TIP SHEET
and other
TIDBITS

Did you know that many grants and other funding agreements require certain internal controls to be in place to be eligible to receive funding? Most of the time that question is asked and certified during the application process. Compliance in that regard is often assumed to be in place and may be audited at some point after funding is granted and expended. Consequences for not having internal controls in place may include having to repay/revert funds, non-reimbursement (if applicable), penalties, and ineligibility for future funding.

Examples:

- Under the **NM Department of Finance and Administration (DFA)** policy, public agencies must maintain an effective internal control framework to be eligible for state grants or other funding. Executive Order and state law require agencies to implement internal accounting controls designed to prevent errors, fraud, waste, and violations of state or federal law, and to ensure that all financial processing documents are accurate and authorized.

- Before accepting funds under a **federal** grant, recipients are expected to have policies, procedures, and controls for procurement, financial management, reporting, and subrecipient oversight. Agencies may receive a review of controls as part of the award process, may be audited at some point during implementation or after project closeout. Failure to demonstrate them can delay or prevent funding or impact future funding. Best-practice guidance from the Government Finance Officers Association (GFOA) emphasizes that grants come with significant requirements and that organizations should have a formal grants policy and compliance processes in place before applying or accepting an award.

- **NM Finance Administration/NM Public Schools Finance Authority,** through law, require agencies/schools/districts to have an established and maintained internal control structure in place before it can engage in financial transactions, including receiving or processing loans.

- For **USDA school meal programs**, requirements are reinforced and are a condition for receiving and maintaining funding. Agencies must have a written internal control system, demonstrate effectiveness through monitoring and audits, and be prepared to show compliance during USDA reviews (which occur every 3-5 years).

ENTITY LEVEL CONTROLS:

For effective internal control, ensure each entity-level control is documented, assigned ownership, reviewed regularly, and supported by evidence such as board minutes, policy approvals, and audit reports.

Examples of entity-level type controls:

- Controls over management override
- Risk assessment processes.
- Monitoring of operations
- Financial reporting processes
- "Whistle-blower hotline"
- Code of Conduct and Mission Statement compliance
- IT environment and organization
- Internal communication and performance reporting
- Segregation of duties/assignment of authority and responsibility
- Hiring and retention practices

CONTROL ACTIVITIES:

Control activities are the specific policies, procedures, and actions an organization implements to reduce risks and ensure objectives are met, such as safeguarding assets, ensuring accurate reporting, and complying with laws. For public agencies and schools, these activities often combine general governance principles with sector-specific requirements.

Examples of control activities:

- Periodic comparisons of what is recorded compared to actuals (physical assets, time sheets)
- Safeguards in place to prevent unauthorized access to or destruction of documents, records, and assets/information security function in place.
- Policies for controlling access and authorization have been established – for example:
  - programs, data files, source documents
  - security software and programs
  - operating systems/application software used to control access.
  - passwords expire =< 90 days

- Segregation of Duties: Assign different individuals for authorizing, recording, and physically safeguarding transactions. (For example, the person who approves a purchase order should not be the one who processes payment.)
- Authorization and Approval Processes: Require managerial or higher-level approval for significant transactions, such as:
  - Purchase orders above a set threshold.
  - Payroll changes or hires.
  - Capital expenditures.
- Physical and Security Controls: Lockable storage for cash, checks, and sensitive documents
  - Access restrictions to secure areas
  - Regular inventory counts of supplies and equipment.
- Reconciliations and Reviews
  - Monthly bank reconciliations
  - Vendor invoice-to-purchase order-to-receipt matching
  - Periodic management reviews of budgets, expenditures, and payroll
- Compliance and Policy Adherence
  - Ensuring all procurement follows state/local purchasing laws and internal policy.
  - Verifying programs comply with federal and state regulations.
- IT and Data Controls
  - Password policies and role-based system access
  - System rules that reject invalid data entries (e.g., negative amounts in financial fields)
  - Regular backups and secure data storage
- Preventive and Detective Measures
  - Preventive: pre-approval checklists
  - Detective: surprise audits, anomaly detection in financial data
- Examples for Schools
  - Student Records: Only authorized staff can update or delete records; changes require dual approval.
  - Food Services: Separate custody of food inventory from preparation; daily temperature logs for refrigerated items
  - Transportation: Vehicle inspections, driver background checks, and route approval before service begins

RISK ASSESSMENT:

1. Identify and Understand the Risk

Risk type and impact: Determine whether the risk is financial, operational, compliance, reputational, or strategic, and assess its importance/potential impact.
Likelihood: Evaluate how likely the risk is to occur based on historical data, trends, etc.
Risk ownership: Clarify which department, process, or role is responsible for managing.

2. Assess the Current Control Environment

Control design: Review whether controls are designed to address the identified risk objectives, are documented, and are consistent with policies.
Control implementation: Verify that controls are operating as intended, not just on paper, through testing, walkthroughs, and evidence review.
Gap analysis: Compare expected controls to actual controls to identify deficiencies.

3. Consider the Risk/Control Relationship

Map each risk to specific controls and determine if the control is sufficient, partially effective, or ineffective.
Evaluate whether the control is manual, automated, or dependent on individual skills, as this affects reliability and key person risk.

4. Evaluate Organizational Context and Appetite

Business objectives: Ensure actions align with strategic goals and operational priorities.
Risk appetite: Determine if the risk is within the organization's acceptable tolerance or requires escalation.
Regulatory and statutory requirements: Ensure compliance with applicable laws, standards, and reporting frameworks.

5. Determine the Scope and Urgency of Actions

Severity: Prioritize actions based on risk severity and potential harm
Urgency: Address high-risk or compliance-related issues immediately; schedule lower risk actions for future improvement
Resource availability: Consider staffing, budget, and technology constraints when planning remediation.

6. Document and Communicate Decisions

Maintain clear records of risk assessments, control evaluations, and agreed actions for audit and governance purposes.
Communicate required actions to all relevant stakeholders, including management, audit committees, and regulators when applicable.

RESOURCES

Guidance on Internal Control – Integrated Framework – Committee of Sponsoring Organizations (COSO) (the leading global authority on internal control)

Modernizing Internal Control checklist in State and Local Governments – Government Finance Officers Association

The Green Book: Standards for Internal Control in the Federal Government – US Government Accountability Office

Internal Controls Checklists – The Association of Public Treasurers of the United States and Canada (APT US&C)

Local Governments: Strengthening Internal Controls to Prevent Fraud – SEK CPAs & Advisors

Strengthening Control and Integrity: A Checklist for Government Managers – The International City/County Management Association (ICMA)

Manual of Procedures PSAB Supplement 2 Internal Control Structure – NM Public Education Department, Education Finance Analysis Bureau

Sample Internal Controls and Procedures: Coral Community Charter School, New Mexico