

# Internal Controls for Federal Grants

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# Agenda

- What are internal controls
- What does the Uniform Guidance say about I/C
- Green Book/COSO
- Common sense implementation
- Recent adoption project

# What are Internal Controls

## § 200.61 Internal controls

*Internal controls* means a process, implemented by a non-Federal entity, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- (a) Effectiveness and efficiency of operations;
- (b) Reliability of reporting for internal and external use; and
- (c) Compliance with applicable laws and regulations.

# What are Internal Controls over Compliance with Federal Awards

## § 200.62 Internal control over compliance requirements for Federal awards

### *Internal control over compliance requirements for Federal awards*

Means a process implemented by a non-Federal entity designed to provide reasonable assurance regarding the achievement of the following objectives for Federal awards:

- (a) Transactions are properly recorded and accounted for, in order to:
  - (1) Permit the preparation of reliable financial statements and Federal reports;
  - (2) Maintain accountability over assets; and
  - (3) Demonstrate compliance with Federal statutes, regulations, and the terms and conditions of the Federal award;
- (b) Transactions are executed in compliance with:
  - (1) Federal statutes, regulations, and the terms and conditions of the Federal award that could have a direct and material effect on a Federal program; and
  - (2) Any other Federal statutes and regulations that are identified in the Compliance Supplement; and
- (c) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

# Uniform Guidance

- Title 2 US “Code of Federal Regulations” (CFR) Part 200, “Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards”
- Referred to as “The Uniform Guidance”
- Issued December 26, 2013 with an effective date for audits of fiscal years that begin after December 26, 2014 for non-Federal entities; (Massachusetts for fiscal years ending June 30, 2016 forward)

# Non-Federal Entites

- Non-Federal entities include:
  - States and Commonwealths
  - Agencies of States and Commonwealths
  - United States possessions
  - Indian Tribal Governments
  - Cities
  - Towns
  - School Districts
  - Special Purpose Districts
  - Housing Authorities
  - Redevelopment Authorities
  - All other Authorities and Districts
  - Non-Public Organizations

# Section 303 – Internal Control

## § 200.303 Internal controls

The non-Federal entity *must*:

(a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award. These internal controls *should* be in compliance with guidance in “Standards for Internal Control in the Federal Government” issued by the Comptroller General of the United States and the “Internal Control Integrated Framework”, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

# Focus of Section 303

- The focus of the Uniform Guidance is internal control over grant administration and reporting
  
- Best practices would be to implement Green Book throughout the organization
  - Schools
  - Enterprises
  - City/town
  
- However, the requirement is grant administration

# What Does “Should” Mean?

- The use of the word “**should**” has raised some concern as it seems to imply that adopting an internal control framework is optional. However, Federal officials [and the AICPA] have made it clear that where Federal programs require effective internal controls, the expectation is that these systems meet or exceed the standards set by GAO.

*Source: National Grant Management Association*

# A Framework

- The Uniform Guidance recommends that this internal control system be based on a recognized internal control framework
  - GAO – **Green Book**
  - COSO – Committee of Sponsoring Organizations – Treadway Commission

# Green Book/COSO

- **Green Book** defines internal controls as a process affected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity are achieved. It is the first line of defense in safeguarding public resources.
- Full copy obtained at [www.gao.gov/greenbook](http://www.gao.gov/greenbook)

# Green Book/COSO (cont'd)



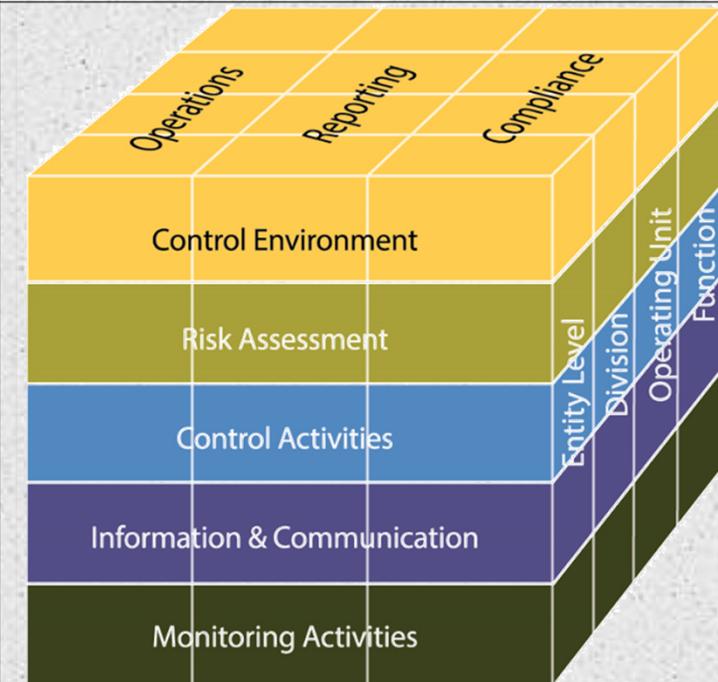
Source: GAO. | GAO-14-704G

# Green Book/COSO (cont'd)

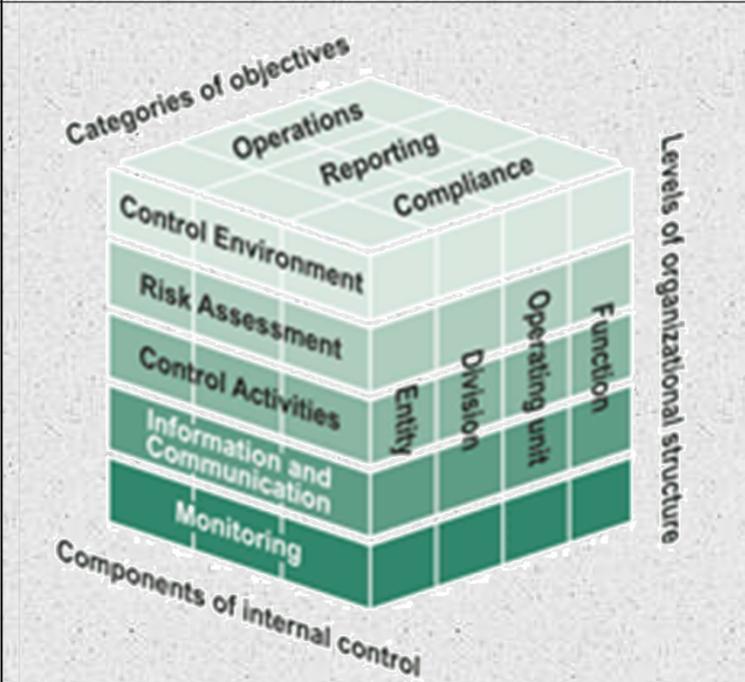
- What are the objectives the Green Book is speaking to?
  - Operations – effectiveness and efficiency of operations
  - Reporting – reliability of reporting for internal and external use
  - Compliance – compliance with applicable laws and regulations [**including The Uniform Guidance**]
  
- The **Green Book's** internal control framework, which consists of five components of internal control, is remarkably consistent with the COSO internal control framework as illustrated on the following slide:

# Green Book/COSO (cont'd)

This is the COSO "cube"



This is the Green Book "cube"



# Green Book/COSO (cont'd)

|  |  |
|--|--|
| <p>1 – The Control Environment<br/> <b>Five (5) individual principles of internal control</b></p>        | <p>This is best described as the “tone from the top.”<br/>         How seriously does your organization take internal controls? Is your organization committed to sound operational practices?</p>   |
| <p>2 – Risk Assessment<br/> <b>Four (4) individual principles of internal control</b></p>                | <p>How does the organization evaluate risks that affect its operating objectives?</p>  |
| <p>3 – Control Activities<br/> <b>Three (3) individual principles of internal control</b></p>            | <p>Has the organization documented its internal control system? Is it following these formal policies and procedures?</p>  |
| <p>4 – Information and Communication<br/> <b>Three (3) individual principles of internal control</b></p> | <p>Have policies and procedures been provided to employees and have the employees been trained?<br/>         Is the organization using accurate and relevant data? How does the organization ensure compliance with external reporting requirements?</p> |
| <p>5 – Monitoring<br/> <b>Two (2) individual principles of internal control</b></p>                      | <p>How does the organization monitor the performance of its internal controls? How does it implement corrective actions? How does it follow up on deficiencies?</p>  |

# Green Book/COSO (cont'd)

## The Five Components and 17 Principles of Internal Control

### Control Environment

1. The oversight body and management should demonstrate a commitment to integrity and ethical values.
2. The oversight body should oversee the entity's internal control system.
3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.
4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.
5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

### Risk Assessment

6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.
7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.
8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.
9. Management should identify, analyze, and respond to significant changes that could impact the internal control system.

### Control Activities

10. Management should design control activities to achieve objectives and respond to risks.
11. Management should design the entity's information system and related control activities to achieve objectives and respond to risks.
12. Management should implement control activities through policies.

### Information and Communication

13. Management should use quality information to achieve the entity's objectives.
14. Management should internally communicate the necessary quality information to achieve the entity's objectives.
15. Management should externally communicate the necessary quality information to achieve the entity's objectives.

### Monitoring

16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.
17. Management should remediate identified internal control deficiencies on a timely basis.

# A Common Sense Approach

- The dollar amount, volume of federal awards and complexity of these awards will dictate how you achieve your goal – compliance!
- If vast majority are educational grants (i.e., SPED, Title I, School Lunch ...), this will be light
- If your organization has significant grants from CDBG, DOT, USDA, this gets more complicated

# US Dept. of Ed Guidance

- The US Dept of Education published a guide on implementing Uniform Guidance internal control for state agencies
- Has applicability to cities, towns and school districts
- 7 step process
- <https://www2.ed.gov/policy/fund/guid/uniform-guidance/fundsguidance.pdf>

# How does a Community Implement

- Form most, focus is on compliance with federal awards and their reporting requirements – very different from Green Book for the entire organization!
- 10 step formula
  - Substantially similar to DOE's 7 step
  - Vary widely organization to organization based on the nature, volume, risk and dollar amount of federal grants

## Step 1 – Identify All Federal Grants

- Skip the Control Environment and jump right to Risk Assessment
- Step 1 – Identify all federal grants received and expended by your organization
  - If you're stuck on whether a grant is federal or state, refer to grant document and last year's SEFA as a guide

## Step 2 – Quantitative Risk Assessment

- Step 2 – Perform a **quantitative** risk assessment
  - Sort the federal awards by their total award dollars
  - The greater the amount of award monies you receive from a particular grant, the greater significance and therefore risk is presents in a **quantitative** risk assessment

## Step 2 – Quantitative Risk Assessment (cont'd)

- Example: XYZ Town's finance director determined total federal grants for this year would approximate \$3 million.
  - Airport grants (DOT) totaled \$2.2mm
  - SPED (DOE) totaled \$300K
  - No other federal "cluster" exceeded \$100K (9 clusters in total)
- Quantitatively, the Airport and SPED are of greatest risk – 83% of total federal dollars

## Step 3 – Qualitative Risk Assessment

- Step 3 – Perform a **qualitative** risk assessment
  - This is very subjective and requires an understanding of the federal awards and the organization
    - Is there a history of audit findings?
    - Is the department head new to this job/federal award?
    - Are there related-party transactions that need to be addressed?
    - Are there procurement matters to consider?
    - Where can fraud present itself?

## Step 3 – Qualitative Risk Assessment (cont'd)

- How effective is the oversight body (i.e., Airport Commission/School Committee in our example)
- Are the periodic financial reporting requirements difficult?
- Are there subrecipients? How do they report to your organization?
- Will the award span over multiple accounting periods?
- Will equipment or construction be purchased/performed?
- Will payroll be paid from the grant?

## Step 3 – Qualitative Risk Assessment (cont'd)

- Has there been recent changes in compliance requirements for the grant(s)?
- Does the organization have the needed funds to prepay goods/services before getting reimbursed or provide its required level of funding?
- Does the department simply record a year-end journal entry to the award for costs?
- Does the organization has an accounting system that can adequately account for the federal award?
- Does the organization have a disaster recovery plan?
- Each year the Fed's publish a compliance supplement that includes a matrix of compliance requirements. This may assist you in your qualitative risk assessment.

## Step 4 – Risk Assessment Grid

- Step 4 – Document Steps 2 & 3!
- Make a risk assessment grid as follows:
  - Identified risk
  - Impact the risk has to the organization's compliance with the federal grant(s)
  - Controls in place to address the risk
    - See step 6
  - How significant is this risk?
    - Low/Moderate/High
  - Does the control(s) in place reduce the risk to an acceptable level?

# Step 4 – Risk Assessment Grid (cont'd)

The following summarizes the risks identified, assessed impact to the overall internal control system, controls put in place to address the risks and exposure.

| No. | Risk Area  | Impact to Airport's Compliance w/ Federal Grant  | Controls in Place to Address Risk   | Significance of Risk | Risk Acceptable With Controls |
|-----|--|--|---|----------------------|-------------------------------|
| 1   | The Airport does not maintain sufficient documentation for AIP project costs | The Airport's inability to produce supporting documentation for AIP reimbursed expenses may subject it to repaying the FAA for these costs.  | <p>The Airport's engineer aggregates all reimbursement request data, invoices and forms and signs off as project engineer on these forms. The Airport Business Manager maintains copies of these in hard and soft copy formats.</p> <p>The Airport Office Manager maintains as a permanent file grant application, award and procurement documentation.</p>   | Nominal              | Yes                           |
| 2   | The Airport pays ineligible/unallowed goods/services paid with AIP monies    | Monies expended from AIP awards are paid for ineligible projects per the terms of the AIP award and FAA AIP regulations and may subject the Airport to repay the FAA for these ineligible costs. | <p>The Airport's engineer aggregates all reimbursement request data, invoices and forms and signs off as project engineer on these forms. The Airport engineer has significant experience in airport operations and grant administration. The Airport engineer will reference FAA Advisory Circulars ("ACs") and the FAA's AIP handbook when needed.</p> <p>The Airport Business Manager will code all purchase requisitions to AIP projects based on knowledge of the Airport's AIP programs, which better ensures that only AIP qualified costs are being coded to AIP projects in MUNIS.</p> <p>The Airport Business Manager reviews all AIP invoices prior to submission to the Airport</p> | Nominal              | Yes                           |

## Step 5 – Identify Controls That Address Risks

- Step 5 – Based on my risk assessment, identify internal controls that address the risks identified.
  - Document these controls
  - Document where control enhancements are needed

## Step 5 – Identify Controls That Address Risks (cont'd)

- Examples of controls that mitigate risk include:
  - Communication of grant award between department and finance director/accountant
  - Multiple levels of review of federal award accounting
    - Department Head
    - SBM/Airport Commissioner
    - Finance Director
  - Regular reconciliation of accounts
  - Training
  - Management experience

## Step 5 – Identify Controls That Address Risks (cont'd)

- Municipality's budget process
- Purchase requisition to purchase order process
- Vendor warrant process
- Cash receipt process
- Vendor web access by department as well as treasury and accounting
- Bank account reconciliations
- Regular budget-to-actual and special revenue account reviews
- Financial reporting package is maintained and source accounting records (i.e., MUNIS) can be reconciled to the federal financial reports

## Step 6 – Policies & Procedures

- Step 6 – Does my organization have policies and procedures surrounding grant administration, compliance and reporting?
  - If so, evaluate the policies to determine if they are relevant
  - If not, it's likely that you should develop several grant management policies to address:
    - Application process
    - Receipts and disbursement processes (including approval and review to ensure expenditures are allowable) \*
    - Procurement compliance practices \*
    - Day-to-day accounting \*
    - Reconciliation
    - Financial reporting

*Note that Steps 6 & 7 are generally done at same time*

## Step 7 – Document Processes and Controls

- Step 7 – For federal awards that are quantitatively and/or qualitatively risky, document for the **key business cycles**:
  - the flow of information and transactions,
  - controls that the organization can rely upon, and
  - gaps in controls.
- Gaps are generally okay in initial year provided you have a plan to address them in the future!
- Timing of resolution depends on the severity of the gap. Serious gaps should be addressed ASAP while minor gaps may take several months to resolve.

## Step 7 – Document Processes and Controls (cont'd)

- Examples of key business cycles:
  - Grant application process
  - Expenditures
  - Payroll
  - Procurement compliance
  - Capital improvement plan
  - Property management
  - Reimbursement requests
  - Reimbursement receipts
  - Account reconciliations
  - Document retention
  - Subrecipient monitoring
  - Financial reporting

# Step 8 – The Control Environment

- Step 8 – Document your control environment
  - “Softer side” of internal controls
  - Tone from the top
    - Biennial conflict of interest testing
    - Fraud and harassment policy
    - Whistleblower protections
    - Staff meetings (key for open communication)
    - Documented job responsibilities and expectations
    - Use of performance reviews

## Step 9 – Communication

- Step 9 – Document how controls are communicated
  - Policies and procedures manuals accessible to all working with the grant's accounting
  - Regular staff meetings
  - How does I/T play a role in grant administration?

## Step 10 – Monitoring

- Step 10 – How will you monitor this Green Book in future periods?
  - Initial year – generally a discussion that this document will be reviewed for relevancy annually or when circumstance require attention.
  - Subsequent years – a statement that a review was performed, document remediations performed

# MASBO Policies & Procedures Manual Template

## ➤ Common inquiry

- So, I have this Internal Control Manual for Federal Grants template that MASBO provided by School Business Manager. Can't I just change the names in this report and be done with this?
  - The MASBO controls manual is very good. However, it is one component of the internal control system. It addresses portions of the Control Activities component of internal control. It does not address the other 4 components.
  - The MASBO controls manual likely doesn't cover your CDBG, public safety, public works and other significant grants.

# Airport Green Book Example

- A total of 316 pages ... lots of exhibits and half-full pages
- Organized with an executive summary, excerpts from Uniform Guidance, full copy of Green Book and principle by principle.
- Exhibits may be useful depending on the programs you are documenting.
- The level of documentation depends on management's determination of risk, the intended use of the financial data, presence or absence of previous audit findings and dollar amount of transactions.
- Can be as little as a dozen pages, if that's all that's needed!

# Questions

