Developing Effective Internal Controls for Special Education Programs

IDEA Fiscal Forum for the Outlying Areas and Freely Associated States
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Presentation Objectives-

- Review the OMB uniform guidance requirements for internal controls.
- Review the 5 components of internal controls included in GAO's Standards for Internal Controls in the Federal Government.
- Discuss key areas of internal control as they relate to special education programs.
- Discuss Entity examples of effective practices, and challenges in the implementation of effective internal controls.

INTERNAL CONTROL FREAK

Uniform Guidance: Internal Controls

❑ **Internal Controls**

◦ 2 C.F.R. 200.303 Internal Controls are elevated as an accountability measure

❑ **Grantees must**:

◦ Establish internal controls that provide reasonable assurance that the entity is managing Federal awards in accordance with Federal statutes, regulations, and grant terms and conditions.

◦ Comply with the 2014 US Government Accountability Office's (GAO's) Standards for Internal Control in the Federal Government.

◦ Evaluate and Monitor for compliance with Federal statutes, regulations, and grant terms and conditions.

◦ Take Prompt Action when noncompliance is identified (including audit findings).

Internal Control: Reasonable Assurance

Internal Controls provide _reasonable assurance_ that the organization will achieve its objectives through:

- Effective and efficient operations
- Reliable reporting
- Compliance with applicable laws and regulations

Internal Control Framework

- **Control Environment** – The organizational culture that influences ethical behavior, workplace integrity, risk and compliance consciousness of its personnel

- **Risk Assessment** – Identifying risks that threaten achievement of objectives

- **Control Activities** – Activities established to support implementation and risk responses

- **Information and Communication** – Right information at the right time to effectively carry out responsibilities

- **Monitoring** – Process to verify that controls are working as intended.

GAO's Standards for Internal Control in the Federal Government
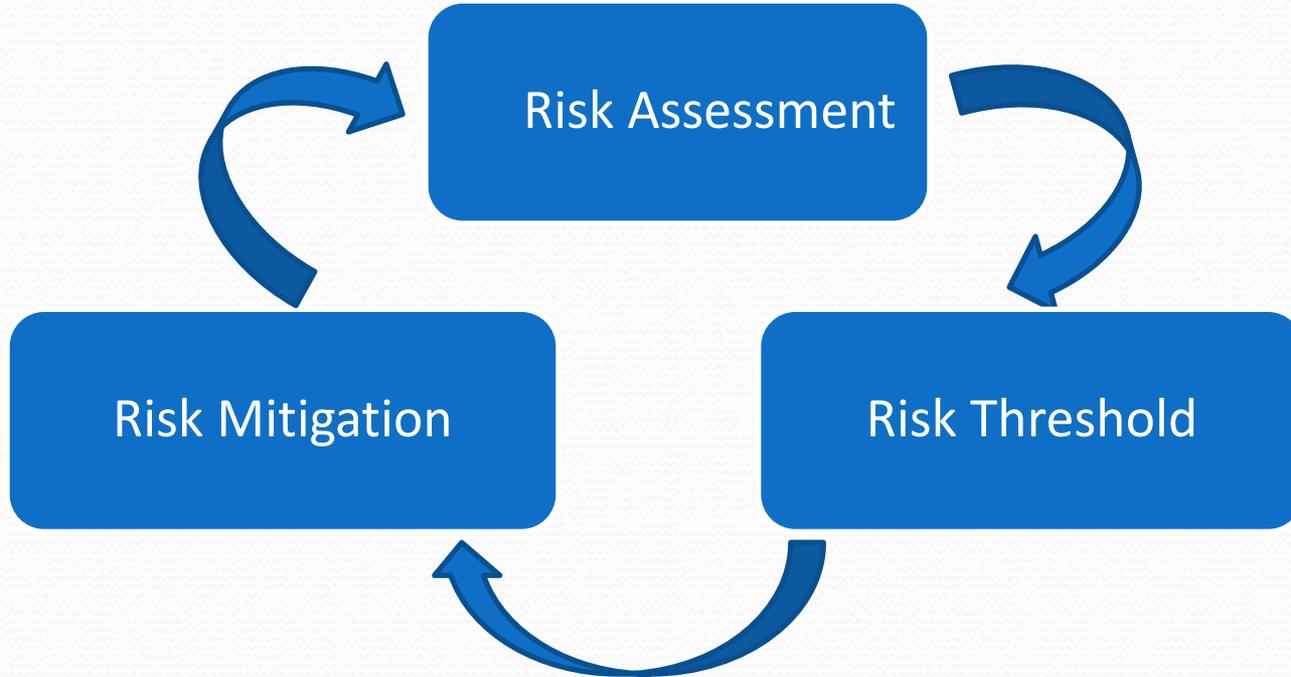
Five components of Internal controls
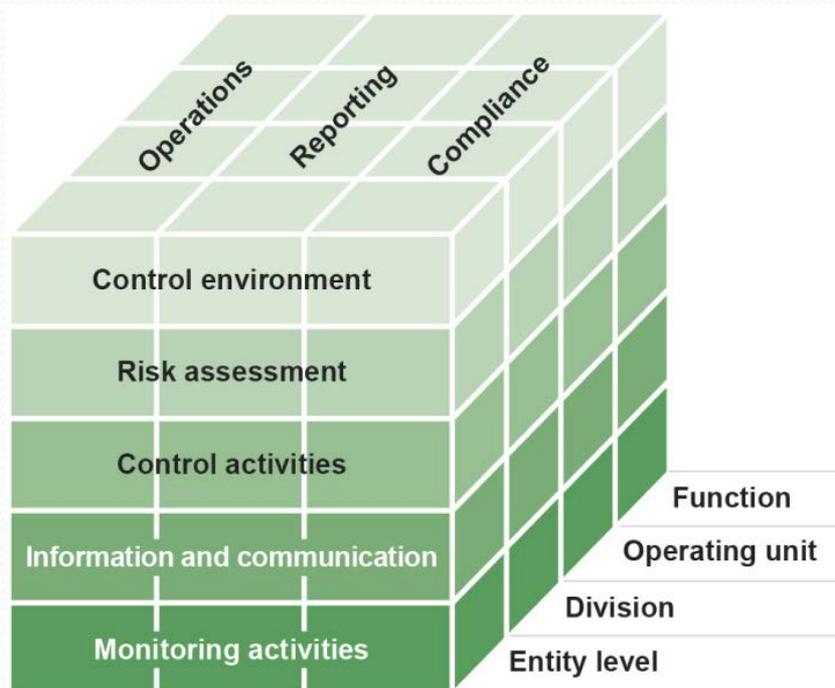
Types of Internal Controls

Type	Definition	Example
Preventative	Controls that help management to avoid issues before they occur	• Training • Review and Approval Process • Segregation of Duties
Detective	Controls that discover issues after they occur	• Inventory • Audits • Monitoring/sampling/testing • Data mining to detect fraud patterns
Corrective	Controls that detect if risk is realized and reacts	Adjust thermostat in computer room to protect valuable equipment

Control Environment

Type of Control	Definition	Examples
Tone at the Top	Demonstrate a commitment to the organization's integrity and ethical values.	• Directives • Policies • Lead by example
Oversight	Oversight Body who oversees management's design, implementation, and operation of the organization's internal control system.	• Board of Directors • Management Team • Chief State School Officer
Commitment to Competence	Management establishes expectations of competence on recruiting, developing, and retaining personnel.	• Position Descriptions • Required skills and certifications
Accountability	Personnel's responsibilities.	• Day-to-day decision making • Roles and responsibilities • Lines of Authority

Risk Assessment

Risk Assessment

Internal Controls – Risk Considerations

- ❑ Complexity of the process
- ❑ Level of manual intervention
- ❑ Fraud risk
- ❑ Management override
- ❑ Non-routine transactions

- ❑ Management by a third party
- ❑ History of audit issues
- ❑ Changes in laws/regulations
- ❑ Human capital management

Control Activities

Internal Controls – Types of Controls

❑ **<u>Preventative</u>**- Controls that helps management to avoid issues before they occur. Examples include:

- Training
- Review and Approval Process
- Segregation of Duties

❑ **<u>Detective</u>**- Controls that discover issues after they occur. Examples include:

- Inventory
- Audits
- Monitoring/sampling/testing

Control Activities

	Management
Design Control Activities	• Designs policies, procedures, techniques, and mechanisms in response to the program office's objectives and risks to achieve an effective internal control system. • Designs appropriate types of control activities (i.e., management of human capital, physical control over vulnerable assets, access restrictions to records, etc.). • Designs control activities for appropriate coverage of objectives and risks. • Considers segregation of duties in designing control activity responsibilities to help prevent fraud, waste, and abuse in the internal control system.
Implement Control Activities	• Implemented policies that document the control activities utilized by the office. • Periodically reviews the control activities for effectiveness.

Compensating Controls

- Additional control activities established to mitigate risk.

- These additional controls are also called mitigating strategies.

- Compensating controls are a type of control used to discover, prevent, and or mitigate mistakes.

Compensating Controls: Examples

- Segregation of duties :
  - One employee responsible for ensuring allowability based either on program law or uniform guidance,
  - One person to do the accounting portion of the job, and
  - One person responsible for signing the checks.
  - Segregation of duties can be difficult for businesses with small staffs. Compensating controls, in this case, may include maintaining and reviewing decision making logs and supporting documentation.

Information and Communication

	Management
Use Quality Information	• Identifies the information required to support the internal control system. • Obtains the relevant data from reliable internal and external sources in a timely manner. • Processes the data and uses it to inform the internal control system.
Communicate Internally	• Communicates information throughout the entity using established reporting lines, ensuring that communication flows to all levels of the organization. • Selects the appropriate method for communicating internally after considering the relevant factors (audience, nature of the information, etc.).
Communicate Externally	• Communicates with, and obtains quality information from, external parties (including other agencies, where appropriate). • Selects the appropriate method for communicating externally after considering the relevant factors (audience, nature of the information, cost, etc.).

Monitoring

	Management
Ongoing Monitoring	• Assesses the current state of the internal control system, compared against the intended design of the internal control system. • Monitors the internal control system through on-going monitoring and periodic separate evaluations (e.g., self-assessments, audits). • Evaluates and documents the results of on-going monitoring and separate evaluations to identify internal control issues.
Control Deficiency	• Identify internal control issues and report the issues through established reporting lines on a timely basis. • Evaluates and documents internal control issues and determines appropriate corrective actions for deficiencies.
Corrective Action	• Completes and documents corrective actions to remediate internal control deficiencies on a timely basis

Systems to Inquire About Internal Control

Record Retention and Access

- Retain for three years after submission of final expense report:
  - Financial records
  - Supporting documents
  - Statistical records
  - Other grantee records
- Access should be timely and reasonable

Walk-thru of Tool-kit

▸ The OCFO <u>toolkit</u> includes:
- ◦ A glossary of terms, common language, associated with the internal controls.
- ◦ A "quick check" document for managers that can facilitate an initial self-assessment.
- ◦ A more detailed self-assessment to identify potential problem areas corresponding to each of the five internal control components.
- ◦ An example of a procurement flow chart which includes a series of questions you might ask yourself in assessing aspects of an example procurement process. These questions are illustrative of the type of analysis you should conduct. In determining the allowability of expenditures involving Federal funds.

Internal Control Challenges

Single Audit Findings have identified Financial Management Weaknesses:

➢ Lack of Internal Controls and Standard Operating Procedures (SOPs)

➢ Potential for Fraud, Waste, and Abuse is HIGH!

➢ Result: "Qualified", Disclaimers", or "No Opinion" on Financial Statement Audits

Internal Control Challenges (cont.)

➢ Missing or Untimely posting of accounting transactions

➢ Accounting and Payments are "out of synch"

➢ Lack of documentation to support financial transactions (purchases, contracts, travel)

Internal Control Scenarios

1. An organization has a fairly new financial accounting system, but lacks the staff to interface with the system to generate financial statements

2. Procurement documentation is maintained in both paper and electronic formats, but not integrated into the organization's financial accounting system

Internal Control Scenarios (cont.)

3. Standard operating procedures (SOPs) have been developed and approved for implementation, but lack testing and validation and are often overridden

4. Property management does not reflect a comprehensive approach for managing and accounting for physical assets.
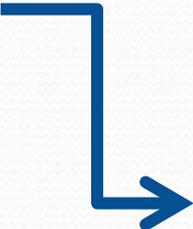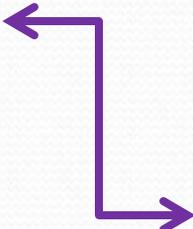
How can you determine if you're making progress toward addressing internal control weaknesses within your organization?

5-Step Organizational Improvement Framework

Measurable Progress

STEP #5: FULLY FUNCTIONAL IMPROVEMENTS

STEP #4: ASSESSMENT & VALIDATION

STEP #3: "BURN-IN" & ADOPTION PERIOD

STEP #2: INFRASTRUCTURE NEEDS ASSESSMENT & IMPLEMENTATION FOR MAJOR AREAS (Financial Management System, Standard Operating Procedures for Procurement, Property Management, Payroll & Travel)

STEP #1: "GROUND ZERO" (FOUNDATION)

Complete Organizational Improvement Framework

Full Implementation of all systems, policies and procedures

FULLY FUNCTIONAL IMPROVEMENTS

Organization successfully demonstrates improvements in all identified major areas

ASSESSMENT & VALIDATION

Assessment & Validation of new systems and procedures completed

"BURN-IN" AND ADOPTION PERIOD

- All major initiatives fully implemented as guided by SOPs
- Appropriate staff hired and trained based on adherence to SOPs

INFRASTRUCTURE NEEDS ASSESSMENT & IMPLEMENTATION

- SOPs developed and approved for all major initiatives (Financial Management System, Standard Operating Procedures for Procurement, Property Management, Payroll & Travel)
- Critical positions that need to be filled

"GROUND ZERO"

Address any single audit or program monitoring findings through the development of a corrective action plan and/or internal management improvement plan

Resources

❑ Your OSEP State Lead and Fiscal Leads

❑ Risk Management Service Leads:

American Samoa, FSM and RMI: Insuk Chinn, insuk.chinn@ed.gov

CNMI, Guam and Palau: Christine Jackson, christine.jackson@ed.gov

Virgin Islands: Mark Robinson, mark.robinson@ed.gov

❑ Email questions to: uniformgrantguidanceimplementation@ed.gov

Questions?