Office of Internal Audit and Compliance

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Briefing

Volume 2, Issue 4

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Welcome

The purpose of the *Briefing* is to provide our colleagues at USG institutions and other stakeholders with substantive summaries of audit policy issues we have encountered concerning governance, risk management and internal control audits. While we will not focus on the institutions themselves, we will provide an overview of the related policy and the relevant details of our audit findings and related recommendations.

In this issue, we continue to focus on **operational internal control issues** in audit shops, grant management and information technology. Our lead discussion looks at the IIA Quality Assessment process and how audit shops are compared to the IIA standards. The article, "*When is the Auditor Audited?*", outlines the litmus test standards that audit offices should strive to achieve. Our other discussion articles focus on internal controls in grant management and the corresponding federal regulations outlined in OMB Circular A-21 and the 17 principles outlined in the COSO information technology framework. Finally, we provide a summary of recent GASB Statement updates.

The on-line Briefing blog may be accessed at: www.usg.edu/audit/briefing and/or you may also sign up to receive articles via the RSS feed. The OIAC will also continue to distribute the hard file Briefing on a quarterly basis.

As always, we enjoy hearing from you, and welcome any thoughts or feedback about this publication. *Thank you for reading*.

Sincerely,
John M. Fuchko, III
Chief Audit Officer and Associate Vice Chancellor

"When internal audit is strong, its work will cause opportunity to float and risk to drown."

-Dan Zitting, CPA, CISA

When is the Auditor Audited?

By Michael J. Foxman

Measuring and assessing performance is just as important for the Office of Internal Audit and Compliance as it is for any department. The *International Standards for the Practice of Internal Auditing* (Standards) requires that an external assessment be conducted of internal audit departments at least once every five years by a qualified, independent reviewer or review team from outside the organization. The purpose of the review is to provide reasonable assurance to management and stakeholders that the Office of Internal Audit and Compliance is in compliance with applicable auditing standards.

The Chief Audit Officer leads the process of selecting an external assessor or independent validator with the full involvement and support of senior management and audit committees. The external assessment looks at the organizations' internal controls, ethics, governance, and risk management processes. An external assessment also builds stakeholder confidence by documenting management's commitment to quality and successful financial practices.

Following are the *Standards* that serve as the criteria for evaluating performance.

- Purpose, Authority, and Responsibility – the purpose, authority, and responsibility of the internal audit activity as formally defined in a charter, are consistent with the *Standards*, and properly approved.
- Independence and Objectivity – the internal audit activity is independent and objective in performing work.
- Due Professional Care – internal audit staff possesses the knowledge, skills, and other competencies needed to perform their responsibilities. Internal auditors enhance their knowledge, skills, and competencies through continuing professional development.
- Quality Assurance and Improvement Program – internal audit has developed and maintains a quality assurance and improvement program that covers all aspects of internal audit activity and one that is continuously monitored for effectiveness.
- Managing the Internal Audit Activity – the internal audit activity is effectively managed to ensure it adds value to the organization. Internal Audit has developed risk-based audit plans.
- Nature of Work – the internal audit activity evaluates and contributes to the improvement of risk management, controls, and governance processes using a systematic and disciplined approach.
- Performing the Engagement – internal auditors identify, analyze, evaluate, and document sufficient information to achieve the engagement's objectives.

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- Communicating Results – communications must include the engagement's objectives and scope as well as applicable conclusions, recommendations, and action plans.
- Monitoring Progress – there is a system in place to monitor the disposition of results communicated to management.
- Resolution of Management's Acceptance of Risk – if Internal Audit believes that management has accepted a level of residual risk that may be unacceptable to the organization, the matter must be discussed with senior management. If the matter is still not resolved, then it must be reported to the board for resolution.

The Office of Internal Audit and Compliance completed an External Quality Assessment in May 2010 and was Generally Conformed with the *Standards*. The next peer review will take place in 2015. We recognize that there are always opportunities to improve performance and look forward to increasing the efficiency and effectiveness of our department.

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COSO Internal Control Integrated Framework 17 Principles

By D. Randy Pearman, CPA, MPA

The Committee of Sponsoring Organizations (COSO) of the Treadway Commission is a voluntary private-sector organization dedicated to providing thought leadership to executive management and governance entities. COSO consults on critical aspects of organizational governance, business ethics, internal control, enterprise risk management, fraud, and financial reporting.

The COSO consists of five supporting organizations, including the Institute of Management Accountants (IMA), the American Accounting Association (AAA), and the American Institute of Certified Public Accountants (AICPA), the Institute of Internal Auditors (IIA), and Financial Executives International (FEI).

In the last issue of the *Briefing*, I discussed the changes in the COSO framework. The updated framework provides attributes, explanations, and examples of how the 17 principles fit into the control component. In this article I will define and describe the 17 principles and how they work in consonance to effect change.

The COSO cube has long been used as an illustration tool for demonstrating the relationship between the control components (listed on the front of the cube), the organizational objectives (listed on the top of the cube), and the organizational units (listed on the side of the cube). An examination of the updated cube versus the original cube reveals that the primary change is reflected in the organizational objectives.

“Financial Reporting” has now become simply “Reporting.” This change in illustration is meant to reflect the broadening of the reporting category to include nonfinancial reporting, both internal and external. This change should make the framework more flexible and useful to users.

Value proposition

COSO asserts the following value proposition.
“The changes will enhance performance with greater agility, confidence and clarity. The updated Internal Control Integrated Framework (ICIF) better supports efforts to design and adapt systems of internal control.”

One might easily see how the broadening of the reporting category would lead to greater agility and the codification of the seventeen principles would offer greater confidence and clarity.

COSO 17 Principles for Internal Control Systems

Control Environment

1. *Demonstrates commitment to integrity and ethical values*
2. *Exercises oversight responsibility*
3. *Establishes structure, authority, and responsibility*
4. *Demonstrates commitment to competence*
5. *Establishes accountability*

Risk Assessment

6. *Specifies relevant objectives*
7. *Identifies and assesses risk*
8. *Identifies and assesses significant changes*
9. *Assesses fraud risk*

Control Activities

10. *Selects and develops control activities*
11. *Selects and develops general controls over technology*
12. *Deploys policies and procedures*

Information and Communication

13. *Generates relevant information*
14. *Communicates internally*
15. *Communicates externally*

Monitoring Activities

16. *Conducts ongoing and separate evaluations*
17. *Evaluates and communicates deficiencies*

Benefits

In addition, COSO claims the following benefits will accrue to users of the updated framework.

- Improvement of governance
- Expansion of the use beyond financial reporting
- Improvement in the quality of risk assessment
- Strengthening of anti-fraud efforts
- Adaption of controls to changing business needs
- Greater applicability for various business models

Like the value assertion it is easy to believe that the updated framework will produce the benefits COSO claims that it will. Expansion of the reporting aspect of the framework is an obvious benefit since the updated framework explicitly states that will occur. Other benefits such as "Improvement of governance" and "Improvement in the quality of risk assessment" can be inferred from the codification of the principles. The true test of benefits will be in the actual use of the updated framework. The skill and commitment of the users will no doubt play a role in the number and type of benefits manifested from the updated framework.

Expected Finalization

COSO expects to complete the final version of the updated framework sometime in the first quarter of calendar year 2013. A press release posted on the COSO web site stated that the original final release date was expected to occur in the fall of 2012. The reason for the push-back in release time was unclear and it is by no means certain that another delay will not occur. University System of Georgia colleges and universities operate on a fiscal year that runs from July through June.

If the final release occurs in early January, the fiscal year will be half over. If the release occurs in late March, the fiscal year will be three quarters complete. At that juncture, it will likely be impractical for USG schools to take any significant action on the updated ICIF. It might be more appropriate for USG audit shops to initiate conversations regarding the updated ICIF. These conversations could begin among the audit group itself and naturally expand to interested members of the campus community. These members might include the executive staff (President, Vice President, Provost, etc.), any risk management group on campus, any legal officers on campus, and any other persons or offices that might be involved in control establishment or risk mitigation. Any action these groups deem appropriate would most likely begin no earlier than fiscal 2014.

Further information

Don't take this brief article as the final word on this matter. Arm yourself with information and knowledge. To get this information go to *www.coso.org*. There you will find the draft version of the new framework. Be forewarned, the document is over 150 pages in length. You will also find: comment letters from interested parties, an FAQ section, PowerPoint presentations offering explanations of the process, and press releases. This documentation should allow you to make an informed decision about how the updated framework may affect your institution. You will then be able to decide what action, if any, your campus needs to pursue.

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Extra Compensation Related to Federal Grants

By Sandra Evans and Rob Roy

In the previous publication of the *Briefing*, we discussed the topic *of Internal Control Issues Concerning Grant Awards* and provided several examples. In this issue, we will discuss another area of Internal Controls, the payment of extra compensation related to federal grants.

Federal agency regulations control the calculation and characterization of grant related billing. The following discussion provides guidance; however, the final authorities are the grant and contract documents, granting agency policies and procedures, and Circulars for Educational and Non-Profit Institutions 2CFR, part 220 (OMB Circular A-21). Federal guidance is given on additional pay for Faculty researchers. No guidance is given on additional pay for professional staff or administrative staff. As such, this should be addressed on a case by case basis paying close attention to the terms, conditions and policies relevant to the sponsored project and those of the BOR. Also please be aware that overtime pay is appropriate for paying non-exempt employees although the cost of the overtime pay must be allocated proportionately across all accounts paying the salary for a given pay period.

The following authoritative sources are summarized related to the issue of Extra Compensation:

1. BOR Policy 8.3.12.4 addresses Extra Compensation as it relates to Faculty:
   a. Research and Saturday classes will ordinarily be carried by USG personnel as part of their normal work load without additional financial compensation. Adequate allowance in time assigned for the extra duties shall be made by a proportionate decrease in the teaching load;
   b. Extra compensation may be paid, however, when all four of the following conditions exist: (1) The work is carried in addition to a normal full load, (2) No qualified person is available to carry the work as part of his/her normal load, (3) the work produces sufficient income to be self-supporting, (4) The additional duties are not so heavy as to interfere with the performance of regular duties.
   c. Although not stated, it should be understood that extra compensation allowed under state regulations and BOR policy would be typically funded by State appropriations or auxiliary funds. Institutions should follow federal, state, BOR and institutional terms, conditions, policies and procedures, and advanced approvals applicable to the sponsored project concerning use of federal funds for extra compensation.

2. USG Business Procedures Manual, Payroll Section 5.3.2 states: “Extra compensation may be paid to employees for tasks performed after normal business hours for duties not included in the employee’s normal job responsibilities, provided the following three criteria are met;
   a. Tasks must be outside of the employee’s regular department; and,
   b. The Department Agreement Form must be completed and signed by the appropriate department heads; and,
   c. The employee must meet at least one of

the criteria listed below (Criteria also can be found in the Official Code of Georgia Annotated Section 45-10-25): Chaplain, Fireman, Dentist, Certified Oral or Manual Interpreter for Deaf Persons, Registered Nurse, Licensed Practical Nurse, Psychologist, Teacher or instructor of an evening or night course or program, Professional holding a doctoral or master's degree from an accredited college or university, or Part-time employee.

d. An employee meeting all three criteria listed above may be paid extra compensation for a task for another department during normal job hours if the task is not part of the employee's normal job responsibilities, and the employee takes annual leave for the portion of time used for the task receiving extra compensation.

3. Federal Regulations

a. Only address extra compensation for faculty researchers.

b. NSF11-1 January 2011, Chapter II, C. g.(i) (a) states: "NSF regards research as one of the normal functions of faculty members at institutions of higher education…NSF award funds may not be used to augment the total salary or salary rate of faculty members during the period covered by the term of faculty appointment…".

c. OMB Circular A-21 J.10.d (1): "Charges for work performed on sponsored agreements …are allowable at the base salary rate. In no event will charges to sponsored agreements … exceed the proportionate share of the base salary for that period…"

d. Exceptions to the process in b. above are rare, but should be included: If faculty members with sponsored support cannot be released from teaching duties, but still perform grant-related research, the situation should be documented, notification sent to the granting agency or prime award recipient (in the case of sub-recipient contracts), and approval received in advance of paying extra compensation.

For Faculty research staff with nine or ten month contracts, summer semester grant effort can result in extra compensation known as summer salary, if included in the approved grant budget.

a. Summer salary calculation involves dividing the contracted base salary by the number of teaching months, usually nine, and multiplying the result by the grant effort percentage times the number of summer months when effort occurred. (Example: For 25 % effort over a period of two summer months: $72,000 base salary divided by 9 = $8,000 per month times 2 months times 25% effort = $4,000 in total summer salary).

b. National Science Foundation (NSF) restricts the summer salary from grants to two months or 2/9 of the annual contracted pay (NSF Grants Policy Manual, Section 611 1.b.2). HHS, Department of Education, and Department of Energy do not have this restriction.

c. Federal regulations specifically prohibit effort "worked" during Fall or Spring semester and "reported" in the Summer.

To summarize: Federal grant funds normally should not be used as a source for additional pay but instead are used to "buyout" the effort of faculty researchers, i.e., course release time. However, unique circumstances as in the case of faculty who cannot be released from their teaching responsibilities are eligible for extra compensation if permitted by institutional policy and procedures, allowed by the contract, included in the budget, and if approved in advance by the granting agency.

Office of Management and Budget

OMB Circular A-21

"Cost Principles for Educational Institutions"

Office of Management and Budget (OMB) Circular A-21, "Cost Principles for Educational Institutions," establishes principles for determining costs applicable to Federal grants, contracts, and other sponsored agreements with educational institutions.

Circular A-21 was reorganized under Title 2 in the Code of Federal Regulations (2 CFR), subtitle A, chapter II, part 220. The reorganization was a part of OMB's initiative to create 2 CFR as a single location where the public can find both OMB guidance for grants and agreements and the associated Federal agency implementing regulations.

In the event an employee is a research subject, the employee can be compensated for time as a participant from federal funds. USG Business Procedures Manual 5.3.2 states: Under no circumstances should an employee receive extra compensation for a task while receiving normal compensation for the same time period." Thus, if the employee participates as a research subject during normal work hours, the employee must take leave time in order to receive the extra compensation.

Penalties may be imposed for falsely certifying an effort report or incorrectly billing a granting agency. Both the institution and the certifier may be charged with violations of law.

Citations:

- Office of Management & Budget (OMB) Circular A-21 Section J.10 (2 CFR 220)
- NSF 11-1 January 2011, Chapter II – Proposal Preparation Instructions – C. Proposal Contents, 2.g.(i)(a)
- USG Business Procedures Manual, Section 5.3.2 Extra Compensation
- BOR Policy 8.3.12.4
- Georgia Constitution Article III, Section VI, Paragraph VI
- NSF Grants Policy Manual, Section 611 1.b.2

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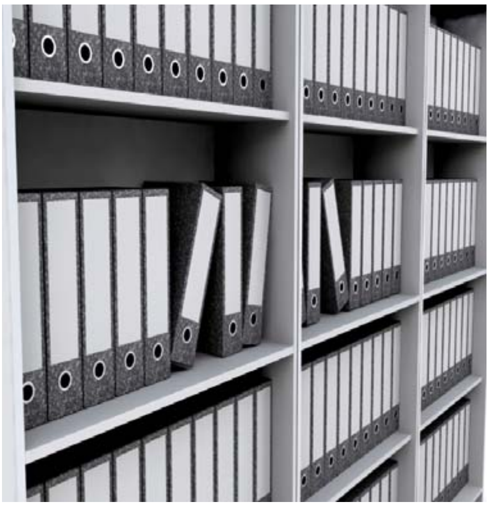
OMB Grant Reform - Policies

The focus on federal accountability and transparency has increased momentum for potential reforms that will have a significant impact on grant recipients. OMB, by Executive Order 13520, evaluated potential reforms to federal grant policies in an effort to increase efficiency, strengthen oversight, and align administrative requirements. Key facets of the Executive Order included:

- *Partner with state and local government to combat fraud, waste and abuse*
- *Provide administrative flexibility that is results-oriented, reduces administrative burden, and shifts focus from monitoring compliance to monitoring results*

On February 28, 2012, OMB published a notice in the Federal Register about reforming federal policies for cost principles and administrative requirements for grants and cooperative agreements. The most significant reform efforts are the Single Audit and Facilities & Administrative Cost Rates and Time and Effort Reporting. OMB developed a series of reform ideas that standardize information collections across agencies, adopt a risk-based model for Single Audits, and provide new administrative approaches for determining and monitoring the allocation of Federal funds. The reforms were published in the Federal Register February 1, 2013, Reform of Federal Policies Relating to Grants and Cooperative Agreements; https://www.federalregister.gov/articles/2013/02/01/2013-02113



DID YOU KNOW?

The Governmental Accounting Standards Board (GASB) is the independent organization that establishes standards of accounting and financial reporting for U.S. state and local governments. The GASB it is an operating component of the Financial Accounting Foundation (FAF), a private sector not-for-profit entity.

Funding for the GASB comes from accounting support fees established under the Dodd-Frank Wall Street Reform and Consumer Protection Act and from the sale of publications. The GASB is recognized by governments, the accounting industry, and the capital markets as the official source of generally accepted accounting principles (GAAP) for state and local governments.

Ben Riden, BOR Associate Vice Chancellor for Fiscal Affairs, prepared a summary of the most recent changes to specific GASB statements and its interpretation that may be applicable to USG institutions, http://www.usg.edu/audit/resources/GASB_summaries.pdf

Office of Internal Audit and Compliance

The Office of Internal Audit and Compliance (OIAC) mission is to support the University System of Georgia management in meeting its governance, risk management and compliance and internal control (GRCC) responsibilities while helping to improve organizational and operational effectiveness and efficiency. OIAC is a core activity that provides management with timely information, advice and guidance that is objective, accurate, balanced and useful. OIAC promotes an organizational culture that encourages ethical conduct.

We have three strategic priorities:

- *Anticipate and help to prevent and to mitigate significant USG GRCC issues.*
- *Foster enduring cultural change that results in consistent and quality management of USG operations and GRCC practices.*
- *Build and develop the OIAC team.*

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