



DEPARTMENT OF EXECUTIVE MANAGEMENT BUREAU OF FINANCE AND MANAGEMENT

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Members of the Government Operations and Audit Committee:

In 2016, the Legislature created the State Board of Internal Controls (SBIC). This was in response to the situation at Mid Central Educational Cooperative (MCEC), where embezzlement by MCEC's business manager was discovered following the termination of MCEC's administration of the federal Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) grant. As Governor Dugaard explained in his 2016 State of the State address:

Overall, South Dakota in our state processes has very good internal controls aimed at safeguarding state government assets and providing assurances that state and federal tax dollars are spent correctly. However, we've learned plainly that our processes don't go far enough to oversee entities outside of state government. These grantees or sub-recipients are not part of state government but may be used by the state to administer federal grants.

The state needs better internal controls to manage these entities that are "arms length" to the state. We must install safeguards that will ensure that federal and state objectives are met, expenditures are documented and appropriate, and potential conflicts of interest are recognized and avoided.

I have asked Lt. Governor Michels to lead an effort to review state government's internal control processes and recommend changes. In particular, focus on situations involving these "arms length" outside entities, such as Mid-Central Coop, where it is more difficult for state government to maintain direct oversight.

As a result of Lt. Governor Michels' review, the 2016 Legislature passed [SB162](#), which was codified at SDCL Chapter [1-56](#), creating the State Board of Internal Controls. SBIC's main purpose is to provide guidelines for an effective system of internal controls. SBIC has developed and will continue to develop additional tools to reduce the State of South Dakota's exposure to risk.

SBIC, consisting of seven members, met monthly for the first year and now meets quarterly. Information about its meetings can be found at <http://boardsandcommissions.sd.gov/Meetings.aspx?BoardID=164>

Pursuant to SDCL [1-56-6](#), SBIC shall establish and maintain:

- (1) Guidelines for an effective system of internal control to be implemented by state agencies that is in accordance with internal control standards;
- (2) A code of conduct for use by state agencies;
- (3) A conflict of interest policy for use by state agencies.

SBIC adopted the Bureau of Human Resources (BHR) [Employee Handbook](#), specifically pages 2-11, and the Board of Regents (BOR) Employee Handbook as the code of conduct for the respective state agencies.

SBIC requires that state agencies comply with all applicable laws, regulations, and internal policies regarding conflicts of interest and other outside interests. These laws are found in SDCL [5-18A-17](#) through [5-18A-17.6](#). State agencies are required to develop plans to inform and make accessible the conflict of interest laws to ensure

their employees are in compliance. BHR developed a waiver and disclosure process to conform with the law, and updated the employee handbook to reflect the law and that process.

The process of establishing and maintaining an effective system of internal controls will take years. SBIC has already accomplished and overseen some statutorily required items. First, SBIC has established Internal Control Officers in each state agency. Second, grant agreements with subrecipients are now available to the public on open.sd.gov. Third, the Auditor General submits to SBIC a copy of any non-profit audit reports sent to a state agency identifying audit findings pertaining to federal award programs administered by that state agency. To date, SBIC has been notified by the Auditor General of 3 subrecipients that received audit findings. The state agency responsible for those subrecipients has come before SBIC with a management decision on how to address each issue.

SBIC has gone further to implement an effective system of internal controls by also establishing the Federal Grant Compliance Workgroup. This group assists SBIC in establishing and maintaining guidelines as it relates to the Uniform Grant Guidance as found in [2 CFR 200](#). The objective of the workgroup is to create tools to assist state agencies with federal grant compliance, make recommendations to SBIC on those tools, review findings within the single audit as they pertain to federal grant compliance, and assist with comprehensive solutions. Members of this group include federal grant employees across state government.

Because of the work done by this workgroup so far, SBIC has adopted four standard tools for state agencies to utilize. These tools play an important role in helping to maintain internal controls and compliance with federal regulations relating to federal pass-through grants to subrecipients. These tools include:

- **[Contractor or Subrecipient Relationship Determinations Checklist](#)**: This tool helps state agencies determine whether a subrecipient or a contractor relationship exists.
- **[Pre-award Risk Assessment Tool](#)**: This tool measures risk attributes of a subrecipient before the state agency enters into a grant agreement with the subrecipient. The risk assessment will help determine the proper monitoring of the subrecipient necessary while the subrecipient is administering the grant.
- **[Subrecipient Monitoring Guide](#)**: This guide has 4 major purposes:
 - o Ensure state agencies develop sufficient monitoring plans and methods to have proper oversight of subrecipient entities receiving pass-through awards;
 - o Define types of subrecipient monitoring;
 - o Assist state agency personnel responsible for monitoring awards in selecting the proper monitoring for pass-through awards; and
 - o Provide tools and suggestions that could be included by the state agency in the monitoring process.
- **[Subrecipient Agreement Template](#)**: This template creates a grant document that would allow for uniformity with all agencies and subrecipients, but also allow some flexibility to meet specific state agency and grant requirements. This form includes the following attestations (SDCL [1-56-10](#)):
 - o A conflict of interest policy is enforced within the recipient's or subrecipient's organization;
 - o The Internal Revenue Service Form 990 has been filed, if applicable, in compliance with federal law, and is displayed immediately after filing on the recipient's or subrecipient's website;
 - o An effective internal control system is employed by the recipient's or subrecipient's organization; and
 - o If applicable, the recipient or subrecipient is in compliance with the federal Single Audit Act, in compliance with SDCL [4-11-2.1](#), and audits are displayed on the recipient's or subrecipient's website.
- **Ongoing risk assessment**: The workgroup is currently working on a standard on-going risk assessment tool that provides an iterative risk evaluation of changing conditions of the subrecipient.

SBIC is also implementing the Statewide Internal Control Framework. The Bureau of Finance and Management (BFM) is hiring a State Internal Control Officer to oversee the implementation of the State of South Dakota's internal control system and framework. This position is responsible for working with all state agencies to implement a successful system of internal controls regarding the state's operation, compliance, and reporting objectives. This position is also responsible for providing administrative support to SBIC (per SDCL [1-56-5](#)).

BFM is establishing a contract with an internal control expert to assist in developing a Statewide Control Environment Framework that will support a scalable and sustainable internal control implementation across all State agencies, aligned to the objectives of the State, SBIC, COSO / Green Book Principles, and Senate Bill 162 from the 2016 Legislative Session (now codified in SDCL [1-56](#)).

BFM will initially implement the Statewide Control Environment Framework within BFM and then work with the contractor to implement the framework in additional agencies to:

- Formalize internal controls at BFM and the additional agencies in alignment with the Statewide Control Environment Framework.
- Gain lessons learned from the implementation to modify and improve the Statewide Control Environment Framework.
- Through knowledge sharing and implementation activities, educate employees on the key internal control concepts to carry this process on beyond BFM and agencies selected.

After the consultant is done, BFM will implement the Statewide Control Environment Framework within the rest of state government. This will require staff from each agency to spend time and effort on this process, as well as continue this framework into the future.

I believe the information presented in this letter will inform GOAC about what SBIC has accomplished since its creation during the 2016 Legislative session. SBIC will continue to develop additional tools to reduce the state of South Dakota's exposure to risk as well as create and strengthen an internal control environment within the State. Please feel free to contact me with any specific questions.

Sincerely,



Liza Clark, Commissioner
Bureau of Finance and Management