

Perspectives

July 2003

Helping your not-for-profit & government organization achieve its mission

Inside: IRS compliance for foreign students, faculty. . .Could your college be vulnerable to financial aid fraud. . .Mike King retiring. . .Reauthorization of federal student aid. . .New accounting rules for guarantors

Establishing an internal audit function

by Wally Wetherill, Fort Wayne, & Julie Zemaitis, Decatur

Given recent lapses in corporate responsibility and the resulting elevated scrutiny from government and funding sources, creditors and the general public, it has become increasingly important for organizations to establish an internal audit function.

The new independence rules established by the General Accounting Office and the *Sarbanes-Oxley Act of 2002* have raised new concerns about independence, integrity and board of directors' fiduciary responsibility.

Audit trend growing

Though board accountability

has risen in proportion to the pace of financial and regulatory changes, a growing trend with not-for-profits is to establish an internal audit function.

A board often regards internal auditors as its eyes and ears, relying on them to provide competent evaluations of the organization's operations, the effectiveness of administration policies and internal controls.

Risk management may be the main reason to establish an internal audit function, but there are others as well:

- ✓ Assess and measure risk
- ✓ Prescribe risk control or mitigating solutions
- ✓ Identify improvement in your processes
- ✓ Increase the integrity and reliability of data
- ✓ Measure the effectiveness of the internal control system
- ✓ Gain confidence of regulators by using an objective, independent party
- ✓ Allow management and board to make more informed decisions with increased confidence in the financial management system

Internal auditor roles

An internal auditor's primary responsibilities are to test the internal control environment's effectiveness, test policy and procedural compliance and identify operational efficiencies.

Along with compliance and

internal control reviews, the internal auditor evaluates the operating effectiveness and efficiency of various departments.

Internal auditors can help an organization build financial resources within certain risk parameters, which helps a board reach its primary goals for an organization.

Independence lends credibility

The internal audit function must abide by the Institute of Internal Auditors' strict code of ethics.

The first standard requires internal auditors to "perform their work with honesty, diligence and

continued on page 2

Changes to single audit requirements

by Debi Ladyman, Indianapolis

On June 27, 2003, the U.S. Office of Management and Budget (OMB) issued revisions to the rules in OMB Circular A-133 governing single audits of governments and not-for-profit organizations that expend federal awards.

The most significant revision is to increase the threshold at which a single audit is required in a particular period from total federal expenditures of \$300,000 to total federal expenditures of \$500,000.

This revision applies to determinations for years ending on or after January 1, 2004. The old threshold continues to apply for years ending before January 1, 2004.

OMB expects the revised threshold to relieve almost 6,000 smaller entities from single audit requirements while only exempting from audit approximately one-

half of one percent of federal awards expended by entities currently having single audits. Other revisions relate to cognizant and oversight agencies.

The threshold at which an entity will have a cognizant agency is increased from federal awards expenditures of \$25 million to \$50 million. This will reduce the number of large non-Federal entities with a cognizant agency for audit from approximately 1,000 to 500.

The process for determining cognizant agency assignment is changed and the definition of an oversight agency is expanded to permit federal agencies to make reassignments of oversight responsibility.

continued on page 3

Correction

In the April 2003 issue of *Perspectives*, there were two errors in Example 3 of Jim Brown's article, "NFP endowments in uncharted water."

Based on the facts presented, the total unrestricted net assets at the end of Year 2 should be a deficit of \$(52,500) rather than a positive \$52,500.

In addition, the total unrestricted net assets at the end of Year 3 should be a deficit of \$(107,625) rather than a deficit of \$(7,625).

We apologize for any confusion this may have caused. □



IRS compliance for foreign students, faculty

by Joyce Dulworth, Fort Wayne

When it comes to withholding procedures and compliance issues, colleges and universities with foreign faculty and students are frequently the target of Internal Revenue Service (IRS) scrutiny.

To avoid exposure and/or penalties, colleges and universities must understand IRS withholding procedures and filing requirements for foreign individuals and comply with them.

It may be helpful to know the key issues that determine withholding requirements for foreign individuals:

- ✓ Type of payment received
- ✓ Immigration status
- ✓ Country of residence
- ✓ Knowledge of applicable treaty with individual's country of residence

This is not an all-inclusive list, but it does simplify the key rules and regulations that affect foreign individuals at your institution.

Because the rules will vary depending on each foreign individual's situation, it's imperative to be informed of the different rules and regulations and understand to whom they apply.

This is a complicated area, which college and university payroll departments often misinterpret. To determine which regulations to use, it's critical to first collect and document complete and accurate information about each foreign student or faculty member. □

by Todd Morriss, Springfield & Debi Ladyman, Indianapolis

Before you say, "Not *my* institution," study the following news headlines that describe a few of the many cases currently under investigation by the U.S. Office of the Inspector General:

- ✓ Former college employee pleads guilty to stealing loan checks
- ✓ Former financial aid director pleads guilty to student financial aid fraud
- ✓ Former financial aid director receives prison term for defrauding U.S. Department of Education
- ✓ Former university employee created unauthorized bank account and kept \$7,500 of the money deposited

Administrators at the institutions where these fraudulent activities were discovered may have

thought *their* campuses were fraud proof, too.

How does it happen?

White-collar crimes like these are often committed not by employees with above-average computer or accounting skills but by those who are *trusted*.

For many institutions, more than half of all tuition and fee revenue comes from students who receive federal and state financial aid to pay their fees.

This constant stream of income is a powerful lure to some college and university employees who find themselves overwhelmed by the temptation to defraud the government or the institution of funds.

Detection and prevention methods are key deterrents but

they can be difficult to implement because many college and university administrators aren't adequately trained or familiar with cutting-edge techniques and technologies available to certified fraud examiners.

To lessen the opportunities for fraud, outside expert assistance may be necessary to establish and

DataProbe

implement appropriate policies and procedures.

BKD can help

Always on the cutting edge, BKD's Forensics & Dispute Consulting (FDC) services division is passionate about developing and implementing prevention strategies and recently launched a series of related service initiatives.

Internal audit. . .

continued from page 1

responsibility."

Independence lends credibility to the internal auditor's evaluation, conclusions and recommendations because personal gain is not an issue.

Given the importance of independence, the internal auditor must report directly to the audit/finance committee or to the board; thus, increasing the integrity and objectivity of the internal audit function.

What regulators want

Having an internal audit function strengthens the internal control system, resulting in a more efficient and less costly external audit and a heightened probability of an unqualified audit opinion.

Establishing a relationship with your regulatory agency is valuable as well. Regulators want organizations to identify errors, irregularities and internal control weaknesses in a timely manner. The existence of an internal audit function sends a positive message to regulators.

The internal auditor can provide the following benefits as they relate to regulatory matters:

- ✓ Keep various departments updated on changes in applicable laws and regulations
- ✓ Supply evidence of adequate compliance testing to regulatory bodies
- ✓ Monitor regulatory inclination on interpretations of regulations and examination concerns
- ✓ Reduce the time a department

contributes to the examination process

Now might be the time

Conduct an internal audit to be confident your organization has adequate controls and procedures that are clear and easily understood.

Risk profiles can change rapidly, so frequent updates may be necessary for some procedures and systems.

Monitoring change and keeping risk management up to date is an invaluable benefit of an internal audit function.

* * *

Contact your BKD Not-for-Profit & Government Group advisor for more information about our internal audit solutions. □

vulnerable to financial aid fraud?

Under the direction of Jim Snyder, BKD principal and an attorney with an extensive background in forensics and economics, FDC works with attorneys nationwide to provide forensic support in the areas of litigation services, expert testimony and consultation and fraud services.

"After reading a series of articles highlighting the discovery of fraud and embezzlement problems on college and university campuses, specifically in student financial aid offices, we began to develop a plan of action," he says.

"As we examined firm resources in both FDC and BKD Not-for-Profit & Government Group, we realized BKD was well situated to provide solutions," says Snyder.

FDC's power hitters

The FDC team includes industry and service experts, consulting

attorneys, forensic accountants, certified fraud examiners, certified information systems security professionals and other litigation services consultants familiar with courtroom testimony and the forensic needs of attorneys.

Computer forensics is one of the fastest growing areas of accounting, and demand for expert testimony from FDC professionals has never been higher.

Cases frequently turn on information obtained through electronic discovery, which has been extremely expensive until recently. Today, FDC's three DataProbe labs (Cincinnati, Houston and Springfield, Missouri) make digital discovery affordable, cost effective and reliable.

Each lab is staffed by computer forensics professionals who use state-of-the-art software and computer technology (the same tools the Federal Bureau of Investigation

and Secret Service use) to expose hidden bank accounts, secure evidence of intellectual property theft and recover deleted information from a suspect's computer hard drive.

FDC can combine an internal control review with an operations assessment of your institution's financial aid programs and recommend and help implement changes targeted to improving efficiency and documenting flow.

"Our new fraud detection and prevention service for colleges and

universities is a major FDC initiative," Snyder says, "and I find it very exciting.

"It beautifully illustrates how well two of our niche areas can work together, and demonstrates BKD's ability to respond quickly to a developing problem."

For more information about investigating fraud on your campus, as well as information about other FDC services, contact your BKD Not-for-Profit & Government Group advisor. □

Retiring partner, Mike King, praised for vision & service

by Jef Fox, Little Rock

Mike King, partner and niche leader for Arkansas' Not-for-Profit & Government Group, retired May 31, 2003, bringing to a close his 33-year accounting career.

He will be greatly missed by clients and colleagues as both a visionary and leader for BKD's Arkansas practice.

Mike graduated in 1970 from the University of Arkansas, Monticello, with a double major in accounting and business administration. He joined BKD in 1971, becoming a partner in 1981.

In the 1980s, Mike found his niche in the not-for-profit and government area. At the time, a practice for this industry didn't exist in Arkansas, so he took it

upon himself to establish one.

Developing the practice from the ground up was no easy task, but thanks to his initiative and determination, Arkansas' Not-for-Profit & Government Group grew to be one of the largest in the firm.

Mike would tell you he's been right for this niche, and it's been right for him and that the satisfaction he felt when helping clients meet their goals was sweeter because, in the process, so many needy people from all walks of life also were helped.

Kevin Kemp, a recently elected Little Rock partner, worked under Mike's guidance for eight years and will become Arkansas' new niche leader for the Not-for-Profit & Government Group.

Thank you, Mike. We wish you the very best! □

FDC offers extensive fraud services

Fraud investigation services

- ✓ Investigation and follow-up on suspected fraudulent activity
- ✓ Help determine if fraud has occurred and amount of loss
- ✓ Gather evidence to support dismissal, criminal charges or civil proceedings
- ✓ Prepare a report of findings and evidence
- ✓ Provide expert witness and testimony



Fraud prevention assistance

- ✓ Identify internal control weaknesses
- ✓ Provide detailed recommendations to improve internal controls
- ✓ Identify fraud-prone areas and fraud risks
- ✓ Review financial aid policies and procedures (as required by regulation) for compliance
- ✓ Test daily processes for compliance with written procedures
- ✓ Provide internal audit support through training, cosourcing or outsourcing

Changes to single audit. . .

continued from page 1

These revisions also are effective for years ending on or after January 1, 2004, except for the change in the oversight agency definition, which is effective July 28, 2003.

Contact your BKD Not-for-

Profit & Government Group advisor to discuss the revisions' impact on your organization.

Visit the following web site for the **Federal Register's** notice regarding these revisions:

http://www.whitehouse.gov/omb/fedreg/062703_audits.pdf. □

Another reauthorization of federal student aid programs

by Todd Morris, Springfield

Congress is required every five years to review the Higher Education Act (HEA), which authorizes federal student aid (FSA) programs.

The HEA of 1965, as amended, is the legal basis for federal student aid programs: Pell Grants, Stafford Loans, Perkins Loans, Federal Work-Study Programs and all other FSA programs.

Because there are sunset provisions in the law to keep the programs from existing forever, the Act must be reauthorized. The last reauthorization was in 1998, making 2003 a reauthorization year.

Reauthorization can be fraught with challenges *and* opportunities. The financial aid community worries a law will be passed that creates havoc in the delivery of financial aid dollars to students, as has happened in the past.

At the same time, reauthorization can create opportunities for amending aspects of the law or regulation that have been

troublesome since the last reauthorization.

Strengthening legislation

On April 15, 2003, the Senate requested recommendations from the aid community on how to improve and strengthen the HEA.

Many organizations have taken the opportunity to inform the Senate of changes that would benefit their constituents.

College and university administrators should make every attempt to participate during this information-gathering stage; at this time, they can have an important impact on the outcome of reauthorization.

If you and/or other administrators at your school have concerns about the FSA programs, now is the time to let Congress know.

It's also time to visit major players' web sites for current information:

National Association of Student Financial Aid Administrators – <http://www.nasfaa.org/Home.asp>

National Association of College and University Business Officers – <http://www.nacubo.org/>

American Council on Education – <http://www.acenet.edu/>

For more than one year, task forces for these organizations have been working on recommendations for changing the HEA, which will carry weight with Congress because they represent so many constituents.

If you are concerned about the future of student aid programs, it's important to stay current with legislative efforts that affect them.

During periods of reauthorization, take the opportunity to let lawmakers know what you

think should and should not be changed.

The reauthorization process can improve HEA, for students *and* for those who administer FSA programs. □



New accounting rules for guarantors

by Mike Wolfe, Springfield

If your organization guarantees the debt of others, including certain affiliated organizations, a recent interpretation by the Financial Accounting Standards Board may affect you.

The interpretation requires guarantors to disclose the nature and maximum exposure of guarantees they have issued in their financial statements.

In many cases, guarantors also must record liabilities for guarantees issued after January 1, 2003, for the benefit of unconsolidated affiliates.


Contact your BKD Not-for-Profit & Government Group advisor for more information on how this interpretation could impact your organization. □

Check out. . . Perspectives

→ @ **bkd.com**

**to How
Reach
BKD**

P.O. Box 1900
Springfield, MO 65801-1900

A member of
Moores Rowland
International 

For a complete list of our offices and subsidiaries and their contact information, go to bkd.com or call Director of Communications at 417 831-7283.

bkd.com

PRSR STD
US POSTAGE PAID
SPRINGFIELD MO
PERMIT #801

Address Service Requested