

# 2 CFR 200.303 Internal Controls

**In the context of HUD's CPD programs, 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.

The rule applies to all non-federal entities.

**§200.69 Non-Federal Entity.**

*Non-Federal entity* means a state, local government, Indian tribe, institution of higher education (IHE), or nonprofit organization that carries out a Federal award as a recipient or subrecipient.

There is a reason HUD is very interested in your policies and procedures.

b. What is the program participant's system(s) or procedure(s) for ensuring that CDBG funds are used in accordance with program requirements?

[24 CFR 570.501(b); 2 CFR Part 200.303]

Describe Basis for Conclusion:

*Source: CPD Monitoring Handbook 6509.2 REV-7*

**What is the objective of internal controls?** To minimize risk for asset loss and provide for the conducting of operations in an efficient and orderly manner through policies, procedures, segregation of activities and other activities.

Financial Management is covered in §200.302.

What does §200.303 require?

The non-federal entity must:

- (b) Comply with Federal statutes, regulations, and the terms and conditions of the Federal awards.
- (c) Evaluate and monitor the non-federal entity's compliance with statutes, regulations and the terms and conditions of Federal awards.

(d) Take prompt action when instances of noncompliance are identified including noncompliance identified in audit findings.

(e) Take reasonable measures to safeguard protected personally identifiable information and other information the Federal awarding agency or pass-through entity designates as sensitive or the non-federal entity considers sensitive consistent with applicable Federal, state, local, and tribal laws regarding privacy and obligations of confidentiality.

HUD is the Federal awarding agency for CDBG, HOME, ESG and HOPWA. The rule defines a “pass-through entity” as follows:

**§200.74 Pass-through entity.**

Pass-through entity means a non-Federal entity that provides a subaward to a subrecipient to carry out part of a Federal program.

As soon as the subrecipient agreement is fully executed, the subrecipient becomes a non-federal entity subject to the same stipulations of 2 CFR 200 as the grantee.

**Which “... statutes, regulations and the terms and conditions of Federal awards...”?** The HUD rule governing the specific award provides guidance (e.g. 24 CFR 570 Subpart K lists all the statutes, rules and Executive Orders incorporated into the CDBG rule by reference.)

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 or the “Internal Control Integrated Framework”, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

*Standards for Internal Control in the Federal Government* (known as the Green Book), provides the overall framework for establishing and maintaining an effective *internal control* system. The term *internal control* in the Green Book covers all aspects of an entity's objectives (operations, reporting, and compliance). The link below is to the current edition:

<https://www.gao.gov/assets/670/665712.pdf>

The 'Committee of Sponsoring Organizations of the Treadway Commission' is a joint initiative to combat corporate fraud. The Green Book defines the standards for the Federal government. Most subrecipient organizations a CDBG entitlement deals with should

probably be looking to the Green Book for guidance on designing and implementing their internal control systems.

Internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved. These objectives and related risks can be broadly classified into one or more of the following three categories:

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

*The Green Book (p. 5)*

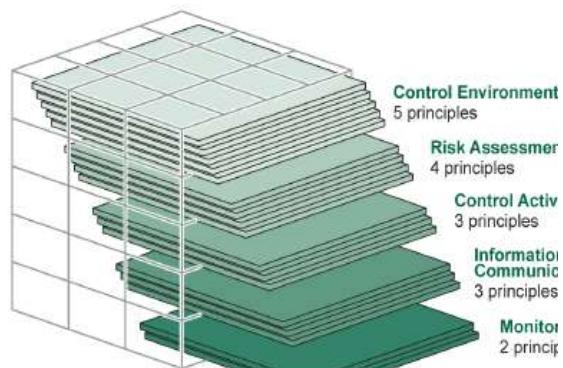
There is no magic checklist in 2 CFR 200 or the Green Book because organizations are different, no two are the same. Factors an organization must consider when developing its system of internal controls:

- ✓ Mission
- ✓ Regulatory environment
- ✓ Strategic plan
- ✓ Entity size
- ✓ Risk Tolerance
- ✓ Information technology

The Green Book lists five components of Internal Control:

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring

The five principles are supported by 17 principles. An Internal Controls Checklist developed using the five components and the 17 principles will satisfy the requirements of §200.303(a) **and** §200.303(b)(c)(d) and (e), as well.



Although organizations are different – no two are the same – the principles apply to both large and small organizations.

## CONTROL ENVIRONMENT

**PRINCIPLE 1 – The oversight body and management should demonstrate a commitment to integrity and ethical values.**

- What are the organization's strategic objectives?
- What are the organization's ethical values?
- How are those communicated to the board?
- What is the level of tolerance for deviations from ethical standards?

**PRINCIPLE 2 – The oversight body should oversee the entity's internal control system.**

- How are board members selected?
- What are the board's responsibilities?
- How does management communicate those responsibilities to board members?

**Principle 3 – Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.**

- What does the organizational structure look like?
- Who delegates responsibility within the organization?
- How is the internal control system – the 'who', 'what', 'when', 'where', and 'why' – documented?

**Principle 4 – Management should demonstrate a commitment to recruit, develop, and retain competent individuals.**

- How are board members selected?
- Does the executive director sit on the board?
- How are the various roles in the organization defined?
- How does the organization recruit new staff?

**Principle 5 – Management should evaluate performance and hold individuals accountable for their internal control responsibilities.**

- Who evaluates whom within the organization?
- How are personnel evaluated with respect to their role?
- If corrective action is necessary, who determines what those actions are and how they are implemented?

## RISK ASSESSMENT

**Principle 6 – Management should define objectives clearly to enable the identification of risks and define risk tolerances.**

- Who submits reports to the Board? the grantee?
- Who oversees compliance?
- Who oversees operations?
- How are objectives measured?

**Principle 7 – Management should identify, analyze, and respond to risks related to achieving the defined objectives.**

- What factors would keep the organization from meeting its objectives?
- Are these factors internal? external?
- Does the organization have a contingency plan?

**Principle 8 – Management should consider the potential for fraud when identifying, analyzing, and responding to risks.**

- What is the potential for:
  - Fraudulent financial reporting?
  - Misappropriation of funds?
  - Corruption?
- How are duties segregated?

**Principle 9 – Management should identify, analyze, and respond to significant changes that could impact the internal control system.**

- What is the organization's plan for:
  - Staff changes?
  - Rule changes?
  - Other issues?

## CONTROL ACTIVITIES

**Principle 11 – Management should design the entity's information system and related control activities to achieve objectives and respond to risk.**

See §200.303(e) – “... reasonable measures to safeguard...”

- How secure is the organization's IT system?
- Who has access to the IT system?
- Has the organization implemented application controls to achieve validity, completeness, accuracy and confidentiality?

**Principle 12 – Management should implement control activities through policies.**

*Policies state the organization's standards of conduct.*

*Procedures outline how policies are implemented.*

- How often are policies and procedures reviewed?
- Who initiates policy and procedure reviews?

## **INFORMATION AND COMMUNICATION**

**Principle 13 – Management should use quality information to achieve the entity's objectives.**

- How does the organization insure the reliability of its data?
- How does the organization use its data to drive policies, procedures, and decision-making?

**Principle 14 – Management should internally communicate the necessary quality information to achieve the entity's objectives.**

- What data is shared internally with staff?
- What data is shared with the Board?
- Has the organization established separate reporting lines to go around normal upward reporting lines if those lines have been compromised?

**Principle 15 – Management should externally communicate the necessary quality information to achieve the entity's objectives.**

- Is data required by the grantee reported accurately and on time?
- How does the organization communicate with community stakeholders? With the community at large?

## **MONITORING**

**Principle 16 – Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.**

*Not an option – Per §200.328(a), the non-federal entity must monitor its own activities.*

- Does the organization have a monitoring plan in place?
- Has the organization established an internal controls baseline on which to base its monitoring?

**Principle 17 – Management should remediate identified internal control deficiencies on a timely basis.**

*Again, not an option – Per §200.328(d)(1), the non-federal entity is required to report any material problems, delays or adverse conditions which will impair delivery of the activity.*

- In the event of such a report, what actions has the organization undertaken to address the issue(s)?

## **DOCUMENTATION**

“Documentation is a necessary part of an effective internal control system. The level and nature of documentation vary based on the size of the organization and the complexity of the operational processes the entity performs.”

*The Green Book (p. 71)*

### **An Internal Controls Checklist – Documentation**

- Subrecipient Agreement
- IRS 501(c)3 Letter
- Articles of Incorporation
- Bylaws
- Mission Statement
- Board Roster
- Board Handbook
- Job Evaluation Tool
- Organization Chart
- Job Descriptions
- Monitoring Reports
- Contingency Plan
- Succession Plan
- Authorization to Request Funds
- Procedures Flow Charts
- Reports to Grantee
- Newsletters
- Social Media Printouts
- Monitoring Schedule
- Performance Reports
- §200.328(d)(1)-related correspondence
- Required Certifications (§200.415 & §200.324(c))
- Certificates of Policy Compliance

## An Internal Controls Checklist – Policies and Procedures Manual

- Non-Discrimination (*§570.602 & 618*)
- Code of Ethics (*Principle 1*)
- Conflict of Interest (*§200.318 & §570.611*)
- Procurement (*§200.318(a)*)
- Grievance (Staff and Clients) *§570.607(a)*
- Termination (Staff and Clients) *§570.607(a)*
- Confidentiality (*§200.303(e)*)
- Record Retention (*§570.506*)
- Information Technology (*Principle 11*)
- Whistleblower (*Principle 14*)
- Monitoring (*§200.328*)

If Housing Activities Involved:

- Fair Housing (*§570.611*)
- Lead-Based Paint (*§570.608*)