

Brown Bag 10/24/07

Topic: ARMICS – Virginia’s Agency Risk Management and Internal Controls Standards

Presenter:

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Presenter Bio:

Susan Herod graduated with an accounting degree from Mary Baldwin College. After serving in the Office of the Chief Financial Officer at the U.S. Dept. of Agriculture in Washington, DC for several years, with projects including financial system implementation, she joined the University’s Comptroller’s Office, where she has served as a Project Manager and Chief of Staff. One of her latest roles has been to coordinate the University-wide efforts in preparing the Commonwealth’s Agency Risk Management and Internal Control Standards (ARMICS).

Links to useful website material links provided at the conclusion.

Goal:

- To increase the awareness of ARMICS and the impacts that it may have throughout the University’s administrative functions.
- ARMICS requirements not only benefit the institution by helping to assure appropriate business practices, but also help to protect the University’s administrative personnel when control policies and procedures are being followed.
- To re-confirm that the University’s answers to ARMICS regarding policies, practices and controls are being followed as documented by our administrative personnel. Assuring that when practices differ from standard University policies and practices, they are appropriately authorized and documented.

Brief History of the ARMICS Document:

- Based on atmosphere of Internal Controls and Enterprise Risk Management. Internal Controls - creating policies and practices that safeguard assets, assure reliable accounting & management data,

promote operational efficiency, & ensure adherence to required federal and state guidelines as required. Enterprise Risk Management - identifying the business mission, determining what factors may compromise that mission, and attempting to mitigate those possibilities as best possible.

- Began with Treadway Commission in 80's formation of the Committee of Sponsoring Organizations (COSO) in attempt for privately-traded industries to set some common standards & definitions about controls.
- With advent of Enron, Tyco, WorldCom, Adelphia, etc., these accounting scandals led Congress to pass the Sarbanes-Oxley Act of 2002 that codified and required compliance of many of these standards for publicly traded companies.
- In 2004, Federal government decided to apply similar standards to federal agencies through the revision of the Office of Management & Budget's Circular 123 (OMB-123).
- Virginia's State Comptroller began developing the Commonwealth's version of these standards in 2005. The draft was circulated to many state agencies for review. Many agencies felt the original draft was too broad with too many options for measuring controls. Agencies requested greater specificity and a focus on finance.
- The ARMICS document was completed in November 2006. It requires 3 stages of response from ALL state agencies (including higher education) and will be annually recertified. The key idea is to insure confidence in an organization's management practices, accounting processes, and financial reporting.
- Keep in mind, that this is an unfunded mandate by the state, so they did not increase our resources toward compliance.
- For more on ARMICS, check out the UVA ARMICS Website at: <http://www.virginia.edu/finance/armics/>

ARMICS Stage 1:

- Stage 1 consisted of 20 Assessments with multiple questions in each category.
- Due September 30, 2007 (recently submitted).

- Given the short time period, we focused on the policy & procedure owners at the agency level (Medical Center, SW Virginia Higher Ed. UVA College at Wise, and the academic administrative offices such as: Budget Office, H.R., Procurement, Comptroller's office, etc.). The key was to determine how to best answer the questions and provide supporting documentation to build the business case for our responses.

Measuring ARMICS:

- The ratings for assessments are on a 5 point scale. (Figures 1 & 2.)

Figure 1: Numeric Scoring for Surveys of Subjective Opinions

<u>Score</u>	=	<u>Description</u>
5	=	Strongly agree
4	=	Agree
3	=	Somewhat agree
2	=	Somewhat disagree
1	=	Strongly disagree
NA	=	Control does not exist or cannot exist due to agency circumstances

From: http://www.doa.virginia.gov/AICCO/ARMICS/ARMICS_Standards.pdf p. 48

Figure 2: Summary of Internal Control Reliability Model

Control Reliability Level	Characteristics of This Control Reliability Level				
	Documentation	Awareness and Understanding	Perceived Value to Employees	Control Procedures	Monitoring
Initial	Very limited	Basic awareness by management	Unformed	Ad hoc, unlinked	No monitoring
Informal	Sporadic, inconsistent	Understanding not communicated beyond management	Controls are separate from business operations	Intuitive, repeatable	No monitoring
Systematic	Comprehensive and consistent	Formal communication and some training	Controls integral to operations	Formal, standardized	No monitoring
Integrated	Comprehensive and consistent	Comprehensive training on control-related matters	Control processes considered part of strategy	Formal, standardized	Periodic monitoring begins
Optimized	Comprehensive and consistent	Comprehensive training on control-related matters	Commitment to continuous improvement	Formal, standardized	Real-time monitoring

* Adapted from *How to Comply with Sarbanes-Oxley Section 404: Assessing the Effectiveness of Internal Control*, by Michael Ramos, John Wiley & Sons, 2004.

From: http://www.doa.virginia.gov/AICCO/ARMICS/ARMICS_Standards.pdf p. 49

- Our response ratings were based on actions we are already taking (the efforts to create the environment). The good news is that we discovered that many of the systems that were being requested or required were already in place at U. Va. Our finding is that overall we were very pro-active.
- The Board of Visitors did a University-wide Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis. Even though it exists, and the V.P.s are aware, the question is always: "Does everyone know about these issues?"
- So what do these questions look like? (Figure 3) Here is an example of one of the starting exhibits.

Figure 3: ARMICS 2007 Exhibit 16, questions 1 & 2

Exhibit 16: Ethics Questionnaire

This Control Implemented and Operating Effectively	Agree/Disagree	Comments
1. The agency's Code of Ethics and other policies regarding acceptable business practice, conflicts of interest, and expected standards of ethical and moral behavior are comprehensive and relevant and address matters of significance.	5 4 3 2 1 NA	
2. Employees fully and clearly understand what behavior is acceptable and unacceptable under the agency's Code of Ethics and know what to do when they encounter improper behavior.	5 4 3 2 1 NA	

Comment: Those seem like very generic statements.

- Yes, the Department of Accounts (DOA, the State Comptroller's department) said, "You should use your professional judgment when answering and feel free to edit the question as it pertains to your agency."
- But, in agreement with many of the other state-supported institutions, we chose to answer these questions as they stand, including notes under "comments," since this was the first version. Two reasons:
 - First, we wanted to avoid the additional questions associated with "Why did you change the question?" and to reduce inter-agency inconsistencies (each institution with disparate versions).

- Since we know this will be an evolving document over the next few years, by providing the notes under “comments” for the questions we will see what DOA’s take would be on our rephrasing and answers (whether our interpretations of their questions suited).

Question: How did you pick the numbers?

- We worked to build the business case. There was collaboration amongst the departments (Human Resources (H.R.), I.T.C., Budget, Procurement, etc.) to provide the documentation to support our assessments based on our policies, procedures, etc.
- In the end, we provided an executive summary to tie it all together. The ARMICS document is a summary of these scores that the State will certify. We are keeping all the backing documentation here for future audits or questions.
 - We decided to keep printed copies for historical purposes, and have found that even in the few days since it was submitted, some of the links and policies have changed. So the hard copies will serve as evidence of “As Is: processes at the time of submission.

Question: Who was the signatory?

- Leonard W. Sandridge, Jr. (Executive V.P. and chief Operating Officer) signed on behalf of President Casteen. R.E. Howell (VP & CEO of the Medical Center) signed for the Medical Center and Steve Kimata (Asst. VP for Finance & University Comptroller) was the signatory for the Academic units. Under the Academic units, David Prior (Chancellor) signed for the College at Wise and Rachel Fowlkes signed for the Southwest Virginia Higher Education Center. Both institutions operate under a Memorandum of Understanding with the University for administrative functions.

Comment: Isn’t this documentation process good for people coming and going at UVA?

- Yes, good point. There is really nothing about this that should not be expected as a recommended business practice. The good news is that having these processes documented not only helps with reviewing and revising for best use, but also for training and use in emergencies.

ARMICS Stage 2:

- This stage will be due in March 2008. ****REVISED June 30, 2008****
There are an additional 85 assessments (many are H.R. related).

Here, the Vice President “process owners” will be signing that their processes are current, documented, and are being followed in the field. The process owners will be preparing a written summary of each policy or process, creating a process map (flow chart) utilizing the ARMICS method, and performing a risk analysis.

- The challenges: Need to identify and process map all “significant fiscal processes” – requires defining this term. There are so many different areas and sub-missions at UVA, that when compared to many State agencies, we are far more diverse and complex with processes that are not reflected elsewhere. Additionally, as one of the largest state agencies, we operate many systems parallel to Richmond’s in order to stream-line our efficiency. The down side is that means we have to document these as well.
- UVA has identified 20 significant processes so far, and JMU has submitted their identified list of processes & sub-processes. It has taken a while to define what these processes are.

Risk Map – An Example

	Low Impact	Medium Impact	High Impact
High Probability	2	3	3
Medium Probability	1	2	3
Low Probability	1	1	2

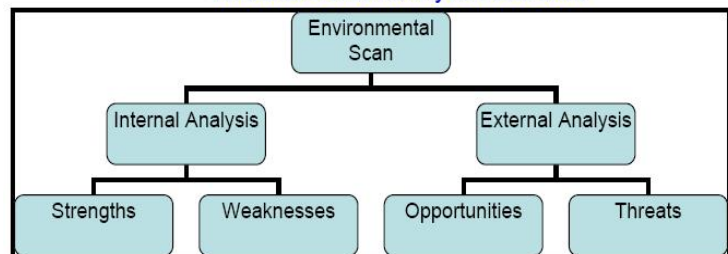
For each event, determine the impact of that event occurring and the probability that it will occur.
 Probability = The likelihood that a negative event will occur.
 Impact = The severity of the consequences of a negative event.

3 Red Zone – high risk – mitigate or reduce the risks.
2 Yellow Zone – medium risk – manage the risks.
1 Green Zone – low risk – accept the risks.

This is just one of many formats that a risk matrix may take.

Figures 4 & 5: A sample risk matrix provided in ARMICS to aid in determining the inherent risks of a given process and the potential need for mitigation processes. The SWOT analysis (below) is the ARMICS recommended method of determining risk.

Exhibit 23 – SWOT Analysis Framework



Question: Will this filter to the departments?

- Yes. The plan is to incorporate as many of these questions in the annual Internal Controls Questionnaires that are required from every department/unit each year. **Basically, if your practice deviates from the documented "University's standard policy/procedure", then you will have to document, map your process, perform a risk analysis, and insure that you have been authorized to utilize a modified process.**

Comment: I gather this is somewhat like Internal Audit's stance, where perhaps there may be no definite "right" or "wrong" in some cases, but that this process can help make sure our processes are safe, and provide ideas about how they can be improved.

- True. Even in the annual Internal Controls Questionnaire (ICQ), there are differences in the interpretation of the questions. Honestly, unless there is really something wrong, it is more a matter of defining how & why we do our business so that we can answer requests to show that we are good stewards of or resources and respectful of use of our assets in keeping with our missions.

Question: Within the framework of the ICQ, how accountable are the signatory people if something is discovered to have gone wrong? In other words, to what degree would they be responsible in remuneration? For example, when signing off on travel, we are often making the assumption that the traveler is telling us the truth.

- Audit perspective: From a legal standpoint, it rarely falls on the approver, though if it were determined that the approver was aware of fraudulent activity and failed to correct it, then they would potentially bear some of the burden. Typically, we would have a conversation with the supervisor to determine the details, but in cases where due diligence was exercised (which is most common), only the perpetrator would face repercussions. That being said, there have been cases where fraud has occurred and because the supervisor was NOT exercising due diligence (blindly signing off, etc.), the case was forced to be dismissed. This becomes a real problem if it means that the employee cannot be removed from the situation. In these cases, if you are the signatory, it would probably reflect poorly on you, but not necessarily in a proscribed way.

Comment: So many people have varying levels of signatory authority & designees, that I am sometimes concerned. The School of Medicine is revising their policy with regard to responsibility implications.

- These processes are most useful in catching problems or mistakes ideally, and less for penalty purposes. The Audit “Rule of Thumb” is: document what you are doing and use common sense.

Question: What do you feel is the take-home message for us to share in the departments?

- We are re-confirming that all the answers that we provided on the Stage 1 assessment are reflective of what people in our departments and unit are actually doing, or that there is documentation or corrective action planning in place for those who are not.
- In the units, we hope you will find that this process also helps us as an institution in refining our policies and processes to better accommodate the flexibility we need. If a large number of departments are legitimately unable to follow a “standard policy”, then it highlights the need to revise that work centrally.
- You will find an increase in the interest in enterprise risk management at the University in the coming months.

Question: What resources are available to help with documentation?

- First, there is an ARMICS web-page that we have created and will continue to update that may be a good place to look for supporting materials, news, and contacts. The web address is:
<http://www.virginia.edu/finance/armics/>
- We also recommend the University’s Process Simplification group – they are a part of the Office of Management & Budget and have a great deal of expertise with mapping and documentation processes. Be aware that they are an internal service provider so they do charge for their services. For more on Process Simplification, check their website at :
<http://www.virginia.edu/processsimplification/>
- In terms of tools, we have found Microsoft Visio to be a good tool for mapping. I believe the license runs about \$30.00.

- Unfortunately, we do not have a team that we can assign to help in the departments (I wish), but Susan Petersen and I are always happy to answer your questions as we can. You can contact us at armics@virginia.edu.

Question: We occasionally get calls from someone who claims to be from the State. How do we know if they are really valid when they call and ask us for information?

- Steve Kimata, the Asst VP for Finance & University Comptroller, maintains the relationship with APA and DOA on behalf of the University. He maintains the listing of auditors officially assigned to review our institution and you can verify them through him.

Follow-up Comment: We would appreciate it if we could ask DOA & APA to contact the Audit department whenever possible so our Audit can let us know to expect such a call and from whom so that we feel more comfortable providing University information over the phone.

Comment: One thing that always concerns me, in the back of my head, is "What did I not catch, and what might the repercussions be?"