

Chapter 3100

Interaction with Auditors

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¶3101 Introduction

Richard Seligman, Ed.D.
Associate Vice President for Research Administration
California Institute of Technology

The ability to deal effectively with auditors is critical to an institution's successful management of sponsored research awards, therefore the interaction between sponsored programs administrators and auditors is explored in this chapter.

Audits are an essential and ongoing part of the sponsored research process. In the age of accountability and compliance, it is highly unlikely that they will disappear from the scene. Denise Clark of the University of Maryland, College Park has provided a highly accessible set of guidelines that will assist research administrators in achieving effective interactions with auditors. Clark makes the case for the importance of research administrators understanding the audit process and their role in it. Clark provides a very complete description of the audit process from the initiation of the audit letter through audit resolution and closure.

Throughout her discussion, Clark offers very practical advice to research administrators on how to get through an audit in a manner that benefits the institution. She has included a set of deceptively simple, but highly effective, tips for interviewees. The auditor may not be your best friend, but as Clark wisely points out, there is not much to be gained by treating the auditor as "the enemy."

This chapter will continue to respond to the information needs of research administrators over time through the addition of new material. Future updates will contain revisions, additions, and enhancements to ¶3105, as appropriate. Content added to other sections of the chapter will provide readers supplementary discussions of related topics (at ¶3120), practical tools (at ¶3130), case studies (at ¶3140), and trends data and other related statistics (at ¶3160). A "knowledge check" containing Q&As and discussion topics is included at ¶3190.

¶3105 Interaction with Auditors

Denise J. Clark

Assistant Vice President for Research Administration and Advancement
University of Maryland, College Park

Audit, auditor, auditee. ... Internal, external, program specific, agency specific. ... Entrance conference, exit conference. ... Scope, population. ... Internal controls. ... Extrapolation. ... Material weakness, immaterial weakness. ... Reportable condition, immaterial finding, material finding.

These are words that are exchanged regularly by research administrators, and all relate to audits. Audits play an essential role in the administration of sponsored programs and serve various, often critical, purposes. For these reasons it is necessary for office of sponsored programs (OSP) personnel to understand the relevant terminology and processes relating to audits and interactions with auditors. This chapter provides such an overview.

¶3105.1 Key Terms

Associated audit terms and definitions to make part of one's vocabulary include the following:

- ◆ *Agency-specific audit*: an audit conducted to ensure compliance with guidelines, regulations, and agency goals
- ◆ *Audit*: examination of records or financial accounts to verify accuracy
- ◆ *Auditee*: organization to be audited
- ◆ *Auditor*: person qualified and authorized to examine and verify records (could also be an "audit team")
- ◆ *Entrance conference*: held between auditors and the institution as a means to launch an audit
- ◆ *Exit conference*: held upon completion of an audit to discuss the process, observations, and outcomes
- ◆ *External audit*: conducted by auditors external to the institution
- ◆ *Extrapolation*: a means of drawing conclusions about an entire population based upon sample testing
- ◆ *Fieldwork*: a review of official records and supporting documentation, usually performed on-site
- ◆ *Immaterial finding (weakness)*: an instance of noncompliance with applicable laws regulations, or agreement terms and conditions of an inconsequential nature
- ◆ *Internal audit*: conducted by auditors employed by the institution
- ◆ *Internal controls*: verifiable mechanisms an institution has in place to provide reasonable assurance of compliance with applicable laws, regulations, and policies

- ◆ *Letter of engagement or audit letter*: the letter sent by the audit team officially notifying the institution of an upcoming audit
- ◆ *Material finding (weakness)*: an instance of noncompliance with applicable laws, regulations, or agreement terms and conditions of a substantive nature
- ◆ *Population*: defines the range and type of files associated with the audit
- ◆ *Program-specific audit*: conducted to ensure the institution has infrastructure to properly manage a particular award in accordance with sponsor guidelines
- ◆ *Questioned cost*: level of uncertainty or doubt as to allowability or appropriateness of a cost
- ◆ *Reportable condition*: internal control deficiency
- ◆ *Scope*: defines the purpose and parameters of an audit
- ◆ *Scope document*: details in writing the purpose, objectives, and intent of the audit

¶3105.2 Overview of Audits

Does preparing for *one* audit prepare an institution for *all* audits? No, each audit differs from the next depending on the auditors, the purpose of the audit, and the scope of the audit. Internal audits differ from external audits and A-133 audits differ from agency audits. (For further discussion of A-133 audits, see Chapter 1300.) Various types of audits and their purposes are discussed below.

- ◆ *Internal audits* are conducted by in-house personnel (usually located in the institution's office of internal audit) for the primary purpose of assuring that policies and procedures are in place, sufficient, and followed effectively and efficiently in order to maintain compliance with associated laws, regulations, and policies. The role of an internal audit office is to work in partnership with management to monitor and assess internal controls and associated risks and recommend enhancements to procedures and processes. Internal audit offices help facilitate compliance for the institution by assessing the probability and impact of noncompliance and by recommending improvements and enhancements to internal controls. Establishing an internal audit office is, in itself, an internal control. Frequently internal audit offices have a reporting relationship to the institution's board of trustees.
- ◆ *External audits* are conducted by outside audit firms, agency representatives, or representatives of a federal office of inspector general (OIG). One of the most common external audits in research administration occurs in relation to the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The scope of an A-133 audit is to determine an institution's compliance with federal regulations and the audit is conducted by private audit firms hired by the institution. The frequency and depth of the external audit differs depending upon variables such as the volume of an institution's total research expenditures, size of the institution, and complexity of the institution's portfolio. A program or topical area-specific audit is initiated by individual granting agencies and is conducted by personnel within the program area, the grants and agreements or contracts area, or the OIG area. A program-specific audit is a means to

evaluate the progress of a particular program or award while also assessing the institution's related internal controls. A topical area-specific audit may include one or many awards and the evaluation of internal controls is usually focused on adherence to the specific topic or topical area of interest.

Although each audit is separate and distinct from any other, there are common threads that occur with every audit. The purpose of an audit is to determine compliance with program and regulatory requirements. In doing so, audits focus on internal controls and assessments of risk.

The typical audit consists of evaluating internal controls of key operations and testing compliance with institutional policies and procedures and related adherence to applicable external regulations.

Internal Controls

What are internal controls? Internal controls are demonstrated means or methods used to provide reasonable assurance of compliance with applicable laws, regulations, and policies. By establishing and implementing sound internal controls, an institution seeks to create an environment where the primary objectives are compliance, reliability, integrity, and the safeguarding of the institution's assets. Examples of internal controls include the following:

- ◆ Promoting ethics and integrity
- ◆ Maintaining adequate knowledge base
- ◆ Operating efficient and effective financial systems
- ◆ Developing and implementing policies and procedures
- ◆ Imposing sanctions for noncompliance
- ◆ Providing training and ongoing communication
- ◆ Monitoring, observing, and testing daily operations
- ◆ Conducting periodic performance reviews

¶3105.3 Preparing for an Audit

Success in interacting with auditors depends upon how well prepared the institution is. A lack of preparation can cause a perceived atmosphere of uncertainty and inefficiency. OSP personnel can eliminate uncertainty, suspicion, and skepticism by being as prepared as possible and creating an environment of confidence and assurance. Having the knowledge of and ability to discuss the subject matter of the audit appropriately while providing verifiable documentation of adherence to internal controls is a key, strategic offense. In preparing for an audit, an OSP should consider the following activities:

- ◆ *Develop a list of acronyms, both institutional and governmentwide.* Consult the standard universal acronym list provided by the Federal Demonstration Partnership (FDP) and supplement it with an internal institutional list (see the FDP Web site at

www.thefdp.org). Include in the institutional section, any relevant financial system acronyms.

- ◆ *Create a list of commonly used terminology and associated definitions as reflected in internal policies, procedures, and systems.* Definitions within financial systems often dictate corresponding terminology cited in internally related policies and procedures. Since vendor-supplied systems may differ from institution to institution, so will the terminology and hence the need to document system-driven terms.
- ◆ *Review related federal regulations and make sure the institution has internal implementing policies and procedures in place to monitor compliance.* After the initial review, it is a good practice to perform periodic “re-reviews” of those policies and procedures to ensure any updates necessitated by changes in federal regulations or institutional policies have been captured and applied.
- ◆ *Review all related internal policies and procedures and determine:* Are they current? Do they match the needs of the university? Are they reasonable for the quantity of the work flow? Do they need to be updated to reflect electronic research administration processes? Have they been reviewed, approved, and accepted by the appropriate institutional officials? Have they been communicated to the research community? Are they readily available to all research administration-related parties?
- ◆ *Maintain a research-related Web site and determine:* Are links to all federal laws and regulations posted? Are links to all agency Web sites posted? Are links to all internal policies, procedures, and forms posted? Are links to all associated training opportunities posted? Perform a periodic review to confirm that all links are operational.
- ◆ *Establish an internal research community listserv.* This will facilitate communication with the institutional representatives responsible for various aspects of research administration. Utilize the listserv to announce new or revised regulations or policies. Establish a procedure to monitor the listserv participant list to ensure all pertinent parties are subscribed.
- ◆ *Provide ongoing education to the campus community through effective training.* Creating training programs enhances the knowledge and understanding of research-related laws, regulations, and policies and strengthens compliance. Training initiatives can be delivered by utilizing various methods and tools. The means used to communicate the necessary information to the research community should be well documented. To demonstrate delivery of training programs, retain copies of training announcements, agendas, and presentation and handout material as well as participant attendance sheets. Training opportunities can be internal and external.
- ◆ *Gain familiarity with prior audits and their associated processes.* Reviewing prior sponsored program-related audits offers insight into the flow of the audit process. Read all available file documentation. Begin the assessment by reading the notification of audit letter or letter of engagement. Give particular attention to the scope identified in the engagement letter and
 - determine how the population and sample selections were chosen;
 - determine if there was an associated narrative;

- review the current status of population and sample selections;
- evaluate the current status of the files involved and look for any connected subsequent events; and
- find out what institutional representatives were involved.

Read any file notes and correspondence connected to the fieldwork, including information related to any interviews and determine the following:

- Who was interviewed?
- How were they selected?
- What questions were asked?

Focus on the draft report and any subsequent versions of the audit report. Pay close attention to how the versions differ — what came out, what went in. Carefully read all sections of the final report and

- concentrate on the observations, findings, or weaknesses;
- take into account any management responses or corrective action plans;
- follow up to determine the status of the implementation of cited, modified, or enhanced internal controls; and
- confirm that all corrective actions have been implemented.

If there are any outstanding items still pending, obtain status updates, including estimated dates of completion. Continue monitoring all pending actions until final resolution has been achieved.

- ◆ *Review other institutions' A-133 reports.* A review of the data collection forms and any corresponding reportable conditions, weaknesses, or findings and associated management responses cited within the full A-133 report can provide insight into topical areas of national interest.
- ◆ *Review other institutions' sponsored programs administration-related Web sites.* In conducting a review, be sure to consider the ease of navigation, formatting, and placement of related policies and procedures. Peruse the policies and procedures of peer and aspirant institutions. Compare philosophy and strategies and consider possible enhancements.
- ◆ *Keep abreast of agency-specific audits by reviewing agency OIG reports.* OIG reports are usually available on agency Web sites. These audit reports can provide awareness into potential areas of federal agency concerns. After researching audit reports, assess the institution's strengths and weaknesses associated with the relevant internal controls. (For more on OIG audit reports and OIG audit work plans, see ¶3120.1.)
- ◆ *Conduct a self-assessment.* Conducting a self-assessment allows the institution to play "devil's advocate" by performing an internal evaluation of the effectiveness of oversight and monitoring programs. The purpose of the assessment is to evaluate adherence to procedures to ensure quality levels and efficiency in relation to

implementation of policies and procedures. A self-assessment is a self-audit and can be accomplished through various means and at various times. One example is to use system reporting tools to build standard queries that can be published and subsequently executed on demand by central or departmental administrators. Such queries can highlight awards or areas that may necessitate further review or oversight. Sample queries could cover

- active projects with expired term dates;
 - projects in overdraft status;
 - projects with subrecipients;
 - projects with cost sharing commitments;
 - projects with direct charges of a normally indirect nature;
 - projects with past due or unbilled receivables;
 - projects with actions pending sponsor approval; and
 - projects in advance account status.
- ◆ *Conduct a risk assessment.* A risk assessment is a proactive approach used to identify unwanted surprises. It is a means to evaluate or gauge potential exposure and related damages the institution would face for a claim of noncompliance. It is a process used to assess and judge possible adverse events by measuring research administration knowledge and the effectiveness of procedural implementations. The degree of risk associated with a given topic is usually defined in financial terms, but damages can be more than monetary and can be based upon real or perceived noncompliance. Risk assessments are the identification and analysis of the probability of something going wrong. Risk priority is measured in terms of the consequence and likelihood of something going wrong. Indicators of risk where risk assessment may be warranted include the following:
- Fund balances consistently in overdraft
 - High volume of cost transfers
 - Inexperienced or ineffective research administrators
 - High frequency of delinquency in meeting deliverables
 - Continual delays in negotiating agreements
 - Staffing constraints or reductions in key positions

When assessing the risk, prioritize the areas needing focus by measuring the likelihood and potential impact of the following due to negative exposure:

- Loss of institutional trust
- Loss of public trust
- Loss of sponsoring agency trust
- Loss of current or future funding

¶3105.4 **Start of the Audit**

Audits can occur at any time and with little advance notice. The usual means of contact commencing an audit is a notification of audit letter or letter of engagement. (An overview of the audit process is included as Figure 1.)

Figure 1: Audit Process at a Glance

1. Audit Letter

After receiving the audit letter, the institution should do the following:

- Appoint a lead individual
- Glean particulars of audit: scope, start/end dates, etc.
- Establish central file
- Prepare for entrance conference

2. Entrance Conference

During the entrance conference the institution should do the following:

- Understand scope
- Discuss overview of audit process
- Establish audit timetable
- Establish audit reporting process
- Begin to respond to data requests

After the entrance conference, in preparation for the audit fieldwork, the institution should do the following:

- Assign auditor work space
- Hold staff meeting
- Inform all potentially involved parties/offices

3. Audit Fieldwork

During the audit fieldwork phase, the institution should do the following:

- Initially meet with on-site audit team; introduce lead institutional official
- Respond to request for assistance package
- Respond to data requests during sample selection and testing phase
- Identify, analyze, and maintain copies of all relevant documentation
- Document all communications
- Involve internal audit, as appropriate
- Prepare staff, PIs, others for interviews with auditors
- Monitor and respond to any possible questioned observations
- Keep audit on schedule and hold update meetings

4. Draft Audit Report

After receiving the draft audit report, the institution should do the following:

- Carefully review the document

continued

Figure 1 (continued)

- Meet with auditors and inquire about report's contents (observations, opinions, findings, recommendations, etc.)
- Prepare management response, including any necessary corrective action plan(s)

5. Exit Conference

During the exit conference the institution should do the following:

- Engage in an open discussion with auditors about the entire audit process
- Provide institutional feedback

6. Final Audit Report

After receiving the final audit report, the institution should do the following:

- Carefully review the document
- Review the report with staff members
- Discuss observations/findings/recommendations with affected parties
- Distribute to management
- Review management response and corrective action plan
- Appoint someone to oversee corrective action plan and proceed with implementation
- Periodically monitor corrective action plan progress

7. Follow-Up

Approximately 6 months after receiving the final audit report, the institution should do the following:

- Meet with the person appointed for oversight for follow-up review to verify implementation of correction action plan
- Prepare for the possibility of additional testing or interviews as appropriate
- Communicate with auditors indicating corrective action plan has been completed
- Check all record retention periods
- Update files as needed
- Review corrective plan for necessary updates to policies, procedures, etc.

Audit Letter

The audit letter, sent by the office of internal audit, the authorized representative of the external audit firm, or the federal agency, frequently is addressed to the vice president or vice provost within the institution. The letter should state

- ◆ the program or topical area to be covered during the audit,
- ◆ the estimated start and end date,
- ◆ the anticipated amount of time for fieldwork, and
- ◆ the date, time, and location for the entrance conference.

The letter also should provide the names and contact information of the auditor representatives.

Audits should be managed by an institution's central sponsored programs administration. Principal investigators (PI) and departmental administrators should be alerted to the possibility of receiving a request regarding an audit directly and if this occurs, encouraged to engage central administration immediately.

Central File. Receiving an audit letter is the first official notice pertaining to the audit and at this point, a central management file should be established. Copies of documentation produced, reviewed, or tested throughout the audit process should be maintained in the file, as well as other material. The file should be retained for institutional purposes and be readily available for reference during and after the audit.

Lead Individual

Upon receipt of the notification of audit letter, a lead individual responsible for the audit and for serving as the main liaison with the auditors should be appointed. This is one of the most important steps in the audit process. This person should be a topical expert in the area of the audit's scope and should be knowledgeable regarding internal policies and procedures. Most, if not all, interactions with the auditors should occur through this lead individual. Appointing a lead liaison has many benefits, and therefore careful consideration should be given when determining who this person should be. This individual will be the point person who will not only represent the OSP but also represent the institution.

There are basic characteristics that this individual should possess. Ideally the individual will have been actively involved in previous audits. Experience is an invaluable asset and may be one of the most significant attributes one can bring to the process. This individual should be a subject matter expert and should possess knowledge of the related federal regulations, agency-specific terms and conditions, and associated institutional implementing policies and procedures. Consequently the scope of the audit plays a fundamental role in determining the lead individual.

In addition to subject matter expertise, an institution should consider communication methods, style, and ability as additional factors in selecting the lead individual. Since most of the interactions with the audit team will be impromptu, frequent, and verbal, strong oral communication and interpersonal skills are vital. Once the individual is identified, he or she should assume immediate day-to-day responsibility for the audit and begin the preparation and strategy development in anticipation of the entrance conference.

Entrance Conference

The audit entrance conference serves many purposes. Most notably, it brings together the pertinent parties and provides an opportunity for all involved to review the scope of the audit as well as discuss an overview of the process, the projected timetable, and the reporting expectations. The conference begins with introductions of the main participants and usually is the first face-to-face meeting to occur. The lead responsible parties are identified at this time and it is essential that the institution's appointed lead representative be present and be an active participant.

At the conference, OSP staff should try to gain an understanding of the auditors' familiarity with sponsored programs administration by inquiring about their backgrounds and experiences with audits of higher education institutions. The tone, tenor, and demeanor of this initial interaction may set the stage and pace for the entire audit. Composure and self-control are fundamental and crucial attributes to demonstrate at this meeting and will be the foundation for establishing a professional working relationship with the auditors.

Scope Document. After the opening introductions, a scope document should be presented and copies made available by the audit team. The scope document should detail the purpose, objectives, and intent of the audit. This document becomes the reference point for any questions and requests for clarification during the audit, and therefore it is very important that any questions regarding the proposed content of the audit be addressed at this time.

In order for the audit to run as smoothly as possible, the scope needs to be well defined and thoroughly discussed at this first meeting. As the scope of the audit is discussed, *clarity* becomes the key focus. The scope determines the parameters of the audit, and it is essential that all parties clearly understand those parameters. The scope is the broad overview of the intent of the audit, and topical areas are lower-level details within the scope. For instance, cost sharing may be cited as the scope of the audit; topical areas might encompass the following:

- ◆ Related policies and procedures
- ◆ Tracking and reporting mandatory versus voluntary cost sharing
- ◆ Mandatory cost sharing agreement requirements
- ◆ Treatment of mandatory and voluntary cost sharing in the facilities and administrative (F&A) proposal
- ◆ Subrecipient monitoring of cost sharing commitments
- ◆ Related financial systems and controls

These topical areas should contain such detail that both parties understand what areas of internal controls will be evaluated and what source documentation will be tested. If there are questions regarding any topical area, the OSP should ask for clarification and refine the expectations at this point. A clear, comprehensive understanding of the topical areas of focus will help the institution prepare for the on-site fieldwork stage (see page 3105:12).

Request for Information on Internal Controls. Once the scope and topical areas have been well defined, the audit team will begin the request for information and data. Before fieldwork testing can commence, documentation of internal controls related to the scope are requested and reviewed by the audit team. This is one of the primary requests for information and data and allows the audit team to become familiar with the related operations of the institution.

In reviewing the documents relating to internal controls, the audit team will first analyze the internal controls themselves. The purpose of this evaluation is to determine

the adequacy, effectiveness, efficiency, reliability, and credibility of the process the institution has in place to assure compliance with laws and regulations associated with the audit's scope. Internal controls are the most relevant form of source documentation because they describe the detailed processes the institution has designed and implemented to provide reasonable assurance that the stated objectives of adequacy, effectiveness, efficiency, reliability, and credibility are achieved.

The fieldwork testing is applied to determine compliance with internal controls, and the testing is the means of validating the institution's ability to oversee and monitor transactions related to the audit's scope. The information and data request includes current policies and procedures that are applicable to the scope of the audit as previously defined in the notification of audit letter.

Project Timetable. Another detail to be discussed at the entrance conference is the project timetable. The timetable should include

- ◆ an indication of when the requests for information and data will be issued,
- ◆ when the on-site fieldwork is projected to begin and end,
- ◆ when a draft audit report will be available, and
- ◆ when a final report is expected to be issued.

Time lines should be established, the estimated milestone dates should be discussed, and outer boundaries should be agreed upon at this point.

It is crucial that the institutional lead pay close attention to the anticipated target dates. In discussing target dates, the lead individual should consider the staffing impact associated with each milestone and allow adequate time for institutional preparation and review while avoiding unnecessary delays. The audit should not be prolonged by establishing long-term time lines. However, an institution should consider how long it will take to do the following:

- ◆ Prepare the necessary parties for the audit
- ◆ Review the related federal regulations
- ◆ Review the related internal controls
- ◆ Pull and review requested sample files
- ◆ Pull, review, and copy sample transaction selections
- ◆ Prepare for and conduct potential interviews
- ◆ Prepare management responses to the draft audit report

Reporting Process. The last objective of the entrance meeting is to engage in a discussion pertaining to the reporting process. It is important to emphasize that the first iteration of any observations, recommendations, or findings is a draft report — a preliminary document — and therefore the audit team needs to share it with the lead responsible individual first. There should be a mutual understanding regarding the progression of the reporting process and the drafting of the report as a collaborative process that includes a sharing of and dialogue concerning items of potential concern.

Clear parameters and boundaries surrounding the audit process need to be established, well documented, and thoroughly understood. The entrance conference is an opportunity to discuss any ambiguities and uncertainties pertaining to the method of communicating preliminary observations. Since the draft report may contain issues that could be resolved by the institution's providing additional explanations or documentation, it is imperative that the lead representative have the opportunity to review and comment on the draft prior to the report being distributed. If any misconceptions, misinterpretations, or misunderstandings occurred during the course of the fieldwork, resolution needs to happen at this early stage in the reporting process.

Preparing for On-Site Fieldwork

At the conclusion of the entrance conference and in preparation for the on-site fieldwork, the audit team continues to request data. Preliminary work is furthered by the auditors requesting and obtaining an overview of the institution's processes for sponsored programs administration and possibly reviewing narratives and flowcharts, conducting interviews with key research administration staff, and examining internal documentation of processes and related policies and procedures.

Auditor Work Space. Prior to the onset of the fieldwork, a designated auditor working space needs to be assigned. If possible, it is preferable that this space be located away from the mainstream, day-to-day activities and routine operations of the office. Employees' working environments should not be impacted, compromised, or disturbed. An audit does not replace, defer, or stop the regular work flow associated with proposal preparation, award negotiation, financial administration, etc. relating to sponsored programs.

To achieve work flow continuity and to sustain the same level of valued customer service to internal and external research community constituents during the audit, it is essential to safeguard against disruptions created by the audit fieldwork process. Preserving the privacy of all employees and their work areas will assist in meeting this objective. Having the audit fieldwork conducted away from the center of the normal office functions and everyday business traffic will reduce interference. In addition, the space that is assigned to the auditors should be in an area that is equipped with appropriate office functionality including adequate desktop working surfaces, telephone access, and Internet connectivity. It is likely that the audit team will need to reproduce relevant file documentation as part of the fieldwork and, accordingly, easy access to a photocopier will help to diminish disruptions and distractions.

Staff Meetings. Prior to the arrival of the audit team, the OSP should conduct an informational meeting with all staff and

- ◆ explain the purpose of the audit and the expected time line;
- ◆ describe the fieldwork process and explain staff's involvement;
- ◆ make clear the protocol to be followed while the audit team is on-site;
- ◆ reinforce the need and importance for all communications to be channeled through the lead designee and introduce this person;

- ◆ emphasize the fact that if staff is approached individually for information, whether oral or written, he or she needs to refer the auditor back to the institutional lead person (Questions and subsequent answers could be taken out of context when staff is approached individually.); and
- ◆ remind staff to be mindful of the auditors' presence in the office while continuing to focus on daily responsibilities.

Affected Parties/Offices. The OSP should identify all campus-related parties/offices that are impacted by the scope of the audit and make sure they are aware that an audit has been initiated and understand the potential impact on the organization. All parties/offices should be apprised of the scope of the audit and advised as to the estimated extent of their involvement. For external audits, the OSP should remember to coordinate with the institution's office of internal audit.

¶3105.5 Conduct of the Audit

On the first day of the fieldwork, the OSP should become acquainted with the on-site audit team and introduce them to the office staff. If there are audit team members present that were not at the entrance conference, the institution's lead individual should review with them the scope document and timetables so everyone involved with the collection, testing, and evaluation of data is performing under the same principles.

The audit team should be given a general overview of the building that includes the locations of such areas as restrooms, cafeterias, snack bars, and vending machines. Making the audit team aware of the building and surrounding facilities will help eliminate questions and prevent distractions to office employees. Keeping the audit activity as separate, distinct, and independent from the daily work environment as possible will help maintain stability in normal operations and work flow.

The audit team should be supplied with a copy of a list of acronyms and commonly used terminology and associated definitions. Providing such reference materials will assist in decreasing the chances of possible misunderstandings.

Sample Selection and Testing Phase

Using the scope and population as defined in the engagement letter and refined during the entrance conference, the audit team will present a "request for assistance package." The package contains a listing of documents to be produced including a sample selection as identified by the audit team. The sample selection is an extraction of the total population and becomes the test base. Selecting this sample size allows the audit team to examine, on a test-case basis, the institution's compliance with the requirements and standards applicable to research administration. This is referred to as an "extrapolation." The sample is a test of the whole population and extrapolation takes the results of the sample and draws conclusions for the entire population.

Once the population and sample size within that population have been identified, the OSP should pull all relevant files. Prior to delivery of the files to the audit team, the OSP should perform an analysis of the files and review the sample selections on behalf of the institution. All files should be in order and maintained in accordance with

internal filing procedures, and all papers within the files should be relevant. The files should be well organized and properly structured to help facilitate the review process. Since the files may be in review for weeks or even months, placing an “out” card or other form of notification in the original filing site will serve as a means of communicating to staff the location of the file, should access to it be required for normal daily operations.

The testing phase requires the auditors to examine documents and, when necessary, obtain explanations. The chosen samples serve as illustrations of the effectiveness and adherence to internal controls. A common form of a sample selection is a representation of individual awards. After reviewing the chosen samples, auditors frequently request additional records and/or documentation. Documents often requested include transactional level-based supporting documentation and are used to test adherence to internal controls. Examples of such documentation include journal entries, cost transfer requests, cost sharing documentation, effort certifications, payroll appointment forms and records, purchase orders, and financial and technical reports. These forms of records and documentation are typically maintained in various files.

Oversight of Relevant Files. The OSP should be careful not to allow original source documentation to leave the office; if necessary, a copy of the documentation should be provided to the auditors. In addition a copy of all documentation should be made for the central file. For the record and for future reference, each document should be dated, initialed, and reviewed prior to presentation to the audit team. It is important for OSP staff to understand the applicable federal and institutional policies pertaining to the document selections. Staff should be conscious of what information is requested and what information is being presented; testing provides the evidence necessary for the audit team to draw conclusions and derive subsequent opinions.

Documenting Communications

Throughout the audit, the OSP should

- ◆ document all communications, written and verbal;
- ◆ take and date file notes of all verbal communications, including on-site meetings and telephone conversations (Many times, clarifying conversations occur subsequent to the auditors’ evaluation of the transactional level-based records.); and
- ◆ maintain a reputation for credibility and provide information that is consistent with what was requested, but no more or no less.

The OSP should provide access to evidential material as requested and make sure the request is completely understood by both parties. An OSP should thoroughly analyze the request to make sure all references to federal regulations are current and cited and tested appropriately. For example, upon review of a multiyear grant from the National Institutes of Health (NIH), the auditor might test payroll transactions against an outdated NIH salary limitation and therefore come to an erroneous conclusion. Maintaining an open dialogue and discussion allows issues such as these to be addressed and resolved before they become auditor-documented conclusions.

Interviews

It is not uncommon for audits to include interviews. Interviews should not be impromptu conversations between the auditors and selected institutional personnel. All interviews should be coordinated by the institution's lead audit person. Prior experience in this area is invaluable. Frequently the audit team will first interview key personnel within the sponsored programs offices to learn more about the operations and gauge management's knowledge of the topical areas. The interviews further provide the auditors with an understanding of management's characteristics and influence over the organization.

An OSP should prepare the affected research community by arranging mock interviews to be used as a "dry run." All key personnel and associated departmental administrative managers should be part of a dry run. Questions should be anticipated and a checklist of potential scope-related inquiries should be developed. Potential interviewees should be told about the purpose of the audit and the intent of the interview process. Instructions on how to craft responses to questions asked during the interview should be provided. For example, if the scope of the audit were effort reporting and the population were all federal awards, a sample selection would be an auditor-identified subset of federal awards.

PIs associated with the chosen sample selection are potential interviewees. PIs should be asked to prepare for interviews by reviewing supporting source documentation such as personnel appointment forms, monthly payroll records, labor distribution and redistribution records, and effort certifications. In the review, related documentation such as award budgets, budget justifications and narratives, and financial and progress reports should also be considered. A review of related policies, procedures, and source documentation can help refresh the potential interviewees' recollections, as some audits may include a review of past years' activities.

PIs and other potential interviewees should be prepped for the interview and provided some interview tactics as included in Figure 2 (see page 3105:16). It is important to remember that the institutional lead individual should not only be present during interviews, but should intervene when it appears that the interviewer(s) and the interviewee are not effectively communicating and to make sure there is little room for misinterpretations between parties.

Interviews may be conducted with various central and departmental sponsored programs personnel. Interviews can bear heavily on the conclusions and outcome of the audit and since the interviews are verbal, the source documentation is an auditor's written transcript of the discussion. Misinterpretations potentially can occur on both sides. The interviewee may not understand the background scope of the audit or the intent of the question and may reply out of context. In doing so, the auditor may derive a conclusion based on a partial or nonsubstantive, nonsubject-matter answer. Therefore it is important that the lead individual always be present and take detailed notes during any interview.

At any point, if the lead individual gets the impression the interviewee and the auditor are not on the same wavelength, he or she should request an opportunity for clarification of either the question or the response. This allows for consistency and

Figure 2: Tips for Interviewees

Interviewees should be reminded about the following:

- During the interview, listen to the question. To accomplish this, do not interrupt, do not anticipate the question, and do not finish the interviewer's question. If the question is in relation to hard-copy documentation, ask for time to see and review the documentation prior to responding.
- Think first, speak second. Take as much time as you need to adequately refresh your memory before responding to a question. Suppress the desire to respond immediately.
- Before speaking, relate the question to the applicable federal law or regulation and the institutional implementing policy or procedure.
- Respond honestly and truthfully based on transactional file documentation, personal knowledge, and experience.
- Suppress the inclination to explain everything you know about a topic and to demonstrate to the auditors your vast knowledge base.
- Articulate your answer mentally before verbally responding to the question. Think about the statement you would like to make before you make it. Keep your answers short and concise.
- Remain calm and do not personalize the interview. Set emotions aside.
- If, after responding to a question, clarification is requested, cite the source of the information provided and maintain your confidence.

reliability in the information generated during the interview. For the institution, this will also be beneficial at the management-response stage (see page 3105:18). Interviews become part of the official audit source document and are sometimes referred to in the audit report. To effectively respond to citations regarding interviews and to clarify and/or expound on the institution's position, every effort should be exhausted to ensure that the interview process is not open to interpretation.

Ongoing Involvement

During the course of the fieldwork, the OSP should remain involved by

- ◆ observing the daily activities of and requesting daily status updates from the audit team;
- ◆ making a concerted effort to keep the audit on schedule; and
- ◆ periodically requesting a listing of any potential questioned costs or findings.

Some issues can be cleared up quickly and observations or findings obviated if the auditors ask for follow-up explanations upon preliminary discovery of issues. Sometimes conclusions based on fieldwork are not taken in proper context or are in error, misleading, or trivial in nature. Bringing these to light early in the process allows the institution the opportunity to present additional justification and may subsequently resolve any issues raised.

In addition OSP staff should be mindful of possible "scope creep." Scope creep occurs when the audit starts to drift away from the original defined parameters, and

questions or requests for documentation extend beyond the stated boundaries as agreed upon in the entrance conference. In such an instance, OSP staff should refer back to the entrance conference materials and discuss the defined scope with the audit team. Should the discussions result in an impasse and resolution with the audit team as to whether a request is in or out of the audit's scope not be reached, it may be necessary to involve upper management (possibly the auditors' management or the institution's). Depending on the nature, extent, and impact of the potential scope creep, discretion and sound judgment should be used in determining whether or not to call upon upper management.

Update Meetings. Throughout the fieldwork, drafting of the management response, and resolution stages of the audit, it may be necessary to convene in-house meetings to provide status updates and develop response strategies. Often these meetings are attended by the lead individual, key administrative personnel, and internal audit staff in cases of external audits. Internal audit staff can bring valuable insight to and therefore play an integral role in the process. The internal audit office supports the mission of the institution by helping protect its assets and reputation and can provide objective assurance and advice on the audit process. Internal audit's knowledge and expertise in the auditing profession will also help ensure that applicable auditing standards and guidelines are being followed.

Although it is recognized that in-house opinions and proposed strategies may vary, it is important to reach a mutual consensus on strategies before any information is relayed to the auditors. Providing a united front to the external auditor community is essential. During the status update meetings, periodic assessments of risk should occur and decisions made as to when to inform upper management of any potential findings — real or perceived. Keeping appropriate personnel apprised of potential outcomes is crucial. Discussions as to whether to engage upper management concerning areas of disagreement need to occur on an ongoing basis.

'Questioned' Costs

Concerns surrounding any potential "questioned" costs should be addressed as soon as they arise. Questioned costs are those costs that through testing to date leave the auditor with a level of uncertainty or doubt as to their allowability or appropriateness. Questioned costs can arise due to real or perceived

- ◆ noncompliance with a federal law or regulation or agency term and condition,
- ◆ noncompliance with internal controls, or
- ◆ inadequate supporting documentation.

Should a questioned cost be identified, the OSP should request that the auditor narrow down the rationale for the opinion. The auditor should be asked to supply the reference to the applicable law, regulation, agency guideline, or internal control that was used, and the citation should be reviewed to determine if the most relevant or most recent version is being used.

The audit team should be asked further to cite the area of perceived violation whether it involves a federal regulation, agency term and condition, internal control, or

occurrence of inadequate documentation. The OSP should review all source documentation, federal regulations, or agency terms and conditions in order to assess the issue. Any conclusion an OSP comes to should be documented and retained in the file.

The questioned costs should be discussed with the audit team. The OSP should share its conclusions and relevant supporting source documentation with the audit team and ask for the costs in question to be reviewed again. If the institution does not provide the necessary documentation in support of the costs charged to an award, the auditor may consider the cost questionable and disallow the expenditure. Therefore maintaining file documentation — including a written justification supporting decision making for actions taken during the life of an award — is not only prudent management, but also provides the necessary backup to support administrative actions and decisions questioned during an audit.

Draft Audit Report

After analyzing, interpreting, and documenting information obtained during the audit, the audit team will prepare a draft report. The draft may include auditor observations not previously disclosed. Therefore it is imperative that the draft report receive careful review by the institution. Upon review, if any findings, reportable conditions, or questioned costs are cited, the OSP should meet with the auditors and inquire about such items, as follows:

- ◆ Ask not just what the opinions, findings, or conclusions are but also how they were arrived at.
- ◆ Question the decisions made leading up to the conclusion.
- ◆ Inquire as to how the supporting documentation provided leads to the conclusion.
- ◆ Revisit the original request for and sample selections to formulate an institutional opinion and response.
- ◆ Review file notes from status meetings.
- ◆ Open a dialogue with the audit team; deliberate both sides' positions.
- ◆ Justify responses with supporting documentation and references to applicable rules, regulations, and/or internal controls.
- ◆ Be persistent in stating the institution's position; maintain confidence.
- ◆ Attempt to resolve identified issues and reach agreed-upon corrective action plans.

Management Response. Before a final report is issued, a management response to the draft report is requested by the audit team. A management response is an evaluation and statement of the institution's position in response to the auditors' observations, recommendations, and findings. With respect to each issue raised in the report, there generally are three components for consideration when constructing the management response:

- (1) Does the institution agree or disagree with the issue?
- (2) What is the corrective action plan to address the issue?

(3) What is the target date for implementation of the corrective action plan?

With respect to corrective action plans, the institution should use sound judgment in articulating the management response. It should formulate corrective action plans based on the draft report and ensure that corrective action plans are reasonable and attainable within the time frame cited. The cost of the corrective action plans should not exceed the expected benefit. An institution should be flexible in determining the necessary resources and approach, taking into consideration changing resource availability. A corrective action measure needs to provide reasonable, not absolute, assurance that an objective will be accomplished. A corrective action plan should be an appropriate response to the findings. If during the drafting of the report mutually agreeable conclusions were not arrived at, it is imperative that the institution restate, with supporting details, its position.

Exit Conference

The final step in the on-site audit process is an exit conference. The exit conference brings back together personnel from the entrance conference and serves as a means to discuss the entire process, observations, outcomes, and management responses to determine if any follow-up action is necessary or required. A frank, detailed discussion surrounding any issues that arose during the audit should occur and should include any indications or intentions for follow-up actions. Institutional feedback at this point in the process is important and can help facilitate and improve future audit interactions.

¶3105.6 Final Audit Report and Follow-Up

The next phase of the audit is the delivery of the final report. Typical sections of the report are

- ◆ an executive summary;
- ◆ a restatement of the scope, objectives, and internal audit procedures;
- ◆ subsequent observations and recommendations; and
- ◆ management's response and action plans.

The final report may also include a summary of the audit process undertaken. The summary of the process includes a listing of the audit procedures performed and the outcome of each, including any observations, findings, or reportable conditions. (After each finding or reportable condition, management's action plan or corrective action plan is listed, with an anticipated date of completion.) The report is distributed to management.

After the final report has been issued, the institution should do the following:

- ◆ Review the audit process and the report with staff members and talk about lessons learned.
- ◆ Discuss any observations, findings, or recommendations with all affected parties.
- ◆ Review the management response, including corrective action plans and implementation timetables.

- ◆ Develop a plan for periodic oversight and monitoring of progress towards meeting the management response goals.
- ◆ Appoint parties responsible for each outstanding observation and assign interim expected completion dates for any corrective action plans, including relevant training to the research community.
- ◆ Provide a system to track follow-up measures until all corrective action plans have been fully implemented.

Follow-Up Review and Remediation

Typically the audit will include a follow-up review that occurs approximately six months after the issuance of the final report. The review is conducted to verify that the institution has implemented all stated corrective action plans. This follow-on review may include additional testing and/or interviews as a means of verification. A letter indicating whether all corrective action plans have been satisfactorily implemented will be issued by the audit team. If the status of the implementation of the corrective action plans is found to be unsatisfactory, other management responses may be required, as well as another follow-up review. When all plans are found to be implemented satisfactorily, the audit is complete and any findings are considered to be remediated.

Record and File Retention

After remediation, on-site follow-up actions need to be completed. Audits may have an impact on record retention periods. All terms and conditions associated with record retention requirements for all awards should be reviewed. This step is extremely important for any awards in which the term date has expired. It is not uncommon for a record retention clause to include a statement extending the expiration date of the retention period and access requirements beyond the normal period due to litigation, claims, or audits. File notations and system data elements should be updated accordingly. Since the sample selected files and supporting source and transactional documentation used in the audit are original, official records of the institution, all such files and documents should be returned to their proper locations.

The management-constructed audit file (the “central” audit file) should be reviewed for copies of the following items:

- ◆ Letter of engagement
- ◆ Notes from the entrance conference
- ◆ Notes or narratives from any interviews conducted
- ◆ Listing of all policies and procedures reviewed
- ◆ Listing of the population and sample selections
- ◆ Source documentation requested and/or tested
- ◆ Drafts of the audit report
- ◆ Drafts of management responses/corrective action plans
- ◆ Notes from the exit conference

- ◆ Final report
- ◆ Follow-up review actions
- ◆ Resolution

Corrective action plans should be reviewed for any necessary updates to institutional policies, procedures, or Web sites, and all revisions to such that have been implemented should be verified and documented. Confirmation that the institution's research community at large has received notification of any corresponding updates should be ascertained and placed in the file as appropriate.

¶3105.7 Conclusion

Does the size of the institution impact the audit process? Should different tactics be followed for smaller institutions? Whether the institution is small, mid-sized, or large or public or private, the philosophy behind an audit is still the same — to assess and address any systemic compliance and accounting controls and problems that may exist. Every institution should plan for an audit accordingly — and in the same manner — by assuring that it has adequate internal controls in place and knowledgeable personnel on staff to facilitate the audit.

However, differences in audits do exist from institution to institution. First and foremost the outcome of an audit is heavily dependent on the institution's preparedness. The control environment established within institutions varies greatly and therefore is a determining factor in the outcome. In addition the audit process and outcome can differ from institution to institution as well as from audit to audit within an institution, depending upon the experience level of the auditor. An institution can proactively evaluate and gauge its preparedness and readiness for an audit by conducting a self-assessment of its internal controls. By establishing, implementing, and periodically testing internal controls for compliance, reliability, and integrity, an institution begins — and continues — the preparation for future interactions with auditors. (For a full discussion of self-assessment activities, see Chapter 3900.)

