# Internal Controls Overview and the FY18 ICQ

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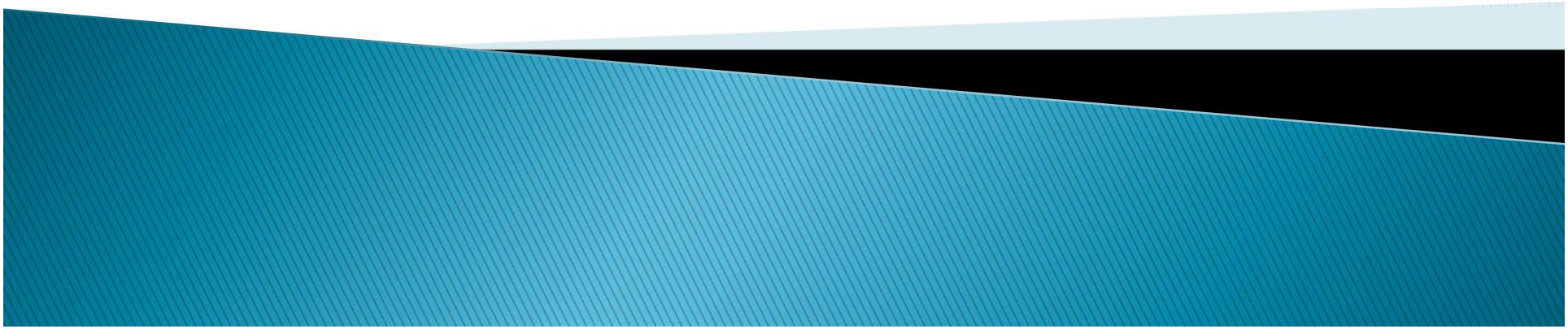

# Presentation Objectives

- Definition of Internal Controls
- COSO – Internal Control Framework
- Internal Controls (2 CFR 200.303)
- Grantee responsibilities
- Awarding state agency responsibilities (2 CFR 200.205)
- Specific Conditions (2 CFR 200.207)

# Definition of Internal Controls

A process, effected by an entity's board of directors, management, personnel and others charged with governance, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiencies of operations
- Reliable, timely and accurate reporting
- Compliance with applicable laws and regulations

# Internal Controls 200.303

Each non-Federal Entity must:

- Establish and maintain effective internal controls over the grant award
- Internal controls must provide reasonable assurance that the grantee is managing the award in compliance with state and federal statute, regulations and the terms and conditions of the grant agreement

# Internal Controls 200.303

Internal controls should comply with guidance:

- "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States, or
- "Internal Control Integrated Framework", issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO)

# Internal Controls 200.303

Internal controls must:

- Comply with State and Federal statutes, regulations, and grant agreement terms and conditions
- Evaluate and monitor compliance with statutes, regulations and the terms and conditions of the grant agreement
- Ensure prompt action when instances of noncompliance are identified – audit findings, on-site reviews and other regulatory reviews

# Characteristics of Good Controls

- Focused on critical points of operations
- Integrated into established processes; not burdensome but a part of processing
- Accurate, in that they provide factual information that is useful, reliable, valid, and consistent
- Simple and easy to understand
- Accepted by employees
- Cost effective – controls should not cost more than the risks they mitigate

# Common Basic Internal Control Principles


## Establish Responsibility

Assign each task to only one person

## Segregate Duties

Don't make one employee responsible for all parts of a process


## Restrict Access

Limit access to system, information, assets, etc. to those that need it to complete assigned responsibilities

## Document Procedures and Transactions

Prepare documents to show that activities have occurred

## Independently verify

Check others' work

# COSO Provides an Integrated Framework for Internal Controls

# COSO Internal Control –Integrated Framework Principles

5 interrelated components of Internal Control

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring


Along 3 main objectives

A. Operations
B. Reporting
C. Compliance

Across the organization, down to the process functions

# 1. Control Environment

- Organization demonstrates a commitment to integrity and ethical values
- Board of directors (oversight team) demonstrates independence from management and exercises oversight of the development and performance of internal controls
- Under oversight, management establishes and structures reporting lines, appropriate authorities, and responsibilities to accomplish objectives

# Organization Control Environment

- Organization demonstrates a commitment to attract develop, and retain competent individuals in alignment with objectives
- Organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives

# Governing Body, Senior Management Oversight Responsibility

Control Environment

- Demonstrates commitment to integrity and ethical values – Establish tone at the top
- Exercises oversight responsibility
- Establishes structure, authority and responsibility
- Demonstrates commitment to competence
- Enforces accountability

# Scope of Control Environment

- Controls should include:
  - Hiring practices
  - Training programs
  - Whistleblower programs
  - Code of Conduct
  - Clear lines of responsibility and authority
- Control Environment must be documented and may include:
  - Procedure manual that include process narratives, flow charts, job aid such as checklists
  - Organizational charts
  - Memorandums
  - Questionnaires

# 2. Risk Assessment

- Organization specifies objectives so it can identify and assess related risks
- Organization identifies risks posed and analyzes risks to determine how risks should be managed
- Organization considers potential for various types of fraud
- Organization identifies and assesses changes that could affect internal controls

# Governing Body and Senior Management Oversight Responsibility

Risk Assessment

- Specifies suitable objectives
- Identifies and analyzes risk
- Identifies and analyzes significant change

# Risk Assessment and Risk Management

- Risk management is a process strategically applied and designed to identify and manage risk within a tolerance level
- Risk assessment is an internal control element within risk management that allows management to identify and assess key risks
  - The risk assessment is the basis for determining control activities

# 3. Control Activities

- Organization selects and develops control activities, including use of technology, to mitigate risk and achieve objectives
- Organization deploys controls activities through policies to establish what is expected and procedures that put policies into action
  - Actions established through policies and procedures help ensure management's directives to mitigate risks are carried out
- Control activities are performed at all levels within the entity

# Control Activities

- Types of control activities:
  - Preventive and Detective
  - Compensating
  - Manual and automated
- Control activity examples:
  - Approvals and authorizations
  - Verifications
  - Reconciliations
  - Independent reviews
  - Asset security
  - Segregation of duties

# Preventive Controls

Prevents the occurrence of a negative event in a proactive manner. Examples:

- Approvals for purchases over $3,000
- Verification that equipment purchases are pre-approved or included in grant budget
- Passwords for access to IT systems
- Pre-numbered checks
- Holding petty cash in a lockbox

# Detective Controls

Detective controls detect the occurrence of a negative event *after the fact* in a reactive manner. Examples include:

- Supervisor review and approval
- Report run showing user activity
- Reconciliation of petty cash
- Physical inventory count
- Review missing and voided checks

# Compensating Controls

- If there is a control weakness or limitation, a *compensating control* may be relied upon to mitigate the risk
- Can be preventive or detective

EXAMPLE: A entity lacks staffing for adequate segregation of duties. Potential compensating controls:

- Automate certain transaction data to limit altering
- Manager reviews detailed summary reports of transactions initiated by staff
- Manager selects sample transactions and vouches to supporting documentation

# Manual and Automated Controls

- Manual controls require action by employees:
  - Obtaining a supervisor's approval for overtime
  - Reconciling a bank account
  - Matching receiving to purchase orders
- Automated controls are built into systems or applications:
  - Data entry validation checks
  - Batch controls

Automated controls are more reliable and cost effective than manual controls

# Governing Body and Senior Management Oversight Responsibility

## Control Activities

Based on the risk assessment and risk management policy:

- Select and develop control activities
- Select and develop controls over IT
- Deploy through policies and procedures

# 4. Information and Communication

- Organization obtains and uses relevant quality information to support the functioning of internal controls
- Organization internally communicates objectives and responsibilities for internal control to support functioning of internal controls
- Organization communicates with external parties regarding matters affecting the function of internal controls

# Information and Communication

- Initiatives
- Goals
- Changes
- Opportunities
- Feedback
- Questions / Answers
- Policies and Procedures
- Standards
- Expectations

Need to communicate

- Policies and procedures manual
- Memorandums
- Directives
- Training, training, training
- Website / intranet
- Meeting deliverables
- If you don't document it did not happen!

Methods of communication

# Governing Body and Senior Management Oversight Responsibility

## Information and Communication

- Communicate necessary information to personnel
- Provide adequate training of controls to responsible staff
- Communicate internally and externally

# 5. Monitoring Activities

- Organization selects, develops and performs ongoing and/or separate evaluations to determine whether components of internal control are present and functioning
  - Organization considers internal and external risks
- Organization evaluates and provides timely communication to senior management and the board of directors, as appropriate regarding internal control deficiencies to foster corrective action

# Monitoring Activities Are

- Evaluations that ascertain whether components of internal control are *present* and *functioning*
- 2 categories of monitoring
  - Ongoing evaluations – built into business processes and provide timely information on underlying controls
  - Separate evaluations – conducted periodically and vary in scope and frequency based on prior assessments of risk, the effectiveness of *ongoing* evaluations, and other management considerations (e.g., resource priorities)
    - Internal Audit activities are a separate evaluation
    - Confirm that findings of audits and other reviews are promptly resolved so internal controls are not compromised

# Monitoring Activity Results

- Monitoring an activity means assessing the performance of an internal control system over a period of time to validate that the control system is operating as expected
  - Includes supervisory review and sign off to help ensure proper checks and balances
- *Findings* should be evaluated against relevant criteria (e.g., how long has the control been compromised, and how high are the risks)
- *Deficiencies*, which are more significant than findings, should be communicated to the Board and Senior Management

# Governing Body and Senior Management Oversight Responsibility

## Monitoring Activities

- Conduct ongoing evaluations
- Evaluate and communicate deficiencies
- Establish and follows up on corrective action plans of deficiencies

# Effective System of Internal Controls

According to COSO, an effective system of internal control requires:

- Each of the 5 components of internal control with relevant principles present and functioning
- All 5 components operating together in an integrated manner

# Grantee and Sub-recipient Responsibilities (200.303 and 200.302)

# Grantee Internal Control Responsibilities – 200.303

- Grantees must take reasonable measures to safeguard protected personally identifiable information and other data the awarding agency designates as sensitive
- Grantees must consider applicable federal, state, and local laws regarding privacy and obligations of confidentiality

# Grantees are Stewards of Grant Funds

- Grantees and subrecipients must carry out goals and objectives stated in the uniform grant agreement
- Grant funds must be used for their intended purposes
  - Grant funds are subject to certain regulations, oversight and audit
  - Grant recipients must account for costs and justify expenditures

# Grantee Financial Management System – 200.302

- Financial management system must include effective control over, and accountability for all funds, property, and other assets
- Records within the financial management system must identify the source and application of funds for grant-funded activities including:
  - authorizations, obligations, unobligated balances, assets, expenditures, income and interest supported by source documentation

# Grantees Must Have

- Effective control over and accountability for all funds, property, and other assets
- Comparisons of expenditures with budget amounts for each grant award
- Written procedures:
  - To comply with cash management requirements
  - For determining allowability of costs in accordance with Cost Principles and terms and conditions of the grant agreement
- If the grantee passes funds, the grantee must also comply with 200.331Requirements for Pass-through Entities

# Federal Uniform Guidance Requires Pre-award Risk Assessments (200.205)

- GATA separates the risk assessment into 2 parts:
  - Fiscal and Administrative (F&A) – conducted once and shared with all grant making agencies
  - Programmatic – conducted with each grant highlighting the programmatic requirements associated with the individual grant program

# Fiscal and Administrative (F&A) Risk Assessment

- Conducted annually after registration and pre-qualification
- Utilizes Internal Control Questionnaire (ICQ)
- ICQ responses must be reviewed by the entity's cognizant agency
  - Cognizant agency – state agency that provided the most funding to the entity in a previous fiscal year (currently FY15 and re-determined every three years)
- Follow-up is encouraged if the cognizant agency believes the entity responded incorrectly (based on prior experience/ knowledge of the entity)
  - ICQ responses can be changed and re-submitted, when appropriate

# ICQ Content

- ICQ covers 10 sections:
  1. Quality of management systems (200.302)
  2. Financial and regulatory reporting (200.237)
  3. Budgetary controls (200.308)
  4. Cost principles (200.400)
  5. Audit (200.500)
  6. Organizational governance (COSO)
  7. Property standards (200.310-316)
  8. Procurement standards (200.317-326)
  9. Sub-recipient monitoring and management (200.330-332)
  10. Fraud, waste and abuse – (COSO)
- ICQ incorporates requirements under:
  - 2 CFR 200
  - Subpart F – Single Audit Compliance Supplement
  - COSO

# State Awarding Agency Responsibilities (200.205 and 200.207)

# Awarding Agency Reviews Risk Posed by the Applicant (200.205)

- Grantee must complete both risk assessments (ICQ and programmatic) prior to making an award
- All grantees are subject to pre-award risk assessment, unless an exception has been authorized
- ICQs are automated and responses are reviewed once by the state cognizant agency
- Programmatic risk assessments are specific to the program application and performed by each awarding agency

# Risk Assessment – Specific Conditions (200.207)

- Cognizant agency reviews and accepts the ICQ
- Automation grades the responses as low, medium or high risk for each of the 10 segments
- Pre-determined specific conditions are automatically assigned based on the risk profile
  - Specific conditions advise grantees and state agencies of internal control weaknesses at the grantee-level
- State agencies utilize specific conditions to correct weaknesses that could result in non-compliance with fiscal and administrative grant requirements

# Specific Conditions

Specific conditions can include:

- Requiring payments to be reimbursement based
- Withholding authority to proceed to the next phase, until performance improves
- Requiring more frequent and/or detail reporting
- Requiring additional project monitoring
- Requiring grantee to obtain technical or management assistance
- Establishing additional prior approvals

# Notification of Specific Conditions

Awarding agency will use the Notice of State Award (NOSA) to notify the applicant of:

- Nature of additional requirements or specific conditions
- Reason why additional requirements are imposed
- Nature of action(s) needed to remove additional requirements, if applicable
- Time allowed for completing the action(s)
- Method for requesting reconsideration of additional requirements imposed

Specific conditions must be removed immediately after acceptable corrective action(s) is taken

# Working Together for Internal Control Compliance

- Internal controls are a backbone of effective operations and federally required
- The ICQ enables state agencies to assess internal controls at the grantee-level
- Capacity building must be needs based
  - Specific conditions are grantee-specific in response to the risk profile

# GATU Contacts for Additional Support

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