RUTGERS

Rutgers Business School
Newark and New Brunswick

Preparing Not-for-Profit Organizations for a CA/CM Implementation

By:
Stephen Kozlowski, and Deniz Appelbaum, and Charlie Dietz, III

Motivation for the NFP CA/CM Pilot Program

❖ Recent incidents publicized in the Washington Post (2013) created visibility for fraudulent activities as based on Form 990 reported significant diversion of assets

❖ Natural extension of academic research to-date in the area of CA/CM:

  ❖ Do firms adopt CA/CM beyond initial use?

   ❖ Adaptation of the Technology Adoption Lifecycle Model (Bohlen and Beal (1957) and Rogers(1962) to CA/CM by Vasarhelyi et al (2012):

TALC Model-Stages:	Adaptation to CA/CM:
R&D	= The traditional audit
Introduction	= The emerging continuous audit
Growth	= The maturing continuous audit
Maturity	= The full continuous audit

What is Continuous Auditing and Continuous Monitoring?

❖ Very often, the terms "continuous auditing" and "continuous monitoring" are used interchangeably.

❖ The difference is the ownership of the process.

❖ Continuous auditing (CA) is the responsibility of internal audit and is a method used to perform control and risk assessments automatically on a frequent basis. Continuous auditing changes the audit paradigm from periodic review of selected transactions to ongoing audit testing of 100 percent of transactions.

What is Continuous Auditing and Continuous Monitoring? (Continued)

❖ Continuous monitoring (CM) is owned and performed by management or the business process owner, as part of their responsibility to implement and maintain effective control systems. Since management is responsible for internal controls, it should have a means to determine, on a ongoing basis, whether the controls are operating as designed. (COSO Internal Control Integrated Framework Principle 19: Ongoing and Separate Evaluations)

❖ By being able to identify and correct control systems on a timely basis, the overall control system can be improved.

❖ Typical additional benefits to the organization are that the instances of error and fraud are significantly reduced, operational efficiency is enhanced, and bottom-line results are improved through a combination of cost savings and a reduction in overpayments and revenue leakage.

Why a Need for Continuous Auditing and Monitoring? (Continued)

❖ Undetected data processing errors and fraudulent activities are occurring at any number of small-to-medium sized not-for-profits

❖ Data Processing Errors
  ❖ Incorrect health insurance payroll withholding
  ❖ Improper employee exclusion and inclusion in retirement plan contributions

❖ Fraudulent Activities
  ❖ Recent cases publicized by the Washington Post (October 26, 2013 and November 24, 2013) included several multi-million dollar fraudulent activities

Criteria for NFPs selected for the Pilot Program

❖ Revenue and/or expenditures in excess of $15 million

❖ Employee headcount in excess of 65

❖ Mature accounting system

❖ Engaged Audit Committee

❖ Usage of third-party generic accounting, payroll, membership and fundraising software

Challenges to a successful CA/CM implementation

❖ Limited ability to identify and provide the necessary data in an appropriate format

❖ Lack of knowledge and familiarity with:
  ❖ Data storage systems
  ❖ Software systems
  ❖ Organizational processes

❖ Data security and integrity concerns

❖ Privacy and confidentiality concerns

❖ Evolving business processes/activities

❖ Learning curve for CA/CM

❖ Cost of data analytics software

❖ Evolution of fraud schemes

❖ Element of concealment

Update on 2014 Pilot Project

Goal: to automate payroll tests in their upcoming cloud ERP (Jan 2016)

- ❖ Preventive and Detective Tests

Results: both phases are successfully running in a pre-implementation stage

- ❖ Reduce/consolidate manual activities
- ❖ Shift from detective to preventative
- ❖ Grow continuous monitoring efforts
- ❖ Support academic research and entity's mission

Observations:

- ❖ Management buy-in goes a long way
- ❖ Adequately allocate time to gathering and understanding the data
- ❖ Set clear roles and responsibilities
- ❖ Internal Audit can add value by championing these efforts

2015 Pilot Project Definition

❖ Requested to develop testing routines over Payroll/HR data (same functional area as for 2014 pilot project)

❖ Smaller organization (less than 100 employees) with minimal automated internal systems

❖ Manual procedures supporting Payroll/HR

❖ CA/CM tools cannot act on hardcopy data

❖ Organization uses 3rd party payroll processor

Action Items for the 2015 CA/CM Pilot

❖ Project team expended additional effort to identify Payroll/HR controls in place at the pilot site, given many processes were manual

  ❖ Reviewed and expanded/enhanced the questionnaire especially in the area of controls (including complementary user entity controls recommended by the third party processor's Service Organization Controls (SOC 1) Report)

  ❖ Conducted a thorough review of the questionnaire with staff to identify if any control issues

    ❖ For this organization the controls in place were deemed adequate

❖ Data scrubbing was required to reformat the data for testing

  ❖ Data was appended with pay period and pay date attributes to allow for loading individual payroll runs (register and timesheets) into single, combined register and timesheet tables

    ❖ Tests across time periods can be executed using a single table

  ❖ Common attributes shared across the tables had to be standardized to allow for table joins

    ❖ Employee numbers existed in 2, 3, and 4-digit configurations

Action Items for the 2015 CA/CM Pilot

❖ In an effort to expand the capabilities of automated CA/CM tools the project team developed a prototype 'Payroll Change Form' so as to capture employee master and change information in a digital format

  ❖ Individual fields in the form are password protected to provide for different access levels

    ❖ Supports unique preparer and authorizer functions

❖ Project team to Investigate cost-effective technical foundation for CA/CM test routines

  ❖ Small organization = limited budgets

Prototype Payroll Change Form

PAYROLL CHANGE FORM

Form Number	2015.001		Form revised as of	18-Mar-2015

Basic Data

Employee Name	Deniz Appelbaum
Employee #	000025
Effective Date	28-Feb-2015
New Hire Date	16-Mar-2015
Termination Date	30-Apr-2015
Title Change	Manager

Address

Street	10508 Sideburn Court
City	Fairfax
State	VA
Zip	22032
Country	USA
DOH	16-Mar-2015
DOB	26-Nov-1952
SSN#	xxx-xx-5362
Security Key	1234

Compensation

Compensation - Type 1	25,000.00		Compensation - Type 2	2,000.00

12

Action Items for the 2015 CA/CM Pilot

❖ Testing scenarios were developed using a tiered approach

  ❖ **Level 1** testing identifies the attributes available and data anomalies such as duplicate social security numbers, addresses and names.

  ❖ **Level 2** testing joins the register and timesheet databases to identify errors such as employees who were paid but did not submit a timesheet

  ❖ **Level 3** testing includes recalculations of specific attributes on the joined tables:

    ❖ Retirement plan contributions
    ❖ Health insurance coverage (family/single)
    ❖ Amount of life insurance coverage based on compensation
    ❖ Facility access for current employees
    ❖ Overtime pay

13

Contribution of NFP CA/CM Pilot Project

❖ Developed and successfully proven a methodology for implementing CA/CM in SME NFP organizations that encompasses
  - ❖ Project initiation activities
    - ❖ Documentation to support project definition, roles, and responsibilities
  - ❖ Execution steps for CA/CM implementation
    - ❖ Documentation to determine extent of and specific activities to be covered by CA/CM
    - ❖ Data extraction and configuration for testing
    - ❖ Development of supporting tools and technology to support CA/CM
    - ❖ Test script development
    - ❖ Presentation and review of results, testing revision iterations
    - ❖ Go live preparation and actualization
  - ❖ Post go live support

Questions?