


**"DO YOU FEEL LUCKY? WELL DO YOU PUNK?":
INTERNAL CONTROL PROCEDURES OVER
FEDERAL PROGRAMS**



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**Internal Controls over the
Organization's Process**


- Objectives
 - Internal Controls: Why are they important?
 - SEFA: What are the requirements?
 - Single Audit and Major Program Determination
 - Testing of Federal Programs
 - Reporting of Internal Control Deficiencies
 - How do the reports tie to the Data Collection Form?
 - Resources
 - Questions

**Internal Controls: Why are they
important?**

- Internal controls:
 - Statement of Auditing Standards' Definition:
 - Includes those policies and procedures that pertain to an entity's ability to initiate, record, process, and report financial data consistent with the assertions embodied with either annual financial statements or interim financial statements, or both.
 - Includes those policies and procedures that pertain to an entity's ability to meet compliance requirements applicable to grant agreements

Internal Controls: Why are they important?


- Committee of Sponsoring Organizations' (COSO) Definition:
 - A process, effected by an entity's board of directors, management, and other personnel to provide reasonable assurance regarding:
 - Effectiveness and efficiency of operations
 - Reliability of financial reporting
 - Compliance with applicable laws and regulations



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Internal Controls: Why are they important?

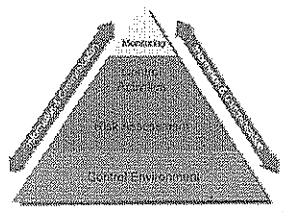
- Committee of Sponsoring Organizations' (COSO) Definition:
 - Provides reasonable assurance—NOT absolute
 - Involves every department/level of the organization
 - Direct relationship between an entity's objectives and internal control components



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Internal Controls: Why are they important?


© COSO's Internal Control Framework:



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Internal Controls: Why are they important?

- Control Environment:
 - The tone at the top sets the tone of the entity.
 - it is the foundation of all other components of internal control, providing discipline and structure:
 - Does management set an consistent example of integrity and ethical behavior?
 - Has management clearly exemplified that fraudulent financial reporting would not be tolerated?
 - Does management have a defined organizational structure?
 - Does management have established policies and procedures to inform the employees of what is expected as well as what will not be tolerated?




Internal Controls: Why are they important?

- Risk assessment
 - The entity's identification and analysis of relevant risk
 - Forming a basis for determining how the risks should be managed.
 - Identifying what items will "keep you up at night"
 - This is not the auditor's assessment
 - Risk is subject to increase during periods of change or in the midst of complex operational programs.



Internal Controls: Why are they important?


- Control Activities:
 - Policies and procedures that help ensure that management directives are carried out.
 - Attempt to prevent or detect and correct undesirable acts from occurring or have occurred.



What process does the entity have in place to keep all the gears working smoothly?


Internal Controls: Why are they important?

- Information and communication systems:
 - Support the identification, capture and exchange of information in a form and timeframe that enable people to carry out their responsibilities.
 - Flows of information back and forth, not just in one direction.




Internal Controls: Why are they important?

- Monitoring:
 - A process that assesses the quality of internal control performance over time.
 - Who should be monitoring each process within internal controls?
 - Are the completed objectives monitored timely? How often? Is there evidence?
 - Can be detective in nature



Internal Controls: Why are they important?

- Responsibility of internal controls:
 - Board Officials-
 - communicating the vision and mission of the organization and how they plan to accomplish it.
 - holding management accountable




Internal Controls: Why are they important?

- ◎ Responsibility of internal controls:
 - Management-
 - establishing specific internal control policies and procedures
 - developing a strategic plan to achieve organizational mission
 - monitoring day to day activity in order to see if operations are effectively accomplishing their intended purpose

Internal Controls: Why are they important?

- ◎ Responsibility of internal controls:
 - Employees-
 - carrying out the day to day operations of an organization
 - communicating to management when a process is operating ineffectively



Internal Controls: Why are they important?

- ◎ Internal Controls at the Auditee's level:
 - Are the foundational flow of transactions and information
 - Assist in maintaining a checks-and-balance within the organization
 - Assist in deterring fraudulent activity
 - Assist in detecting errors and omissions

Internal Controls: Why are they important?

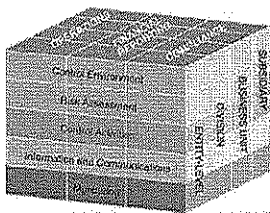
- Internal Controls at the Auditor's level:
 - AICPA's second standard of fieldwork requires that the auditor "obtain sufficient understanding of the entity and its environment, including its internal control"
 - Will require questions as well as getting more clarification

Internal Controls: Why are they important?

- Internal Controls at the Auditor's level (cont.):
 - Risk assessment procedures are based on this understanding obtained
 - This understanding incorporates knowledge about the design of the controls relevant to compliance with laws and regulations

Internal Controls: Why are they important?

- Internal Controls cover every aspect of the entity:
 - Operations
 - Financial Reporting
 - Compliance

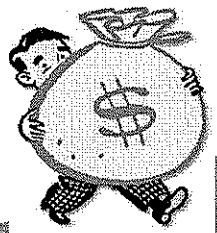


SEFA: What are the requirements?

- ⊙ Schedule of Expenditures for Federal Awards (SEFA):
 - Prepared by management
 - Includes all federal activities:
 - Grants and cost reimbursement contracts
 - Loan and loan guarantees
 - Food commodities
 - Donated property
 - Amounts passed through to sub-recipients

SEFA: What are the requirements?

- ⊙ The auditee is required to identify the federal awards received/expended; under which program
 - CFDA number
 - Grant ID number




SEFA: What are the requirements?

- ⊙ The auditor is required to determine whether the information provided in the SEFA is "fairly stated, in all material respects, in relation to the financial statements as a whole"
- ⊙ The results of the PCIE's report issued June 2007 stemmed new task forces established by the AICPA to enhance the Single Audit process


SEFA: What are the requirements?

- The AICPA issued additional practice aids for auditors to test the SEFA in June 2010.
 - Auditors procedures include:
 - Inquire of management whether the schedule was prepared in accordance with A-133.
 - Obtain an understanding about the methods of preparing the information.
 - How did the entity gather the information?




SEFA: What are the requirements?

- Auditor's procedures include (cont):
 - Compare and reconcile information to the underlying accounting and other records used in preparing the financial statements.
 - Does the schedule list individual federal programs by federal agency, CFDA numbers, individual awards within a cluster, total federal awards expended.
 - Evaluate the appropriateness and completeness of the information, considering procedures and other knowledge obtained.
 - What supporting documentation is used to complete the SEFA?
 - Obtain written representations from management



SEFA: What are the requirements?

- Assistance in obtaining the correct information for completing the SEFA:
 - www.cfda.gov
 - <http://doe.louisiana.gov/divisions/edfn/gap.html>
 - Review grant agreement or contact grant representative



Single Audit and Major Program Determination

- Single Audit determination:
 - Based on the information presented in the SEFA
 - Completeness is critical to avoid over testing or missed programs
 - Circular A-133 requires nonfederal entities that expend \$500,000 or more of federal awards in a fiscal year to have a single audit.

Single Audit and Major Program Determination

- Testing of major programs is based on total federal expenditures for each program:
 - Type A programs:
 - Is the greater of:
 - \$300,000
 - 3% of total federal expenditures on the SEFA

Single Audit and Major Program Determination

- Type A programs (cont.):
 - Risk Assessment:
 - Considered low risk, if
 - Audited as a major program in at least 1 of the 2 preceding years
 - No audit findings in the last audit
 - Oversight agency does not deem high-risk
 - Auditor judgment
 - Current and prior audit experience
 - Major changes in program regulation, personnel or systems

Single Audit and Major Program Determination

- Type A programs (cont.):
 - All Type A programs that are not considered to be low risk are deemed as high risk which requires it to be tested.



Single Audit and Major Program Determination

- Type B programs:
 - Is greater of:
 - \$100,000
 - .3% of total federal expenditures
 - Risk Assessment Considerations:
 - Weakness in internal control over compliance
 - Skill level of those responsible for the program
 - Information systems utilized
 - Prior audit findings
 - Audited as a major program in the past
 - Auditor judgment



Single Audit and Major Program Determination

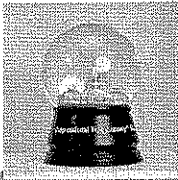
- ◉ Major programs to test are:
 - All Type A programs that are identified as high-risk
 - Type B programs identified as high-risk using 1 of 2 options:
 - Option 1—At least 1/2 of Type B programs identified as high-risk
 - Option 2—One high-risk Type B for each low-risk Type A
 - Such additional program to comply with 50% rule or 25% if low-risk auditee

Single Audit and Major Program Determination

- Low-risk Auditee:
 - Considerations for the two preceding years:
 - A-133 audit performed
 - Unqualified opinion on Financial Statements and SEFA
 - No material weakness noted
 - No compliance findings that have a material impact on Type A program
 - No known/likely question cost greater than 5% of the total awards expended on Type A program
 - Low-risk = 25% coverage
 - High-risk = 50% coverage

Single Audit and Major Program Determination

- American Recovery and Reinvestment Act (ARRA) Considerations:
 - Imposes new transparency and accountability requirements on both federal awarding agencies and their recipients

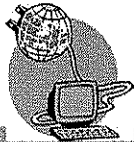


Single Audit and Major Program Determination

- If a program became a part of the cluster, then it is considered to be a new program.
- The auditor may consider a Type A program or cluster to be low-risk if all of the following conditions are met:
 - (1) the program or cluster had ARRA expenditures in the prior audit period;
 - (2) the program or cluster was audited as a major program in the prior audit period;
 - (3) the ARRA expenditures in the current audit period are less than 20 percent of the total program or cluster expenditures; and
 - (4) the auditor has followed §.520(c) and §.525 of OMB Circular A-133 and determined that the program or cluster is otherwise low-risk.

Testing of Federal Programs

- Once programs are determined, then testing of the federal programs begins
- Office of Management and Budget (OMB) – *Compliance Supplement*
 - Updated annually
 - Available at <http://www.whitehouse.gov/omb/>



Testing of Federal Programs

- Compliance Supplement (cont.):*
 - Provides a source of information for auditors to understand federal program's objectives, procedures and types of compliance requirements relevant to the audit, as well as the audit objectives and suggested audit procedures for determining compliance with these requirements

Testing of Federal Programs

- Compliance Supplement (cont.):*
 - Contains 7 parts
 - Part 1—Background, purpose & applicability
 - Part 2—Matrix of compliance requirements
 - Part 3—Compliance requirements
 - Part 4—Specific program requirements
 - Part 5—Cluster information
 - Part 6—Internal control
 - Part 7—Guidance for auditing programs not included

Testing of Federal Programs

- Part 2—Matrix of compliance requirements:
 - For most of the federal programs, this part list all applicable compliance requirements for each program.
 - The following is an example of the matrix

Testing of Federal Programs

CFDA #	Types of Compliance Requirements													
	1. Admin. Structure	2. Financial Management	3. Information Management	4. Personnel	5. Procurement	6. Reporting	7. Subgrants	8. Unallowable Costs	9. Other Federal Awards	10. Federal Acquisition Regulation	11. Federal Acquisition Regulation	12. Federal Acquisition Regulation	13. Federal Acquisition Regulation	14. Federal Acquisition Regulation
10.001*	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
10.004	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
10.011	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
10.014	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
10.015	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
10.016	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
10.017	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
10.018	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y

Testing of Federal Programs

- Part 3—Compliance requirements
 - There are 14 compliance requirements:
 - Activities Allowed or Unallowed (A)
 - Specifies the activities that the program can or cannot fund
 - Requirements for activities allowed or unallowed are contained in program legislation or, as applicable, ARRA, Federal awarding agency regulations, and the terms and conditions of the award.

Testing of Federal Programs

- Allowable Costs/Cost Principals (B)
 - Specifies the costs that the program can or cannot fund and how the costs are calculated and supported
 - Refers to three costs principal circulars:
 - OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments" (2 CFR part 225)—*This is the most common one.*
 - OMB Circular A-21, "Cost Principles for Educational Institutions" (2 CFR part 220)—This is for higher educational institutions
 - OMB Circular A-122, "Cost Principles for Non-Profit Organizations" (2 CFR part 230)

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Testing of Federal Programs

- Cash Management (C)
 - Pertains to:
 - Request for reimbursements are properly supported
 - Advance payments are properly managed
 - Interest earned on advances are properly remitted to the grantor, if it is not inconsequential
- Davis-Bacon Act (D)
 - All laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2000 financed by Federal assistance funds must be paid wages not less than those established for the locality of the project

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Testing of Federal Programs

- Eligibility (E)
 - Specifies the criteria for determining the individuals, groups of individuals (including area of service delivery), or sub-recipients that can participate in the program and the amounts for which they qualify.
- Equipment & Real Property Management (F)
 - Specifies the management, use and disposal of equipment or real property in accordance to specific grant requirement



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Testing of Federal Programs

- Matching, Level of Effort, and Earmarking (G)
 - Matching—requirements to provide contributions (usually non-Federal) of a specified amount or percentage to match Federal awards
 - Level of effort—requirements for
 - a specified level of service to be provided from period to period
 - a specified level of expenditures from non-Federal or Federal sources for specified activities to be maintained from period to period
 - Federal funds to supplement and not supplant non-Federal funding of services
 - Earmarking—requirements that specify the minimum and/or maximum amount or percentage of the program's funding that must/may be used for specified activities, including funds provided to subrecipients

Testing of Federal Programs


- Period of Availability of Federal Funds (H)
 - All funds were spent or obligated within the grant funding period
 - All obligated funds are liquidated within 90 days after grant funding period
- Procurement and Suspension & Debarment (I)
 - Federal, state or local procurement laws are followed
 - ARRA funds include the Buy-American provision
 - Vendors or sub-recipients are not suspended and debarred
 - www.epls.gov

Testing of Federal Programs

- Program Income (J)
 - Income received from the federal activity is:
 - deducted from outlays
 - added to the project budget, or
 - used to meet matching requirements
- Real Property Acquisition and Relocation Assistance (K)
 - Provides for equal treatment by persons displaced by the Federal government

Testing of Federal Programs

- Reporting (L)
 - Reporting results:
 - Performance
 - Financial
 - Special Reporting
- Sub-recipient Monitoring (M)
 - Properly monitoring pass-through funding to a sub-recipient
- Special Test (N)
 - Other program specific requirements



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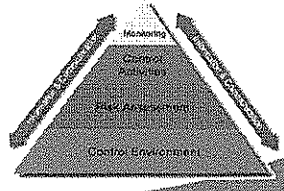
Testing of Federal Programs

- ◉ Part 5—Clusters of Programs
 - A cluster of programs means Federal programs with different CFDA numbers that are defined as a cluster of programs because they are closely related programs that share common compliance requirements.

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Testing of Federal Programs

- ◉ Part 6—Internal Control:
 - Addresses each of COSO's internal control components for each compliance requirement



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Testing of Federal Programs

- Compliance Supplement internal control procedures:
 - For each compliance requirement that is direct and material to the federal program the auditor is to perform procedures over internal controls

Testing of Federal Programs


- Suggested audit procedures are:
 - Using the guidance provided in Part 6 – Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
 - Auditor is required to document their understanding of internal control for each direct and material compliance requirement applicable to the federal program, discussing each level of the internal control components

Testing of Federal Programs

- Suggested audit procedures are (cont.):
 - Plan the testing of internal control to support a low assessed level of control risk for activities allowed or unallowed and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.

Testing of Federal Programs

- Suggested audit procedures are (cont.):
 - Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance



Testing of Federal Programs

- ⊙ Testing of internal controls is based on the understanding that was obtained:
 - Written policies and procedures
 - Authorized signatures or proper approvals
 - Documentation of reviews
 - Quality control procedures are performed
 - Adequate segregation of duties
 - Equipment and inventory is periodically counted

Reporting of Internal Control Deficiencies

- ⊙ Reporting Package:
 - Reports related to financial statements—
 - Opinion on financial statements
 - Report on Internal Control over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed in accordance with *Government Auditing Standards*
 - "In relation to" opinion on SEFA

Reporting of Internal Control Deficiencies

- Reporting Package:
 - Reports relating to federal programs—
 - Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133
 - Schedule of Findings and Questioned Cost

Reporting of Internal Control Deficiencies

- Statement of Auditing Standards (SAS) No. 117:
 - Definitions:
 - Significant deficiency*: a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
 - Material weakness*: a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Reporting of Internal Control Deficiencies


- Revises the list of deficiencies in internal control that are indicators of material weaknesses consist of:
 - Identification of fraud, whether or not material, on the part of senior management.
 - Restatement of previously issued financial statements to reflect the correction of a material misstatement due to error or fraud.
 - Identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicated that the misstatement would not have been detected by the entity's internal control.
 - Ineffective oversight of the entity's financial reporting and internal control by those charged with governance.

Reporting of Internal Control Deficiencies

- ⦿ According to Circular A-133, if the auditor is unable to support a low assessed level of control risk of noncompliance for a relevant assertion, then the auditor should report a significant deficiency or a material weakness in internal control over compliance as part of the audit findings.
- ⦿ Prudent official test:
 - If the auditor determines not a significant deficiency or material weaknesses, would the prudent official agree?

How do the reports tie to the Data Collection Form?

- ⦿ Circular A-133 states that the auditee should submit a Data Collection Form (DCF) that states whether the audit was completed in accordance with Circular A-133 and provides information about the auditee, its federal programs and the results of the audit.



How do the reports tie to the Data Collection Form?

- ⦿ DCF is not part of the reporting package but rather is a summary of information contained in the reporting package.
- ⦿ DCF and the reporting package are required to be submitted electronically to the Federal Audit Clearinghouse within the earlier of 30 days after the receipt of the auditor's report or 9 months after the end of the audit period.

References

- www.aicpa.org
- www.aicpa.org/GAQC
- www.coso.org
- <http://www.whitehouse.gov/omb/circulars/default/>
- AICPA Audit Guide: *Government Auditing Standards* and Circular A-133 Audits



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Questions??
