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# Internal Control Over Compliance An Auditee Perspective

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# Agenda

- What is Internal Control?
- Understanding the 14 compliance requirements
- Using the Compliance Supplement
- Looking forward and common findings

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# What Is Internal Control?

Process to provide reasonable assurance of:

- Reliability
- Effectiveness/Efficiency
- Compliance

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## Why Should You Care?

### ■ Specific Requirement in Circular - § 500 (c) (2)

- Auditors should perform procedures to obtain an understanding of I/C over Federal programs sufficient to plan the audit to support a **low assessed level of control risk** for major programs.
  - Plan testing of IC over the relevant compliance requirements for each Major Program
  - Perform testing of internal control as planned

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## Specific Requirements of the Circular

- Each major program
- Each direct & material compliance requirement
- Each of the 5 elements of COSO
  - Control Environment
  - Risk assessment
  - Information and Communication
  - Control Activities
  - Monitoring
- A-133 says to plan testing of internal control to support low level of control risk



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## What Is Internal Control?



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## What Is Internal Control?



Control Environment

*Sets the tone of an organization.*

Risk Assessment

*Influences control consciousness*

*Foundation for all other components*

Control activities

*Provides discipline and structure*

Information / Communication

Monitoring

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## What Is Internal Control?



Control Environment

*Identification and analysis*

Risk Assessment

*Relevant risks to objective achievement*

*Forms basis of risk management*

Control activities

Information / Communication

Monitoring

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## What Is Internal Control?



Control Environment

Risk Assessment

*Policies and procedures*

Control activities

*Help ensure achievement of management objectives*

Information / Communication

Monitoring

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## What Is Internal Control?

*Information identification, capture, and exchange*

*Forms and time frames*

*Enables people to carry out responsibilities*

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## What Is Internal Control?

*Process that assesses quality of internal controls over time*

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## 14 Compliance Requirements

- Allowable Activities
- Allowable Costs
- Cash Management
- Davis-Bacon Act
- Eligibility
- Real Property and Equipment Management
- Matching, Earmarking, and Level of Effort
- Period of Availability
- Procurement
- Program Income
- Real Property Acquisition and Relocation Assistance
- Reporting
- Subrecipient Monitoring
- Special Tests

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## Activities Allowed/Unallowed & Allowable Costs/Cost Principles

• **Allowable/Unallowable Activities** - are ones that can or cannot be funded under a specific program.

• **Allowable Costs/Cost Principles** - describes the cost accounting requirements associated with federal awards. These include OMB Circular A-21, "Cost Principles for Educational Institutions;" [Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments;"](#) Circular A-122, "Cost Principles for Nonprofit Organizations."

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## Activities Allowed/Unallowed & Allowable Costs - Testing Internal Control

### ■ Examples of key controls for each of these compliance requirements?

- Manager approval (control activity)
- PO process (control environment and activity)
- Establishment of program budgets (control environment)
- Review of program budget to actual results (monitoring)
- Training programs (information and communication)
- Others

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## Cash Management

- When entities are funded on a reimbursement basis, program costs must be paid for by entity funds before reimbursement is requested from the Federal Government.
- When funds are advanced, recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement.
- Interest earned on advances by local government grantees and subgrantees is required to be submitted promptly, but at least quarterly, to the Federal agency.

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## Cash Management - Testing Internal Control

### Examples of key controls for this compliance requirement?

- Manager approval of cash draws (control activity)
- Review of budget to actual G/L (monitoring)
- Routine assessments of cash needs (risk assessment, monitoring)
- Others

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## Davis – Bacon Act

- Requires that wages for "laborers and mechanics" employed by contractors (including subcontractors) of federally-funded construction in excess of \$2,000 be paid in accordance with the prevailing local wage established by the Secretary of Labor.
- Auditors are not expected to determine whether prevailing wage rates were paid.
- However, must verify the auditee is receiving and monitoring compliance.

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## Davis Bacon - Testing Internal Control

### Examples of key controls for this compliance requirement?

- Inclusion of language in contracts/bid documents (control activity)
- System of monitoring receipt of certified payrolls is established (monitoring)
- Management logs instances of noncompliance (control activity, risk assessment)
- Others

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## Eligibility

- Specifies the criteria for determining the individuals, groups of individuals, or subrecipients that can participate in the program and the amounts of assistance for which they qualify.
- Eligibility of those participating in the program funded by the grant or contract rather than the eligibility of the primary recipient.

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## Eligibility - Testing Internal Control

### Examples of key controls for this compliance requirement?

- Training requirements for staff (information and communication)
- Checklist completed and signed off for each application (control activity)
- Standardized case file maintaining documentation (control activity)
- Supervisory review of eligibility conclusions (monitoring)
- Realistic case loads (control environment)
- Others

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## Equipment and Real Property Management

- Equipment and real property management provides standards for the use and disposition of equipment and real property purchased with federal funds.
- These requirements cover records and inventory management.
- Equipment means tangible nonexpendable property, including exempt property, charged directly to the award having a useful life of more than one year and an acquisition cost of \$5000 or more per unit.
- Title vests with non-federal entity

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## Equipment and Real Property Management Testing Internal Control

### Examples of key controls for this compliance requirement?

- Process for tracking assets purchased (and disposed) with federal funds (multiple)
- Accounting system allows for separate identification of property acquired with federal funds (information and communication)
- Management reviews inventory counts and discrepancies (monitoring)
- Property tags are used (control activity)
- Others

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## Matching, Level of Effort, Earmarking

- Matching is amount (or percentage) of grantee contributions or matching funds provided.
- Matching, or cost sharing, includes requirements to provide contributions (usually non-federal) of a specified amount or percentage to match federal awards.
- Matching may be in the form of allowable costs incurred or in-kind contributions (including third-party in-kind contributions).

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## Matching, Level of Effort, Earmarking

- Level of effort (LOE) is specified service or expenditure levels maintained from period to period.
- Level of effort may include provisions for funds to supplement and not supplant non-federal funding of services.
- Earmarking is minimum or maximum limits for specified purposes.
- Earmarking may relate to amounts or types of participants covered.

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## Matching, LOE, Earmarking - Testing Internal Control

### Examples of key controls for this compliance requirement?

- Match amounts included in budget (control environment)
- Match coordinated with cash management transaction or function and its review process (control activity)
- Review of budget to actual reports by management (monitoring)
- Accounting system capability of tracking requirements (information and communication)
- Supervisory verification that requirements are met (monitoring)
- Others

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## Period of Availability

- Time period during which the non-federal entity can use the grant funds
- Only costs incurred during the specified period may be charged to the grant award
- Sometimes pre-award costs are approved
- Can sometimes be “carried over”

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## Period of Availability - Testing Internal Control



### Examples of key controls for this compliance requirement?

- Manager approval of expenditures (control activity)
- Review of expenditures immediately before and after grant cut-off date to ensure compliance (monitoring)
- Budgetary process considers term of grant funding (risk assessment)
- Accounting system prevents processing of expenditure outside of grant period (control activity)
- Others

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## Procurement, Suspension & Debarment



•Procurement - States, and governmental subrecipients of states, shall use the same state policies and procedures used for procurements from non-federal funds.

•Some contracts exceeding \$100,000 may require federal awarding agency approval

•Suspension & Debarment - Non-federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred.

•Excluded Parties Listing – [www.epls.gov](http://www.epls.gov), now managed by [www.sam.gov](http://www.sam.gov).

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## Procurement, Suspension & Debarment – Testing Internal Control



### Examples of key controls for this compliance requirement?

- Evidence of the auditee verification process for S&D – auditee use of EPLS.gov or sam.gov (control activity)
- Inclusion of language regarding S&D in RFP or other bid documents (control environment)
- Board approval of large or complex procurement contracts (control environment)
- Conflict of interest policies for individuals with procurement responsibilities (risk assessment, control activity)
- Utilization of a procurement checklist which is reviewed and maintained in file (control activity, monitoring)
- Others?

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## Program Income

- Gross income received that is directly generated by the federally-funded project during the grant period.
- Program income includes, but is not limited to, income from fees for services performed, the use or rental of real or personal property acquired with grant funds, the sale of commodities or items fabricated under a grant agreement, and payments of principal and interest on loans made with grant funds.

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## Program Income – Testing Internal Control

### ■ Examples of key controls for this compliance requirement?

- Accounting system ability to track program income (information and communication)
- Grant budget (control environment)
- Analysis of budget to actual (risk assessment)
- Proper segregation of duties for collection and recording of program income (control activities)
- Others

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## Real Property Acquisition and Relocation Assistance

- The Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended, (URA) provides for uniform and equitable treatment of persons displaced by federally-assisted programs from their homes, businesses, or farms.
- Federal requirements govern the determination of payments for replacement housing assistance, rental assistance, and down-payment assistance for individuals displaced by federally-funded projects.
- Common requirement for HUD Single Audits (HOME, CHIP, etc.)

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## Real Property Acquisition and Relocation Assistance - Testing Internal Control

### Examples of key controls for this compliance requirement?

- Completion and review of standard checklist for acquisitions (control activity)
- Standardized file for documentation (control activity)
- Policies and procedures for program (control environment)
- Training and experience of staff (information and communication)
- Others

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## Reporting

•Grant recipients are required to use standard financial reporting forms for submitting information to the grantor agency

•Many times these reports are required of state agencies who develop their own reports for sub-grantees (local governments)

•Performance or special reports may be required

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## Reporting - Testing Internal Control

### Examples of key controls for this compliance requirement?

- Manager approval of reports (control activity)
- Personnel preparing reports have the appropriate skills and ability (control environment)
- Existence of a tracking system to remind staff when reports are due (control activity)
- Supervisory comparison of reports to supporting records (monitoring)
- Existence of policies and procedures for reporting (control environment)
- Use of common information system (information and communications)
- Others

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## Subrecipient Monitoring

•Subrecipient monitoring requires recipients to monitor the activities of subrecipients relative to their federal awards.

•An award recipient is responsible for:

- At the time of the award, identifying to the subrecipient the federal award information and applicable compliance requirements.
- Monitoring the subrecipient's use of federal awards.
- Ensuring that subrecipients expending \$500,000 or more in federal awards are audited.
- Evaluating the impact of subrecipient activities on the pass-through entity's ability to comply with applicable federal regulations.

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## Subrecipient Monitoring - Testing Internal Control

■Examples of key controls for this compliance requirement?

- Inclusion of required communications in agreements/contracts (information and communication)
- Dedication of knowledgeable resources for subrecipient monitoring (control environment)
- Existence of risk assessment process for monitoring (risk assessment)
- Use and review of monitoring checklists (control activity)
- Monitoring receipt of, and review of, subrecipient A-133 reports (control activity)
- Others

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## Special Tests & Provisions

- Additional requirements set forth by federal agency – see Part IV of the Compliance Supplement
- Found in the laws, regulations, and the provisions of contract or grant agreements pertaining to the program.
- Not every federal program has special tests and/or provisions

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## Special Tests & Provisions -Testing Internal Control

### ■ Examples of key controls for this compliance requirement?

- Will vary according to special test requirements

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## Using Part 6 of the OMB *Compliance Supplement*

- Internal control considerations for each compliance requirement for each major program
- Guidance not a checklist
- Facilitates discussions with management

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## Using Part 6 of the OMB Compliance Supplement

- Describes characteristics of IC relating to each of the five components of internal control that should reasonably assure compliance with the requirements of Federal laws, regulations, and program compliance requirements.
- Describes the components of IC and examples of characteristics common to the 14 types of compliance requirements.
- Provides objectives of IC and examples of characteristics specific to each of 13 of the 14 types of compliance requirements follow this introduction (Special Tests and Provisions excluded).

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## Using Part 6 of the OMB Compliance Supplement – Excerpt

### CASH MANAGEMENT

- **Control Objectives:** To provide reasonable assurance that the (1) drawdown of Federal cash is only for immediate needs, (2) reimbursement is requested only after costs have been incurred, (3) States comply with applicable Treasury agreements, and (4) recipients limit payments to subrecipients to immediate cash needs.

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## Using Part 6 of the OMB Compliance Supplement – Excerpt for Cash Management

### Control Environment

- Appropriate assignment of responsibility for approval of cash drawdowns, requests for reimbursement, and payments to subrecipients.
- Budgets for drawdowns are consistent with realistic cash needs.
- Reimbursement is requested only have costs have been incurred.

### Risk Assessment

- Mechanisms exist to anticipate, identify, and react to routine events that affect cash needs.
- Routine assessment of adequacy of subrecipient cash needs.
- Management has identified programs that receive cash advances and/or reimbursements and is aware of cash management requirements.

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**Using Part 6 of the OMB Compliance Supplement – Excerpt for Cash Management**



**Control Activities**

- Cash flow statements by program are prepared to determine essential cash flow needs.
- Accounting system is capable of scheduling payments for accounts payable and requests for funds from Treasury to avoid time lapse between draw down of funds and actual disbursements of funds.
- Appropriate level of supervisory review of cash management activities.

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**Using Part 6 of the OMB Compliance Supplement – Excerpt for Cash Management**



**Control Activities (cont.)**

- Written policy that provides:
  - Procedures for requesting cash advances as close as is administratively possible to actual cash outlays and reimbursement only after costs have been incurred;
  - Monitoring of cash management activities; and
  - Repayment of excess interest earnings where required.
- For State programs subject to a Treasury-State agreement, a written policy exists which includes:
  - Programs covered by the agreement;
  - Methods of funding to be used;
  - Method used to calculate interest; and
  - Procedures for determining check clearing patterns (if applicable for the funding method).

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**Using Part 6 of the OMB Compliance Supplement – Excerpt for Cash Management**



**Information and Communication**

- Variance reporting of expected versus actual cash disbursements of Federal awards and drawdowns of Federal funds.
- Established channel of communication between pass-through entity and subrecipients regarding cash needs.

**Monitoring**

- Periodic independent evaluation (e.g. by internal audit, top management) of entity cash management, budget and actual results, repayment of excess interest earnings, and Federal drawdown activities.
- Subrecipients' requests for Federal funds are evaluated.
- Review of compliance with Treasury-State agreements.

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# Looking Forward – Internal Control

- OMB issued its long-awaited final grant reform rules in a document titled, [Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards](#) (Referred to as **Omni Circular**)
  - Omni Circular recommends/requires non-federal entities to use both COSO and the GAO Green Book in establishing internal control over compliance
  - Auditor requirements for testing and reporting on internal control over compliance appear to be consistent with Circular A-133 requirements
  - Omni Circular leaves any future reduction of compliance requirements to OMB discretion
- **Access Internal Control Frameworks**
  - COSO released final on May 14, 2013, [click here](#) to view.
  - On September 10, 2014, GAO released an update Green Book, <http://www.gao.gov/greenbook/overview>

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# Common Compliance Findings

When considered risk assessment for internal controls – consider any past findings you've had but also these common findings we see:

- Allowable Costs – lack of OMB-87 documentation for payroll
- Cash Management – Funds drawn in advance of expenditure
- Davis Bacon Act – Failure to include required language regarding prevailing wages and Department of Labor requirements in construction contracts

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### Common Findings

- Davis Bacon Act – Failure to obtain required certified payrolls from contractors
- Equipment and Real Property Management - Failure to appropriately identify on the books and records of the entity capital assets purchased with federal funds by funding source and other required identifying information
- Suspension & Debarment – Failure to verify non-federal entities paid with federal funds are not suspended or debarred.

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### Common Findings

- Subrecipient Monitoring – Failure to properly monitor the activities of subrecipients
- Subrecipient Monitoring – Failure to obtain Single Audits of subs when required and/or not following up timely on findings.

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### Questions

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