



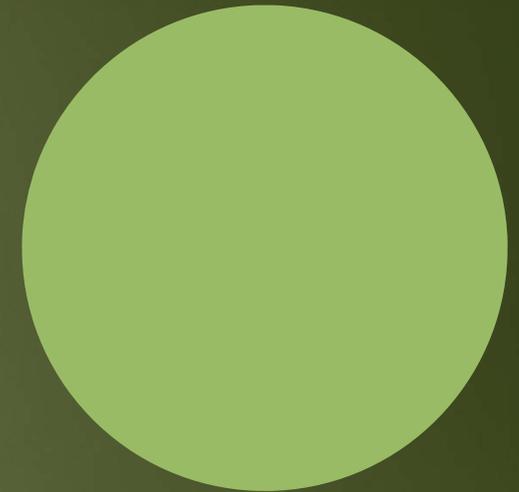
# 2016 Legal & Ethics Conference

**AUDITOR BREAK OUT SESSION II:**

INTERNAL CONTROLS – OVERVIEW, REQUIREMENTS & EXAMPLES

# Internal Controls – Overview, Requirements & Examples

- ▶ Overview of Internal Controls
- ▶ Auditee Requirements
- ▶ Auditor Requirements
- ▶ Internal Control Examples



# Internal Controls - Overview

## ▶ Internal Control References

- ▶ Chapter 2, Accounting & Uniform Compliance Manual for State & Quasi Agencies
- ▶ Part 6, June 2016 Federal Compliance Supplement
- ▶ "Standards for Internal Control in the Federal Gov't" (GAO Green Book)
- ▶ "Internal Control Integrated Framework" (COSO)
- ▶ Uniform Guidance – 2 CFR 200.62 – IC Over Compliance Requirements for Federal Awards

# Internal Controls - Overview

## ▶ 2 CFR 200.62 – IC Over Compliance Requirements for Federal Awards

- ▶ A process, implemented by a non-Federal entity, designed to provide reasonable assurance regarding the achievement of the following objectives for Federal awards:
  - ▶ Transactions are properly recorded & accounted for, in order to:
    - ▶ Permit the preparation of reliable financial statements and federal reports
    - ▶ Maintain accountability over assets; and
    - ▶ Demonstrate compliance with federal statutes, regulations, and the terms and conditions of the Federal award:
  - ▶ Transactions are executed in compliance with:
    - ▶ 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
    - ▶ Any other federal statutes and regulations that are identified in the compliance supplement; and
  - ▶ Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

# Internal Controls - Overview

- ▶ 5 Components of Internal Control:

<http://www.gao.gov/assets/670/665712.pdf> - GAO Green Book

- ▶ Control Environment – Refers to the attitude of management and staff regarding internal controls. Do you take internal controls seriously, or do you ignore them?
- ▶ Risk Assessment – Identifying your riskiest areas and implementing controls to prevent or detect errors or fraud that could result in material misstatements.
- ▶ Control Activities – Policies & procedures you have implemented that help ensure that management's directives are carried out.
- ▶ Information & Communication – Ensuring information is recorded and communicated to management and other staff who need it in a manner that enables them to carry out the internal control and other responsibilities.
- ▶ Monitoring – Management's evaluation of internal controls and the effectiveness of those internal controls implemented.

# Internal Controls – Auditee Requirements

- ▶ **Uniform Guidance – 2 CFR 200.303**
- ▶ Non-Federal Entity MUST:
  - ▶ Establish & maintain effective internal control over the federal award
  - ▶ Comply with federal statutes, regulations, and terms & conditions of the federal award
  - ▶ Evaluate & monitor their compliance with above items
  - ▶ Take prompt action when instances of non-compliance are identified, including non-compliance identified in audit finding
  - ▶ Take reasonable measures to safeguard protected personally identifiable information or other sensitive info

# Internal Controls – Auditor Requirements

- ▶ 2 CFR 200.514(c) *Scope of audit – Internal Controls (UG)*:
  - ▶ Requires auditor to perform procedures to obtain an understanding of internal controls over federal programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program - 2 CFR 200.514(c)(2)
  - ▶ Requires auditor to plan testing of IC over compliance to support low assessed level of control risk – 2 CFR 200.514(c)(3)(i)
  - ▶ Perform testing of key controls as planned in above – 2 CFR 200.514(c)(3)(ii)

# Internal Controls – Auditor Requirements

- ▶ Based on testing of key controls completed (Design & Implementation & Effectiveness Testing):
  - ▶ Determined key controls to be effective in preventing or detecting material non-compliance
    - ▶ Proceed to Compliance testing for specific compliance requirement
  - ▶ Determined key controls are NOT effective in preventing or detecting material non-compliance
    - ▶ Increase Compliance testing based on evaluation of control risk
    - ▶ Required to report Significant Deficiency or Material Weakness in federal audit finding. – 2 CFR 200.516
      - ▶ Significant Deficiency – a control deficiency, or a combination of control deficiencies, that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Deficiency noted adversely affects the entity's ability to administer a Federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected.
      - ▶ Material Weakness – a significant deficiency, or combination of significant deficiencies, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

# Internal Controls – Case Study 1 – Allowed/Unallowed Activities & Allowable Cost/Cost Principles

- ▶ Scenario:
  - ▶ Susie works for a state agency as a program director over a federally funded program. All expenditures that are charged to this federal program are reviewed by Susie, to ensure it's an allowable activity, prior to the A/P Clerk inputting the A/P voucher into the state's accounting system. Susie does not maintain supporting documentation of her A/P voucher approval, rather, she verbally informs the A/P Clerk that the bundle of vouchers she put on the A/P Clerk's desk are reviewed and ready to pay.
  
- ▶ What is the Key Internal Control present?
- ▶ Is it designed properly?

# Internal Controls – Case Study 2 – Cash Management

- ▶ Scenario:
  - ▶ Margo works in the federal program cash management division within state government. She prepares the cash draw request for numerous individual federal programs (Reimbursement Grants Only). She generates an expenditure query from the state's accounting system and gathers pertinent documentation to support the cash draw requests for each federal program. She provides the draw requests, with the supporting documentation, to her supervisor Greg for final review/approval prior to the cash draw being requested from the Feds. Greg reviews the draw request and supporting documentation for accuracy and ensures that all disbursements were paid by the State prior to the draw request date. Greg initials and dates the cash draw request, indicating his review of the draw.
  
- ▶ What is the Key Internal Control present?
- ▶ Is it designed properly?

# Internal Controls – Case Study 3 - Reporting

- ▶ Scenario:
  - ▶ Tom is the CFO for a state agency and is tasked with the duty of ensuring the quarterly financial reports are accurate and submitted timely. Tom runs reports from the state's accounting system and uses these figures in preparing the quarterly financial reports. He compares the quarterly reports to the system report figures, foots, and cross-foots the quarterly report. He signs off on the report and submits it electronically.
- ▶ What is the Key Internal Control Identified?
- ▶ Is it designed properly?