

RISK SERVICES UPDATE



Watkins, Meegan, Drury
& Company, L.L.C.

Clear Vision, Powerful Results

CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS & FINANCIAL ADVISORS
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Data Mining and Risk Management

Data mining is the use of technology to sort through large data stores of information and extract data based upon set criteria. Data mining technology has been used by organizations for many years to detect and mitigate business risk and discern patterns of inefficiencies within business processes.

Companies can use data mining to identify and detect abnormal trends and improve corporate profitability. For example, credit card companies use data mining techniques to monitor individual spending patterns to mitigate the risk of fraudulent transactions when purchases fall outside of normal spending routines. Spending pattern data can also be a powerful tool for developing marketing strategies.

Internal and external auditors and consultants use data mining software to gain reasonable assurances over the integrity and completeness of data and transactions. Data mining is often used on attest and consulting engagements for Sarbanes-Oxley and OMB A-123 compliance, financial statement audits, litigation support, and business process re-engineering.

Data mining gives the user the ability to:

- Query 100% of data stores to detect unusual trends not discovered by sampling techniques;
- Sort, stratify, and compare data at the transaction level;
- Report results without the constraints of canned reports in a financial reporting system;
- Validate the effectiveness of data transmissions between IT systems;
- Identify circumvention of internal controls and segregation of duties problems;

- Perform analytical modeling to uncover unusual financial relationships or suspicious transactions.

Data mining has become a valuable tool in the risk management process by identifying errors, inefficiencies, or unusual transactions. The examples that follow provide a more detailed description of the types of tests that can be conducted with this tool.

“Companies can use data mining to identify and detect abnormal trends and improve corporate profitability.”

Data Interface Tests

Data interface tests can be conducted to determine the accuracy of data transmissions between multiple systems. The tests can be used to understand if communication between systems is operating effectively and if there is any breakdown in transmission of information from source to destination. The tests can also be used to reveal errors such as data links not working correctly or consistently. For example, we often find that queries are written and executed to extract critical information from a data store. Any updates that are made to the data stores may have a potential impact on the data link (query) that is used to extract information.

Data Stratification Tests

Data stratification tests can be used to identify clusters of transactions just below authority thresholds to uncover a purchasing manager's scheme to split invoices or an accounts payable manager's attempt to hide unauthorized disbursements.

(CONTINUED ON PG. 4)

RISK SERVICES UPDATE

The Watkins, Meegan, Drury & Company, L.L.C. Risk Services Update welcomes feedback and suggestions for articles to assist business leaders and other professionals in meeting their organization's objectives. If you wish to submit an idea, request use of any information in this issue, or be added to or removed from our mailing list, please contact Lindsay Howarth at (703) 847-4415. Or e-mail her at Lindsay.Howarth@WatkinsMeegan.com.

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CLEAR VISION,
POWERFUL RESULTS

WATKINS, MEEGAN, DRURY & COMPANY, L.L.C.
Certified Public Accountants
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Outsourcing and Co-sourcing: An External Approach to Internal Audit

Internal Audit departments are faced with a growing volume of compliance responsibilities. One way to ease the burden placed on an in-house internal audit department is to co-source certain functions to outside consultants. Co-sourcing is used when an internal audit department is in place at the organization but additional resources are needed to complete the work plan or specialists/subject matter experts are required to analyze specific areas. Although third party consultants have higher hourly rates than employees, the benefits of short-term assistance often outweigh the costs when organizations take into account the costs of a full-time employee, including salaries, benefits, down time, and overhead costs (equipment, training, office space, etc.). A second option some organizations may want to consider is full outsourcing of the internal audit function where duties are performed by a third party firm who reports directly to the Audit Committee of the organization.

In-House Internal Audit Departments

Many public and larger private companies maintain internal audit departments in-house for a variety of reasons. The auditors maintain relationships with management year-round. This increases their ability to communicate during audit testing and facilitates discussions when issues arise. Furthermore, these employees are still at the corporation when the project ends to follow up and facilitate the resolution of audit issues with long-term corrective action plans. In-house internal audit departments are available to complete other services for the organization without a lengthy scheduling process or the requirement of an additional request for proposal or an engagement letter. Companies value their in-house internal audit department employees because of their knowledge base of institutional processes and procedures, which often grooms them for other managerial roles within the organization. For these reasons, maintaining an in-house department may be the best option for some organizations. However, co-sourcing or outsourcing internal audit may be a more attractive option for some companies.

Co-sourcing

Some of the advantages of co-sourcing include:

- Additional staff can be hired on an as needed basis during periods of peak work;
- Individual consultants, like an IT audit specialist or staff auditor, can be used to fill a specific short-term need at the organization;

- Consultants bring broad industry experience and best practice methodologies;
- Co-sourcing also combines the consistency of the internal managerial staff with the objectivity, independence, and professional skepticism provided by a qualified outside consultant.

Outsourcing

Some companies will benefit most from outsourcing their internal audit function entirely. This model has many of the same benefits as co-sourcing. In addition, by outsourcing the internal audit department, the company reduces the expenses associated with hiring a full-time staff that may only be effectively utilized on a seasonal basis. While consultants may carry a higher hourly rate, their time billed to the organization is fully devoted to the project at hand and not internal operating distractions. Consultants enter the organization as outsiders and provide an external approach to internal audit, which means a level of independence and objectivity not found in-house. In addition, experienced consultants can bring valuable tools, templates, and methodologies which have been proven effective.

For these reasons, in a 2006 Institute of Internal Auditors (IIA) study, 33% of the Chief Audit Executives surveyed planned to increase their budgets for co/outsourcing in the following three years.

Co-sourcing provides staff augmentation for short-term needs. Outsourcing is a viable solution for companies initially establishing an internal audit department or not wanting to commit internal time and resources for building and maintaining the audit function. By employing an outsourced or co-sourced internal audit department, the company effectively solves the dilemma of scarce, trained resources while maintaining a level of department oversight. To be successful, co-sourcing or outsourcing requires clearly defined expectations as well as open communication between the company and the third party provider.

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WATKINS MEEGAN UPDATE

WEBINAR SERIES

Segregation of Duties (SoD)

Creative Methods to Overcome the “One Head, Many Hats” Dilemma – Is your organization facing the “one head, many hats” dilemma – not enough resources to separate duties? Are you concerned about staff having too much access to critical processes and information? Are your auditors citing SoD as an issue in their management letter comments?

Watkins, Meegan, Drury & Company, L.L.C. is presenting a two-part webinar series on how to deal with segregation of duties issues *without significant increases to overhead*. The first part of the webinar will focus on the various kinds of SoD issues and the associated risks; the second session will present different solutions for resolving the issues and reducing the impact of conflicting duties.

Wednesday • October 29, 2008 • 12:30 – 1:30

Part I: What is “Segregation of Duties” and Why is it important?

Wednesday • November 19, 2008 • 12:30 – 1:30

Part II: Segregation of Duties – Solutions, Automation, Cost/Benefit

TO REGISTER, OR FOR ADDITIONAL INFORMATION, CONTACT:

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RiskServices@WatkinsMeegan.com**

RECENT EVENTS

Clean the Bay Day – The Risk Services team participated in the 20th Annual Clean the Bay Day on June 7, 2008. We worked with the Reston Association in Reston, VA, to clean Lake Thoreau and the surrounding area. The event was a huge success, collecting trash and debris from the lake shoreline.

Implementing Business Controls – A Seminar for Government Contractors – Watkins Meegan hosted a seminar for CFOs, Controllers, and Compliance Executives on July 15, 2008. Topics included implementing controls aligned with strategic objectives, understanding and implementing the new FAR requirements on contractor ethics and internal controls, and how to assess risk and implement controls appropriate to your organization’s size, complexity, and culture.

WATKINS MEEGAN’S RISK SERVICES GROUP PROVIDES:

Practical, Realistic Solutions to help organizations strengthen corporate governance, assess and control risk, and comply with regulatory requirements.

For additional information about our services, contact us at:

RiskServices@WatkinsMeegan.com.

For specific topics discussed in this issue, contact information is provided above.



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Data mining software is a powerful, sophisticated tool. But as important as the tool is the person who designs and creates the queries and assists in interpreting the results. Our professionals have in-depth understanding of data mining techniques and are experienced with different tools and software. We are available to discuss how data mining could be useful in your business.

tal items, and revenue which might indicate manipulation of the books and records. Additionally, patterns can emerge which identify who entered or authorized the suspect transactions.

Data queries can be run to match the address fields from payroll and vendor databases to uncover disbursements routed to employees' homes. Data queries can uncover suspicious EFT transactions by sorting the data and uncovering fund transfers to seemingly identical companies using different routing numbers.

Additional Tests for Unusual Transactions

Analytical tests can be developed to reveal inefficiencies that may be inhibiting the profit potential of your company. An inventory valuation analysis can be conducted that will compare the unique inventory SKU# to the sales database of items sold for the prior years. The analysis can potentially reveal a large percentage of the inventory that had no sales or inventory that failed to turn more than once a year. This information can assist management in making better valuation and buying decisions.

Analytical Tests