THE SIXTH SENSE: UNDERSTANDING AND APPLYING THE GUIDANCE IN PART 6 OF THE OMB COMPLIANCE SUPPLEMENT

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OVERVIEW: INTERNAL CONTROLS

AGENDA
1. Overview
2. Single Audit Application
3. Organizational Impact
4. Developing an Internal Controls Structure
5. Q&A
“Internal Controls means a process, implemented by a non-Federal entity, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

+ Effectiveness and efficiency of operations;
+ Reliability of reporting for internal and external use; and
+ Compliance with applicable laws and regulations.”

The Uniform Guidance states that internal controls should be in line with:

- “Standards for Internal Control in the Federal Government” (i.e., the Green Book) issued by the Comptroller General of the United States;
- “Internal Control Integrated Framework”, issued by the Committee of Sponsoring Organizations (COSO); and
- OMB Compliance Supplement, Part 6.

Part 6 describes characteristics of internal control relating to each of the five components of internal control (as defined by the Green Book).

Part 6 serves dual purposes:

- For institutions, Part 6 serves as a guide to defining a control environment that facilitates compliance with Federal laws, regulations, and the terms and conditions of Federal awards.
- For auditors, Part 6 serves as a guide to conducting the Single Audit to auditing the institution’s compliance with Federal program requirements.
INTERNAL CONTROLS
COSO FRAMEWORK: COMPONENTS OF INTERNAL CONTROL

<table>
<thead>
<tr>
<th>Control Environment</th>
<th>Risk Assessment</th>
<th>Control Activities</th>
<th>Information and Communication</th>
<th>Monitoring Activities</th>
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</thead>
<tbody>
<tr>
<td>Sets the tone of an organization and establishes the control consciousness of its people. It is the foundation for all other components of internal control.</td>
<td>Evaluation, analysis, and control of risk to ensure the achievement of objectives</td>
<td>Policies and procedures that help to implement management directives and ensure objectives can be achieved.</td>
<td>Identification, analysis, and communication of information in a form and time frame that enable people to carry out their responsibilities.</td>
<td>Process to assess the quality of internal control performance over time.</td>
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SINGLE AUDIT APPLICATION

SINGLE AUDIT APPLICATION
COMPLIANCE REQUIREMENTS

Using Part 6, the Single Audit tests 12 Compliance Requirements:

| A. Activities Allowed or Unallowed | H. Period of Performance |
| B. Allowable Costs/Cost Principles | I. Procurement and Suspension and Debarment |
| C. Cash Management | J. Program Income |
| D. Reserved (Davis-Bacon Act) | K. Reserved (Real Property Acquisition & Relocation Assistance) |
| E. Eligibility | L. Reporting |
| F. Equipment and Real Property Management | M. Subrecipient Monitoring |
| G. Matching, Level of Effort, and Earmarking | N. Special Tests and Provisions |
**Internal controls will differ from institution to institution, considering:**
- Research volume (granting agencies, number of subawards).
- Institutional history (past audits, internal investigations).
- Enterprise structure (affiliated institutions, faculty appointments).

**Focus controls on high-risk processes:**
- Greatest chance for misapplication of charges to a Federal award.
- High-dollar transactions.
- Transaction type (equipment, foreign travel, etc.).

**Too many controls can result in inefficient operations.**

**Strength of controls should be balanced with the relative risk.**

**The benefits of controls should outweigh the costs.**
EXAMPLE 1:
COST PRINCIPLES

OVERVIEW

+ Cost principles must be used in determining allowable costs of work performed by the non-Federal entity under Federal awards.
+ To charge a cost to a Federal award, a cost must be:
  – Allowable;
  – Reasonable; and
  – Allocable.
+ Items of cost must be consistently treated.

COST PRINCIPLES
POTENTIAL RISK AREAS

<table>
<thead>
<tr>
<th>Entity Level</th>
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<tbody>
<tr>
<td>* Guidance around cost principles is not defined in policy.</td>
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<tr>
<th>Division / Operating Unit</th>
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<tr>
<td>* Management lacks ability to restrict individuals who have access to make direct charges in the accounting system.</td>
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<tr>
<td>* Management lacks ability to identify charges that were applied to an award in error.</td>
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<tr>
<th>Function</th>
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<tr>
<td>* Individuals without full knowledge of policy are allowed to charge awards.</td>
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<tr>
<td>* Individuals who charge awards do not have sufficient guidance to determine the allocability of a direct charge.</td>
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</table>
Control Environment

Management’s commitment to compliance ensures that staff receive adequate training to perform their duties. (Principle 4)

Do the research community – including departmental staff, central staff, and PIs – receive adequate training on cost principles and how they are applied?

Would staff be able to recognize instances of misapplication of charges?

Does management initiate responses to reports of noncompliance and prior compliance and control findings?

Risk Assessment

Program managers and staff understand and have identified key compliance objectives and risk tolerances. (Principle 6)

Is there an overall approach to monitoring direct charges on grants?

Have major indicators of noncompliance been identified?

Are there processes in place for monitoring major indicators of noncompliance? For example, are there notifications/triggers indicating if:

– Charges exceed the proposed budget?
– Unallowable direct costs are charged?

Control Activities

Adequate segregation of duties is provided between performance, review, and recordkeeping of a task. (Principle 10)

Are policies and procedures in place that identify responsible parties for direct charging? For example, identifying, approving, posting, and reviewing charges?

Hot Topic: Clerical and Administrative Salaries

The Uniform Guidance no longer requires that a project must be considered a Major Project in order to charge clerical and administrative salaries.

How can (and should) the revision impact the allocability analysis when determining whether to charge an administrative salary to a federal project?
Adequate segregation of duties is provided between performance, review, and recordkeeping of a task. (Principle 10)

**COST PRINCIPLES**

**EVALUATING AGAINST PART 6**

**Control Activities**

+ Is there adequate segregation of duties?
+ Can direct charging policies and procedures be overridden?

**Sample Segregated Process**

- Initiator (Department Administrator)
- Requestor (PI)
- Approver (Department Business Officer and/or Central Office)
- Recorder (System)

Adequate source documentation exists to support amounts and items reported. A recordkeeping system is established to ensure that records are retained for the time period required. (Principle 13)

**COST PRINCIPLES**

**EVALUATING AGAINST PART 6**

**Information and Communication**

+ Do record retention policies require maintaining supporting documentation for purchases on grants?
+ Is responsibility for maintaining source documentation clearly defined?
+ Is source documentation readily available so that detailed questions can be answered during the Single Audit?

Periodic site visits are performed at decentralized locations and checks are performed to determine whether procedures are being followed as intended. (Principle 16)

**COST PRINCIPLES**

**EVALUATING AGAINST PART 6**

**Monitoring**

+ Are there expectations of monitoring direct charges?
+ How is monitoring accomplished? For example:
  - Are "signed-off" reports reviewed?
  - Are charges reviewed prior to reporting?
+ How is monitoring being reported? To what bodies is it reported?
EXAMPLE 2: SUBRECIPIENT MONITORING

OVERVIEW

- Pass-through entities must monitor the activities of subrecipients as necessary to ensure that the subaward is used for authorized purposes, in compliance with Federal statutes, regulations, and the terms and conditions of the subaward, and that subaward performance goals are achieved.

- Monitoring must include:
  - Reviewing financial and performance reports required by the pass-through entity;
  - Following-up and ensuring that the subrecipient takes timely and appropriate action on all deficiencies pertaining to the Federal award; and
  - Issuing a management decision for audit findings pertaining to the Federal award.

SUBRECIPIENT MONITORING

POTENTIAL RISK AREAS

**Entity Level**

- Failure to take enforcement action when a subrecipient does not meet the expectations of award management.
- Failure to evaluate existing and future subcontracts with a subrecipient if there are issues with the subrecipient.

**Division / Operating Unit**

- Incorrectly identifying subrecipient versus contractor.
- Incomplete review of a subrecipient’s management practices and past audits.

**Function**

- Initiating a subaward with an excluded party.
- Failure to communicate subaward responsibilities to a subrecipient.
SUBRECIPIENT MONITORING
EVALUATING AGAINST PART 6

Control Environment
Management initiates positive responsiveness to prior compliance and control findings. [Principle 4]

+ Has subrecipient monitoring been a previous finding on your Single Audit? Or ....
+ Has internal audit found weakness in this area?
+ If so:
  – Has the process been appropriately reexamined, and have necessary revisions been made?
  – Has the revised process been evaluated?

Risk Assessment
Management considers the potential for fraud (or waste or abuse) when identifying, analyzing, and responding to risk. [Principle 8]

+ Has a proactive risk assessment process for subawards been implemented?
+ Is the risk assessment process recurring throughout the life of the subaward?
+ Are the outcomes of the assessment directly informing how the agreement is structured?

Control Activities
Personnel possess adequate knowledge and experience to discharge their responsibilities. [Principle 10]

+ Do staff conducting the risk assessment have the appropriate level of expertise to review the subrecipient’s Single Audit output?
+ Do staff understand how to conduct a risk assessment for subrecipients that do not undergo a Single Audit?
+ Is there an escalation process if staff are unsure about proceeding with an area of the risk assessment?
SUBRECIPIENT MONITORING
EVALUATING AGAINST PART 6

Information and Communication
There are established channels of communication between the pass-through entity and subrecipients. [Principle 15]

+ Do PIs and the central office have regular channels and approaches to communicating with subrecipients?
+ Is current contact information a required component of subcontracts?
+ If the PI needs assistance, is the central office available, responsive, and trained to help?

SUBRECIPIENT MONITORING
EVALUATING AGAINST PART 6

Management follows up on irregularities and deficiencies to determine the cause. [Principle 17]

+ When issues are identified, is immediate action taken to revise the subrecipient’s contract? Are other contracts with the subrecipient examined?

ORGANIZATIONAL IMPACT
The Federal government emphasizes the importance of a “culture of compliance” in multiple guidance documents, including Part 6 and Draft Compliance Program Guidance for Recipients of PHS Research Awards.

- Is compliance woven into your institution’s operations?
- Does your institution prioritize compliance, along with operational efficiency and customer service?

### Culture of Compliance

- There is a sense of conducting operations ethically, as evidenced by a code of conduct or other verbal or written directive. [Principle 1]
- Management demonstrates respect for and adherence to program compliance requirements. [Principle 2]
- Key managers have adequate knowledge and experience to discharge their responsibilities. [Principle 4]
- Supervision of employees is commensurate with their level of competence. [Principle 10]

### Managerial Oversight

- Management’s commitment to competence ensures that staff receive adequate training to perform their duties. [Principle 4]
- Staff are knowledgeable about compliance requirements and are given responsibility to communicate all instances of noncompliance to management. [Principle 4]

### Skills and Abilities of Staff

- Staff are knowledgeable about compliance requirements and are given responsibility to communicate all instances of noncompliance to management. [Principle 4]
**ORGANIZATIONAL IMPACT**

EVALUATING YOUR INTERNAL CONTROL STRUCTURE: PART 6 EMPHASES

<table>
<thead>
<tr>
<th>Documentation of Authority</th>
<th>Management prohibits intervention or overriding established controls. (Principle 11)</th>
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<tbody>
<tr>
<td>Organization and Reporting Structure</td>
<td>The organizational structure provides identification of risks of noncompliance. (Principle 7)</td>
</tr>
<tr>
<td>Policies and Processes</td>
<td>Operating policies and procedures exist and are clearly written and communicated. (Principle 11)</td>
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DEVELOPING AN INTERNAL CONTROL STRUCTURE

**INTERNAL CONTROL STRUCTURE**

Evaluate Existing Controls

- **Start Small**: Do controls exist for each area of Single Audit focus?
- Are existing controls:
  - Appropriately **designed** to meet the control objective?
  - **Implemented** in a manner that allows the control to function as designed?
  - Consistently **deployed**?

Internal Controls should be evaluated on an ongoing basis.
INTERNAL CONTROL STRUCTURE
EVALUATE EXISTING CONTROLS

Cost  Service  Efficiency  Compliance

Are you striking the right balance?

INTERNAL CONTROL RESOURCES

- Part 6, OMB Compliance Supplement
- COSO
- Green Book

Though these documents are not checklists, they are there – and it is easier than starting from scratch.

QUESTIONS?
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