foster homes and ensure that the foster homes are meeting standards.

**MOVING TO ACTIVE ENFORCEMENT**

# **There may not be sufficient management controls in place to support the recent philosophy change from “partner” of the child care facilities to “protector of children”. This shift has focused agency management on systems for regulating, monitoring, assuring quality, managing information, and maintaining policies and procedures.**

**REGULATING CHILD PLACING AGENCIES**

RCCL management reported that lack of follow through to ensure foster homes make improvements based on inspection findings has fostered inconsistency and a lack of regulatory controls. Furthermore, the CCLP does not have procedures for making sure that its standards are enforced in all the regions. The Child Placing Agencies are responsible for reporting on whether foster homes are making improvements based on inspections and for assessing overall compliance with standards.

CPAs are responsible for ensuring that agency foster parents meet and maintain minimum standards, but licensing inspections and investigations conducted within the past two years indicate that agencies are failing to carry out this responsibility. Media stories have begun surfacing on the issues facing RCCL and the State’s ability to manage the foster care system. RCCL staff has reported instances in which:

* CPAs allow foster homes that do not meet standards to continue to operate;
* Foster parents who have been unable to meet standards under the supervision of a CPA, will switch to another CPA with no questions asked;
* Foster children are not receiving recommended services and treatment and some appear to be overmedicated; and
* CPA staff corrects specific instances of non-compliance, but does not address the underlying weaknesses that are causing the non-compliance.

**STRENGHENING THE CPA’s FOSTER HOME MONITORING SYSTEM**

Child placing agencies (CPAs) have not been monitoring the foster homes they certify in a timely and efficient fashion, to ensure compliance with standards. CCLP management admits this is a weak enforcement area and described disagreements at several levels that have prevented the agency from taking action until recently.

To address this lack of coverage and enforcement, CCLP management finally obtained funding to supplement CPA monitoring with contract inspectors hired from private firms. An inspection process was implemented two years ago and the number of inspections completed has steadily increased. However, during this two year period cost per inspection has also continued to climb. Based on the most recent analysis, the cost per inspection increased from an average of $300.00 per inspection in the first quarter of the first year to $500.00 per inspection in the most recent quarter. To reduce unit costs by increasing inspections, inspectors now have the opportunity to earn annual performance bonuses based on reaching or exceeding goals for number of homes quarterly reported as “completing inspection.”

Despite additional investigative resources, special RCCL staff visits to selected foster homes conducted within the past two years indicate that the inspections may not be fully effective in making sure CPAs are performing their duty to ensure that agency foster parents meet and maintain compliance with minimum licensing standards. Finally, allegations have recently been made to reporting that some CPA’s “own and operate foster homes.”

Given this situation, concerns are not only being raised about the cost of inspections but the quality of the inspection work being performed by the contractors. RCCL staff members have once again attributed the problems to lack of sufficient resources while contractors have recommended that IT solutions be implemented to streamline processes and cut “bureaucratic red tape.”

**FIXING THE QUALITY ASSURANCE PROCESS**

The Child Care Licensing staff inputs information about their performance (using 10 performance measures including license issuance, monitoring visits, and investigations) into an automated system that supports the measures. The measures are reviewed by the regional directors. However, there is no process to ensure the information that supports the measures is accurate.

The regulation directors are responsible for making sure that regions comply with the quality assurance program. They have the autonomy to develop their own quality assurance program.

The quality assurance process measures timeframes, not quality processes, and is not standardized.

In the absence of an adequate, accurate software application to support the program, a standardized, consistent quality assurance process with a well-defined feedback loop, becomes more critical.

**FIXING THE INFORMATION SYSTEM**

The centralized automated system which supports child placing, facility licensing, and other services is antiquated. A CCLP project identified a limitation of the current software application for the licensing program that impedes the timely flow of sufficient program information to management for decision making.

Program management is moving aggressively to address this problem and has developed a comprehensive plan that has been approved by the information resources department. Furthermore, this project is being monitored by an interagency information resources over-sight committee.

**FIXING THE PROCEDURES HANDBOOK**

The new procedures handbook was issued months ago.

Some licensing changes from the last legislative session became effective several months ago. However, guidelines for implementing these changes have not been fully documented or communicated to staff.

There are 12 sets of licensing standards for various types of child care facilities. This presents a problem for policy analysts (to continually update the various sets as required by law), and is an enforcement and training issue (too many sets of regulations to master).

A CCLP task force in December 2008 cited the numerous sets as a barrier to enforcement. GAO auditors identified this problem, also, but delayed work due to conflicting congressional priorities. The strong child care lobby has been fighting about revised day care minimum standards. Another CCLP task force has recently been appointed to develop recommendations to reengineer the standards.