

# Internal Controls

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# Purpose

To discuss the importance of understanding and evaluating internal controls during on-site subrecipient monitoring visits.



# Subrecipient Monitoring

Regulations require monitoring of subrecipients. However, the state is given flexibility with implementation of its monitoring program.

- According to OMB Circular A-133, A pass-through entity shall...monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- OMB Circulars A-102 and A-110 require that non-Federal entities receiving Federal awards establish and maintain internal control designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements.
- Section 80.40 of EDGAR requires grantees to monitor their subgrantees to ensure compliance with applicable federal requirements and that performance goals are achieved.



# Subrecipient Monitoring (cont'd)

Monitoring programs should be comprehensive and include desk reviews, a review of budgets, reviewing audit reports, on-site monitoring visits, etc.

Monitoring should include the review of internal control to determine if the financial management and accounting system are adequate to account for program funds in accordance with state, federal, or other requirements.



# What are Internal Controls?

Internal Controls are mechanisms and processes established and controlled by management to provide **reasonable assurance** related to the following objectives:

- Reliable financial reporting;
- Efficient and effective operations; and
- Compliance with laws and regulations.

Internal controls should be proactive, value-added, and cost effective.

When designed and operating effectively, internal controls can often prevent and detect fraud



# Who is Responsible for Internal Controls?

Management of an organization is responsible for ensuring that internal controls are properly designed and put in place. Staff is responsible for ensuring those internal controls are properly followed. All levels of an organization have a role in ensuring that internal controls are established and followed.

- Internal control impacts every aspect of an organization - all of its people, processes and activities.
- Internal control is a basic element that permeates an organization.
- Internal control is dependent upon people and will succeed or fail depending on the attention people give to it.
- Internal control is effective when all of the people and the surrounding environment work together.



# COSO's Internal Control Framework

Controls should be assessed and evaluated in relation to the following five components:

- Control Environment - sets the tone of an organization and serves as the foundation for the other components of internal control.
- Risk Assessment - management's formal process for assessing its operating environment and taking actions.
- Control Activities - the policies and procedures implemented that help ensure that objectives are followed.
- Information and Communication - the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
- Monitoring - a process that assesses the quality of internal control performance over time.



# Internal Control Weaknesses

Inadequate segregation of duties

- The same person should not be responsible for authorization, recording, and custody. For example, someone in accounts payable should not have the ability to establish new vendors and the ability to authorize payments.

Assets are not properly safeguarded

- Assets purchased with federal grant funds should be properly safeguarded. Ensure controls are in place to inventory, reconcile and account for all assets purchased.

Lack of proper approvals and authorization

- Documents are not properly authorized before the transaction occurs.



# Weaknesses (cont'd)

Procurement practices do not adhere to procurement guidelines

- o Ensure procured goods and services are the result of arms-length transactions.

Poor and/or limited supporting documentation for transactions or activities

- o Payments are made to vendors based on improper supporting documentation.

Accounting system does not segregate federal awards and expenditures from non-federal expenditures

Expenditure reports for reimbursement do not agree to the general ledger

No formal document retention policy or support destroyed before time



# Monitoring Results

- Notify subrecipients of your monitoring results in writing and request corrective action within a specified period of time.
- Share any findings and internal control weaknesses with the Single Audit Section.
- Follow-up with all corrective actions.



# Questions

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