

The logo for FORVIS, featuring the word "FORVIS" in a bold, red, sans-serif font. A registered trademark symbol (®) is located at the top right of the letter "S".

**FORVIS<sup>®</sup>**

A decorative graphic on the right side of the slide, consisting of a grid of overlapping, semi-transparent red rectangles that create a 3D effect of depth and perspective.

# **Internal Controls and Grant Compliance**

AGA Ozarks Chapter / November 15, 2023

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# Presenter



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# WHY ARE YOU HERE?

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# Learning Objectives

- Reinforce basic understanding of internal controls
  - Distinguish between processes and controls
- Recognize the components of internal control
- Apply understanding to internal controls over compliance
  - Identify entity-wide controls versus specific controls for each type of compliance requirement

# Agenda

- Overview of Internal Controls
- Internal Control Standards
- Examples of Internal Controls
- Internal Controls and Single Audits
- Questions
- Resources and References

# Overview of Internal Controls

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# Definition of Internal Controls

Mechanisms designed and implemented by an entity to provide reasonable assurance regarding the achievement of the entity's objectives in the following areas:

- Effectiveness and efficiency of operations
- Reliability of reporting for internal and external use
- Compliance with applicable laws and regulations

# Objectives of Internal Control over Compliance

- Transactions are properly recorded and accounted for in order to:
  - Permit the preparation of reliable financial statements and federal reports
  - Maintain accountability over assets
  - 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
  - Any other federal statutes and regulations that are identified in the Compliance Supplement
- Funds, property and other assets are safeguarded against loss from unauthorized use or disposition



# Importance of Internal Controls

- Safeguard assets
- Protect employees
- Provide more accurate financial statements
- Reduce risk of noncompliance with laws and regulations
- Reduce risk of de-obligation of federal funds
- Reduce risk of fraud, waste, and abuse

# Process versus Control

Process (Compliance)	Control (Internal Control over Compliance)
<ul style="list-style-type: none"><li>▪ Captures data</li><li>▪ Changes data</li><li>▪ Introduces errors</li></ul>	<ul style="list-style-type: none"><li>▪ Does not change data</li><li>▪ Prevents or detects and corrects instances of noncompliance</li><li>▪ Cannot introduce/generate errors</li></ul>
<p><b>Example:</b> Cost is recorded in the general ledger as an allowable charge under the grant provisions</p>	<p><b>Example:</b> Review of costs charged to grant for allowability and agreement to the GL</p>

# Process versus Control

- Controls may be viewed as part of a process and the flow of transactions, but need to be separately identified
- When identifying controls, first consider the processes and the resulting “what-could-go-wrong”
- When it is difficult to differentiate between the process and the control, its often because the control is missing
- Process owners = doers; control owners = reviewers

# Types of Controls

- Preventative controls
  - Designed to avoid unintended results
  - Catch problems before they begin
- Detective controls
  - Designed to discover an unintended event after it has occurred but before it becomes an issue

Both types of controls should be used in an effective control environment

# How Good are Your Internal Controls?

- General characteristics of satisfactory internal controls:
  - Policies and procedures that provide for appropriate segregation of duties to reduce the likelihood that deliberate fraud can occur
  - Personnel qualified to perform their assigned responsibilities
  - Sound practices to be followed by personnel in performing their duties and functions
  - A system that ensures proper authorization and recording procedures for financial transactions

# Uniform Guidance – 2 CFR 200.303

Non-federal entity responsibilities include:

- Establish and maintain effective internal control over federal awards that provides reasonable assurance that the nonfederal entity is managing federal awards in compliance with federal statutes, regulations, and the terms and conditions of federal awards
- Comply with federal statutes, regulations and the terms and conditions of federal awards
- Evaluate and monitor compliance with statutes, regulations, and the terms and conditions of federal awards
- Take prompt action when instances of noncompliance are identified
- Take reasonable measures to safeguard protected personally identifiable information

# Introduction to Internal Control Standards

- Best practice per Uniform Guidance is for internal controls to be compliant with guidance in either
  - “Standards for Internal Control in the Federal Government” (the Green Book) issued by the Comptroller General of the United States
  - “Internal Control Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)

# Internal Control Standards

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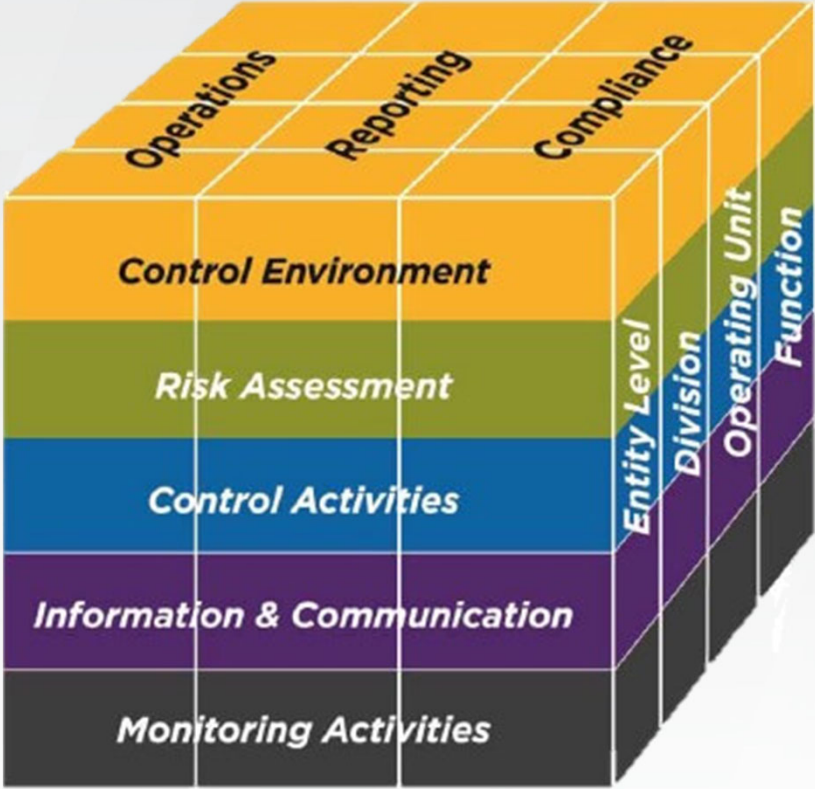


# COSO Framework

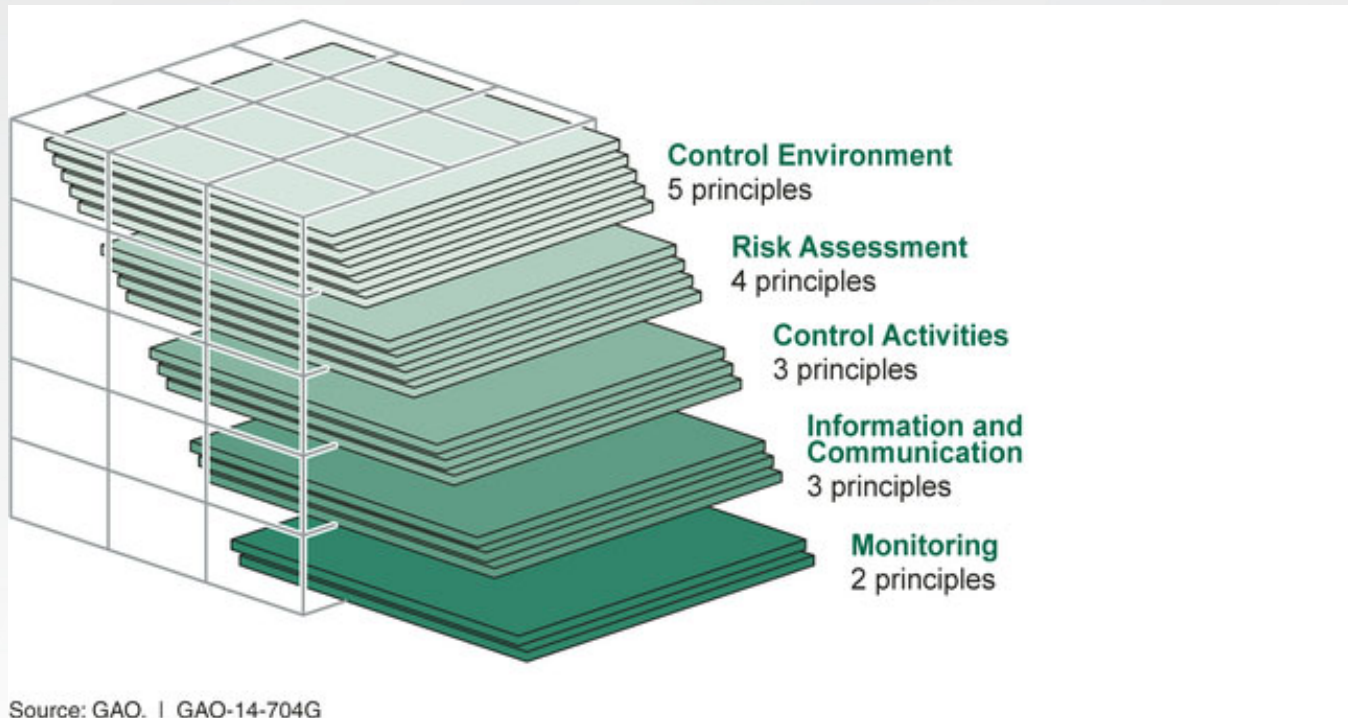
Direct relationship exists between:

- Objectives – what an entity strives to achieve
- Components – what is required to achieve the objectives
- Organizational structure

# COSO Framework



# Green Book Components of Internal Control



# Components of Internal Control

- Control environment
- Risk assessment
- Control activities
- Information and communication
- Monitoring

# Control Environment

- Foundation for an internal control system – Provides the discipline and structure to help an entity achieve its objectives
- Principles:
  - Demonstrate commitment to integrity and ethical values
  - Exercise oversight responsibility
  - Establish structure, responsibility, and authority
  - Demonstrate commitment to competence
  - Enforce accountability

# Risk Assessment

- Assesses the risks facing the entity as it seeks to achieve its objectives and provides the basis for developing appropriate risk responses
- Principles:
  - Define objectives and risk tolerances
  - Identify, analyze, and respond to risks
  - Assess fraud risk
  - Identify, analyze, and respond to change

# Control Activities

- Actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity's information system
- Principles:
  - Design control activities
  - Design activities for the information system
  - Implement control activities

# Information and Communication

- Quality information management and personnel communicate and use to support the internal control system
- Principles:
  - Use quality information
  - Communicate internally
  - Communicate externally



# Monitoring

- Activities management establishes and operates to assess the quality of performance over time and promptly resolve the findings of audits and other reviews
- Principles:
  - Perform monitoring activities
  - Evaluate issues and remediate deficiencies

# Examples of Internal Controls

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# Entity-Wide Controls versus Specific Controls

## Entity-Wide Controls

- Typically covers four of the five components:
  - Control environment
  - Risk assessment
  - Information and communication
  - Monitoring
- Considered governance controls that apply to most, if not all, types of compliance requirements for one or more federal programs
- Example: Code of conduct sets tone at the top

# Entity-Wide Controls versus Specific Controls

## Specific Controls

- Typically covers control activities, the remaining component, for each type of compliance requirement
- Considered operational-level controls that apply to individual types of compliance requirements
- Example: Control over identification of allowable costs

## Entity-Wide Controls versus Specific Controls

**CAUTION**



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- Specific controls may be established for components typically having entity-wide controls
- Federal programs may be administered under multiple internal control structures
- Illustrative controls discussed here are only a portion of those included in Part 6 of the Compliance Supplement, which is not intended to be all-inclusive or a checklist of required internal control characteristics

# Entity-Wide Controls

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# Control Environment: Principle 1

The oversight body and management should demonstrate a commitment to integrity and ethical values

- A code of conduct is developed, documented, communicated and periodically updated
- A code of conduct explicitly prohibits inappropriate management override of established controls
- Conflict of interest statements are obtained periodically from those charged with governance (TCWG) and key management

# Control Environment: Principle 5

Management should evaluate performance and hold individuals accountable for their internal control responsibilities

- Appropriate performance evaluations are provided that establish goals, accountability, and feedback
- Consequences for noncompliance with the code of conduct are communicated and enforced
- Penalties for inappropriate behavior are adequate and publicized



# Risk Assessment: Principle 6

Management should define objectives clearly to enable the identification of risks and define risk tolerances

- Management establishes an effective risk assessment process that includes the use of a specific risk matrix
- Management identifies key compliance objectives for types of compliance requirements
- Management identifies and evaluates risk tolerances related for controls over compliance

## Risk Assessment: Principle 8

Management should consider the potential for fraud when identifying, analyzing, and responding to risks

- If an internal audit function exists, it reviews fraud risks and the internal control structure
- Management reviews audit findings to identify fraud risks
- TCWG periodically review a report of the potential fraud risks identified and actions taken in response to those risks during the period

# Information and Communication: Principle 13

Management should use quality information to achieve the entity's objectives

- Financial and programmatic systems capture, accurately process, and timely report pertinent information
- The accounting system provides for separate identification of federal and non-federal transactions
- Adequate source documentation exists to support amounts and items reported

# Monitoring: Principle 17

Management should remediate identified internal control deficiencies on a timely basis

- Findings, recommendations and other observations by independent auditors, internal auditors, and federal auditors are distributed and reviewed by those individuals responsible for compliance with federal requirements
- Control deficiencies and instances of noncompliance are reported to and evaluated by management and TCWG, if applicable, for resolution on a timely basis

# Specific Controls

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# Control Activities: Principle 10

Management should design control activities to achieve objectives and respond to risks

- Activities Allowed or Unallowed and Allowable Costs/Cost Principles – Supervisors review and approve invoices, cost allocations, efforts of personnel, fringe benefits and indirect charges for allowability, adherence to cost principles, accuracy, and completeness
- Period of Performance – Supervisors review and approve invoices, cost allocations, efforts of personnel, fringe benefits and indirect charges to ensure they were incurred during the period of performance

# Control Activities: Principle 10

Management should design control activities to achieve objectives and respond to risks

- Cash Management – Drawdowns are reviewed/authorized by supervisors to ensure that amount requested minimizes the time elapsing between the transfer of funds from the US Treasury/Pass-Through Entity and their disbursement
- Eligibility – Manual checklists or automated processes used when making eligibility determinations are reviewed and approved by a knowledgeable supervisor

# Control Activities: Principle 10

Management should design control activities to achieve objectives and respond to risks

- Equipment and Real Property Management – A sample of physical inventory counts are reperformed by a supervisor to ensure accuracy
- Reporting – Knowledgeable supervisors review and approve reports for completeness and accuracy, including comparing to source documentation (general ledger, third party evidence or other reliable records) and any reconciliations between source data to final reporting



# Control Activities: Principle 11

Management should design the entity's information system and related control activities over technology to achieve objectives and respond to risks

- Activities Allowed or Unallowed and Allowable Costs/Cost Principles
  - The information system configuration is set up such that invoices, payroll authorization forms and time sheets are only routed to personnel who have the authority to approve them for coding and payment
- Cash Management – Access to the external electronic drawdown information system(s) is (are) restricted to authorized individuals

# Control Activities: Principle 11

Management should design the entity's information system and related control activities over technology to achieve objectives and respond to risks

- Matching, Level of Effort, Earmarking – The information system configuration prevents amounts or other data from being applied as match for more than one federal funding source
- Procurement and Suspension and Debarment – The information system (procurement card system, purchase order system, etc.) is configured for purchasing/approval hierarchy and any quantity or monetary limits depending on the purchasing authority of the user

# Control Activities: Principle 12

Management should implement control activities through policies

- Activities Allowed or Unallowed and Allowable Costs/Cost Principles – Written policies/procedures exist outlining processes and control activities for costs coded to federal awards (award set-up, cost of personnel and fringe, direct costs other than personnel, indirect costs, etc.)
- Subrecipient Monitoring – Written policies/procedures exist outlining processes and control activities for oversight of subrecipients

# Reminder from an Auditor



Written policies and procedures are required for:

- Allowability of costs – 2 CFR 200.302(b)(7)
- Cash management – 2 CFR 200.302(b)(6), 2 CFR 200.305(b)(1)
- Procurement – 2 CFR 200.318(c), 2 CFR 200.319(d)
- Subrecipient monitoring – 2 CFR 200.332(d)

# Internal Controls and Single Audits

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# Auditor Responsibilities

- Perform procedures to obtain an understanding of internal control over compliance
  - Includes both evaluating the design of the control and determining whether the control has been implemented
  - If internal control is likely to be ineffective in preventing and detecting noncompliance, report a significant deficiency or material weakness and consider whether additional compliance testing is needed

# Auditor Responsibilities

- Plan and perform testing of internal control over compliance
  - Includes testing operating effectiveness of internal control
- Report on internal control over compliance describing the scope of the testing of internal control and the results of the tests and, where applicable, referring to the separate schedule of findings and questioned costs

# Auditor Responsibilities

- Obtaining an understanding and testing controls technically only applies to major programs and compliance requirements that are subject to audit and direct and material for each major program
  - Entity is still responsible for compliance with compliance requirements not subject to audit and internal control over compliance
  - May obtain an understanding of internal control as part of risk assessment process in determining major programs
  - If non-major program is material to the financial statements, may need to obtain an understanding of the internal control over financial reporting



# Audit Procedures

- Procedures for gaining an understanding of internal control over compliance and an assessment of the risks of noncompliance may be performed concurrently
- Some tests of the operating effectiveness of controls may be performed concurrently with obtaining an understanding of controls
- Obtaining an understanding of controls ordinarily does not provide sufficient evidence about their operating effectiveness

# Audit Procedures

- Testing compliance gives indirect evidence on the effectiveness of controls but cannot serve as the basis for assessing controls as operating effectively
- “Dual purpose test”
  - Auditor may design a test of controls to be performed concurrently with a test of details on the same transactions

**Have you ever wondered what your auditor is doing?**



**What have you always wanted to know about your Single Audit, but been afraid to ask?**

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# Questions

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# Resources and References

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# Internal Control Standards & Regulations

- COSO Internal Control – Integrated Framework
  - [Executive Summary \(coso.org\)](https://www.coso.org)
- [GAO Standards for Internal Control in the Federal Government](#)
- [Uniform Guidance](#)

# Compliance Supplement

## [Part 6 - Internal Control \(whitehouse.gov\)](http://whitehouse.gov)

- Summary of the requirements for internal control for both nonfederal entities receiving federal awards and auditors performing Single Audits
- Background discussion on important internal control concepts
- Appendices that include illustrations of entity-wide internal controls over federal awards and internal controls specific to each type of compliance requirement

# Other Resources and References

## [Part 3 - Compliance Requirements \(whitehouse.gov\)](#)

- For each compliance requirement, suggested audit procedures for internal control over compliance

## AICPA “Audit and Accounting Guide, Government Auditing Standards and Single Audits” – Part II Single Audits Under the Uniform Guidance

- Overall guidance for auditors when performing a compliance audit of federal awards



# Thank you!

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