



Office of the Washington State Auditor

Pat McCarthy

Audits of Federal Grant Funds: Common Causes of Audit Findings and Strategies for Preventing Them

Presented to Infrastructure Assistance
Coordinating Council

Cavan Busch, Assistant Audit Manager

Objectives

- Understand the “single audit” and what auditors are required to look for
- Gain insight on common causes of findings and how to avoid them to:
 - Reduce the number of audit issues; and
 - Have a positive audit experience!

Topics

A

- Overview of the single audit

B

- Common findings

C

- What if we receive a finding?

Section A



Overview of the “single audit”

Federal single audit

These audits focus on:

- Entities with federal expenditures over \$750,000
- Adequate internal controls over compliance requirements
- Testing compliance requirements

Our website contains a list of single audit resources at:

- www.sao.wa.gov/resources/Pages/SingleAuditResources.aspx

Federal single audit

How we conduct a federal single audit

Step 1: Verify the SEFA (a financial report) and other planning

Step 2: Conduct risk assessments and select major program(s)

Step 3: Contact program managers to review all applicable compliance areas of the selected programs

Step 4: Conclude and report

Federal single audit

What does our testing involve?

- Determine which compliance requirements are applicable, direct and material
 - Davis-Bacon Act, program income, procurement, etc.
- Understand the controls over requirements
- Test controls' effectiveness
- Test compliance
- For issues:
 - Follow up with management
 - Evaluate if reportable



Levels of reporting

- Exit items/written recommendations
 - ❑ Housekeeping items for improvement
 - ❑ Communicate with management
 - ❑ Does not appear in audit report
- Management letters
 - ❑ Deficiencies/non-compliance with less-than-material effect
 - ❑ Reported to the governing body
 - ❑ Mentioned briefly in the audit report
- Findings
 - ❑ Significant deficiencies and material weaknesses
 - ❑ Appears in the audit report

What types of findings are reported?

- Inadequate internal controls and accounting systems
- Noncompliance with laws and regulations
- Questioned costs (both known and likely):
 - ✓ Unallowable
 - ✓ Undocumented
 - ✓ Unapproved
 - ✓ Unreasonable
- Known or likely fraud affecting a federal program

Section B



Common findings

Most common areas leading to findings

1. Procurement
2. Suspension & debarment
3. (un) Allowable costs
4. (lack of) Adequate supporting documentation
5. (lack of) Prior written approval
6. Special tests & provisions – with public works focus
7. Davis-Bacon Act
8. Equipment & real property management
9. SEFA financial reporting
10. (lack of) Adequate internal controls

1. Procurement



Federal procurement outline

Method	Threshold	Applies to	Involves
Micro purchase	Under \$3,500*	Services, Supplies or Other Property	Competition not required, but must equitably distribute funds
Small purchase procedures	Under \$150,000	Services, Supplies or Other Property	Price or rate quotations
Sealed bids	Equal to or over \$150,000	Services, Supplies or Other Property as appropriate	Formal solicitation with a firm-fixed price contract awarded to responsive bidder
Competitive proposals	Equal to or over \$150,000	When sealed bids are not appropriate (Services)	More than one source submits an offer, and either a fixed-price or cost-reimbursement type contract is awarded
Competitive proposals	No threshold	Architecture & Engineering (price not a factor)	
Non-competitive proposals	Not applicable	Only when the award is infeasible under other option and it is either: sole source of supply, emergency or authorized by awarding agency	Cost analysis must be completed, determination that requirements are met and possibly obtain awarding agency approval

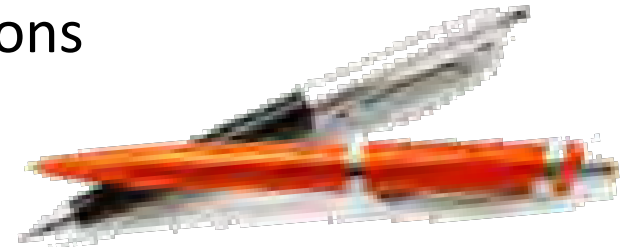
NEW: Federal procurement policies

Written Policy 1: Must have procurement policy

- Mention *specifically* how to procure with federal funds

Written Policy 2: Must have policy covering conflict of interest/standards of conduct

- For employees performing procurement
- Real or apparent conflict of interest
- No bribes, favors or anything of value
- Include disciplinary actions for violations



Key do's and don'ts

- Do come up with an estimate of the project cost before determining which procurement method to use
- Do include all costs associated with the project in the estimate – labor, materials, equipment, etc.
- If piggybacking on another contract, do make sure your required procurement method was used (beware of cooperatives)
- Do use Municipal Research and Services Center (MRSC) as a resource: mrsc.org/Home.aspx

Key do's and don'ts

- Do communicate with other departments in the organization (for those entities that have decentralized purchasing) to avoid acquisition of unnecessary or duplicative items and/or to consolidate or break out procurements to obtain a more economical purchase
- Do document procurement decisions!
- Do retain procurement documentation according to record retention schedule

2. Suspension & debarment

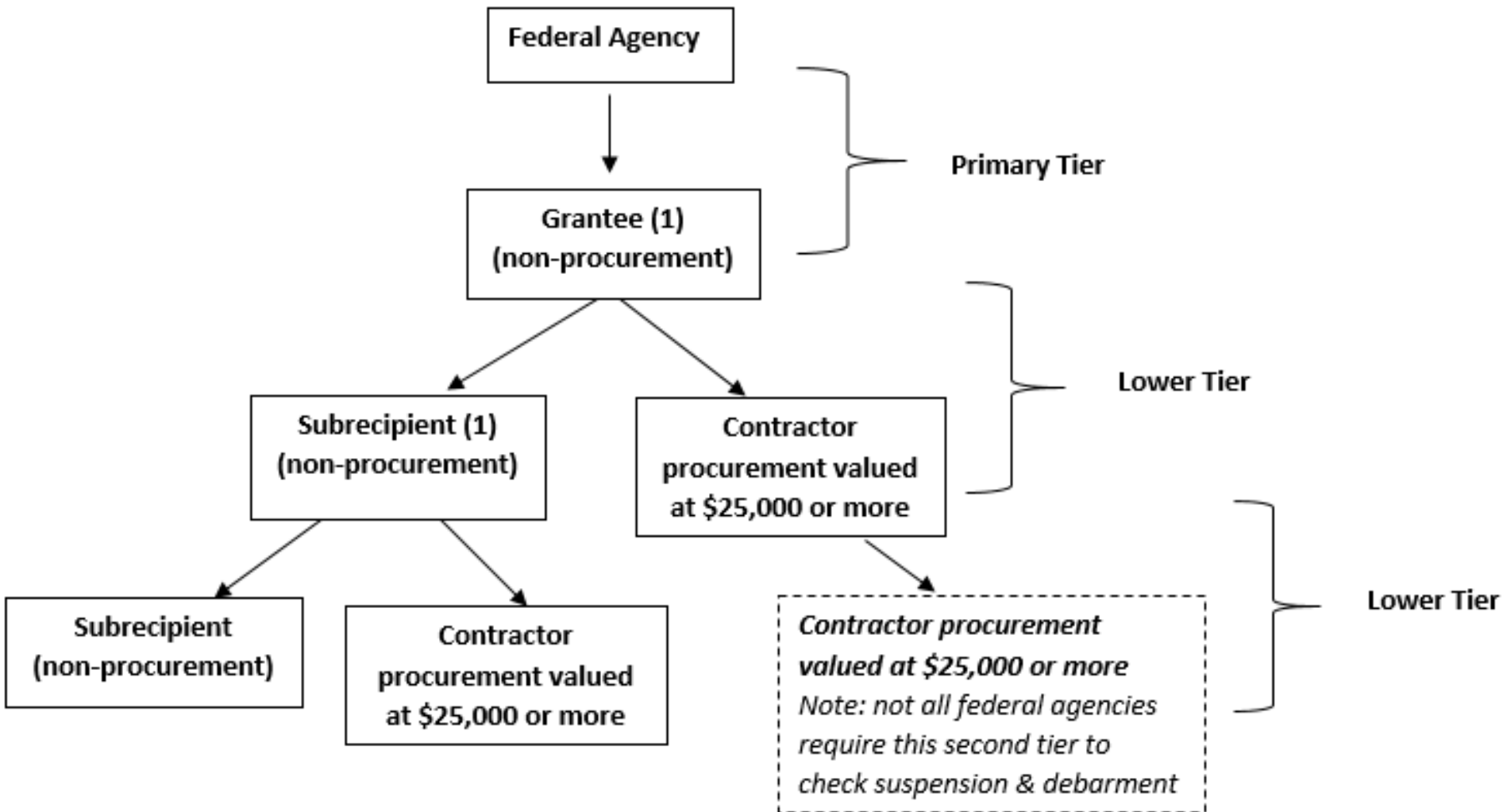


Suspension and debarment

For any contract over \$25,000 and all sub-recipients, the grantee must perform one of the following to ensure the lower-tier party is not suspended or debarred from federal programs:

- Check the Excluded Parties List System (EPLS) at www.sam.gov (**be sure to print out or keep a record of search results**); **OR**
- Collect a certification from the lower-tier party; **OR**
- Add a clause or condition to the contract with the lower-tier party.

Suspension and debarment



Key do's and don'ts

- If using a standard template contract, do ensure suspension and debarment language is included
 - ▣ Be careful when using a non-standard contract
- Do ensure EPLS search results are dated and the search occurs *before* contract is signed (*best practice)
- Consider re-checking the status of multi-year contracts during the life of the contract or during renewals
- Make sure subcontractors are free of suspensions and debarments by:
 - ▣ Performing your own check
 - ▣ Making the general contractor check and report to you by contract

3. (un) Allowable costs



Where to find guidance on allowable costs

Information on allowable costs can be found in:

- Your grant agreement / contract
- Grantor manuals or guides
- OMB Compliance Supplement

 **When in doubt, ask your grantor agency**

Cost must be reasonable and necessary

Consideration *must* be given to the following:

- ☑ Is the cost *ordinary* and *necessary* for the operation of the program?
- ☑ Did you pay a *fair market price*?
- ☑ Did you act with *prudence*?
- ☑ Did you *significantly deviate* from established practices/policies of your governmental unit, which may unjustifiably increase the federal award's cost?

Key do's and don'ts

- Don't charge questionable or superfluous items just because there is still budget available
- Don't charge maintenance or consumable items if this is not allowed under the grant agreement
- Beware of items, such as some travel or meal costs, that require pre-approval

4. (lack of) Adequate supporting documentation

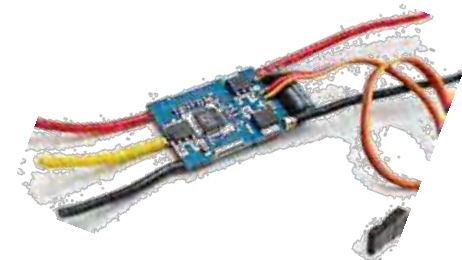


Adequate documentation

Examples include:

- ☑ Payroll reports
- ☑ Employee time and effort records
- ☑ Detailed invoice vouchers from subrecipients
- ☑ Original vendor invoices
- ☑ Methodology for internal service charges
- ☑ Updated cost allocation plans / indirect cost rates

Documentation may be in an electronic form –
but must be kept for the duration of the
applicable record retention period



2 CFR §200.430 compensation – personal services

Time-and-effort reporting focuses on **establishing internal controls to allow the entity to validate the costs**, as opposed to specific forms – examples *removed*.

(1) Charges to Federal awards for salaries and wages must be *based on records that accurately reflect the work performed*.

These records must:

- (i) Be **supported by a system of internal control** which provides reasonable assurance that the charges are accurate, allowable, and properly allocated;
 - (ii) Be **incorporated into the official records** of the non-Federal entity;
- Note other requirements contained in (iii) through (ix)*

Time-and-effort rules: New vs. old

(old) Circular A-87	(new) Uniform Guidance
Single - semi-annual certification	<ul style="list-style-type: none">• Supported by control system• Official record and in accordance with accounting policies• Show 100% of activity• Use same document or subsidiary records• Support percent distributed• Budget estimates are not support (!!)• Nonexempt employees' time must be supported by records indicating the total number of hours worked each day
Multiple – PAR <ul style="list-style-type: none">• Show percent worked• After-the-fact• Show 100% of activity• At least monthly• Sign/date by employee or supervisor	

Support cost allocation to the program

A cost is allocable if the goods/services are chargeable in accordance with the *relative benefits received*.

- **Ensure this allocation is supported**

In other words, you should charge each grant its fair and equitable share of the cost and support that split.

Key do's and don'ts

- Do keep records organized and available for audit. This is extremely important and helpful in cases of staff turnover.
- Do ensure review and signatures on supporting documentation occur promptly
- Don't charge indirect costs to a grant without a *documented* and certified cost allocation plan (unless you're using the 10 percent de minimis rate)

5. (lack of) Prior written approval



NEW: Prior written approval

Do I need prior written approval?

- It may be difficult to determine *reasonableness* and *allocability* in every case.
- To avoid disallowance or disputes over costs – ask before spending!
- For the first time, federal regulations provide a comprehensive list of the **22** elements for which non-federal entities must seek **prior written approval** from the federal awarding agency **under certain circumstances**.

Prior written approval

Elements that require *prior* approval *in certain circumstances

Use of grant and cooperative agreements and contracts	Compensation – personal services
Cost sharing or matching	Compensation – fringe benefits
Program income	Entertainment costs
Revision of budget and program plans	Equipment and other capital expenditures
Real property	Exchange rates
Equipment	Fines, penalties, damages and other settlements
Fixed amount subawards	Fundraising and investment management costs
Direct costs	Goods or services for personal use

Prior written approval

- Insurance and indemnification
- Memberships, subscriptions and professional activity costs
- Organization costs
- Participant support costs
- Selling and marketing costs
- Taxes
- Travel costs (!!)

Be familiar
with this list!

What is prior written approval?

- Anything in writing
 - Preferably with a date
 - Specifically identifies the cost as approved
- Examples:
 - Grant agreement (if specific enough)
 - Memo
 - Letter
 - E-mail



Key do's and don'ts

- Don't rely only on a verbal approval or a conversation
- Do obtain approvals for expenditures or changes in writing
- Do take action to obtain approvals (especially for changes to the grant agreement)
- Don't "assume" what the contract means if not clear

6. Special tests & provisions

(public works focus)



What are special tests?

- Program-specific requirements
- Find in:
 - Grant agreement
 - Compliance supplement
 - Amendments, correspondence from grantor
- Common public works special test:
 - **American Iron and Steel (AIS)**

Special test: American Iron and Steel

- Found in: CFDA 66.458, 66.468, etc.
- *All* iron and steel products used for the project, for construction, alteration, maintenance or repair must be produced in the United States
- Complete the following:
 - Ensure it is included in purchase and public works contracts
 - Obtain proof:
 - Clearly stated on invoice/receipt the product origin
 - Certificate or attestation by vendor
 - **Or**, obtain a waiver from the EPA administrator

Key do's and don'ts

- Do be familiar with your grant agreement and know *all* of the actions required

7. Davis-Bacon Act



+



Davis-Bacon Act (federal prevailing wages)

Contractors and subcontractors:

- Must pay their laborers prevailing wages
- Must complete the following:
 1. Insert *the complete* required clause in the contract(s)
 - Can't just reference the requirement
 2. Obtain weekly certified payroll reports
 - Collect and review before vendor is paid, at the latest
 3. Review payroll reports to ensure correct wage was paid

Davis-Bacon Act compliance

- State prevailing wage \neq federal prevailing wage rates
 - Must use the higher of the two rates
- Prevailing wages: Consult the “Register of Wage Determinations” published by U.S. Department of Labor Wage and Hour Division
- **CAUTION** – The Davis Bacon Act does not apply to all grants; check with your grantor if you are not sure whether it applies to your grant

Key do's and don'ts

- Don't wait until the project is *over* to collect certified payroll reports
- Don't “**trust**” or **rely on** the contracted project manager to obtain the payroll reports
- Do keep reports organized chronologically to ensure they have all been received
- Do include “no activity reports” for weeks a contractor does not have certified payroll
- Do compare weeks received to Department of Labor & Industries start and end dates from Intents and Affidavits

8. Equipment & real property management



Changes to equipment rules

- Tangible personal property:
 - Life more than one year
 - Lesser *per unit* cost of \$5,000, or grantee's threshold
 - Computers?
- Intangible property:
 - Acquired under award
 - Not developed or produced



Changes to equipment rules

Compliance requirement:

1. Property records meet minimum requirements
2. Inventory performed on schedule
 - ▣ Once every two years
3. Used for original intended purpose
4. Disposals:
 1. Per-unit *fair market value* > \$5,000, reimbursement likely required (not book value)
 2. If additional instructions, they were followed (pre-approval, retention, remittance)

Changes to real property rules

- Revised: real property *acquired or improved* with federal funds
- Compliance requirement
 1. Use it for original program objectives
 2. Asset's disposal meets federal requirements



Key do's and don'ts

- Do be sure to document if the asset or which portion was purchased with federal funds
 - ❑ Recommend: In asset record, document it where readily identifiable
 - ❑ Make sure to now include real property improved with federal funds
- Do ensure the records include all required elements
 - ❑ description, ID, source of funding including FAIN and CFDA #'s, title, acquisition date, cost, % of participation, location, use and condition, disposition data including date of disposal and sales price, etc.
- Do ask for disposal instructions
 - ❑ Recommend: Make a note in a central asset list or attach a copy of the instructions to the asset records.
- Do track assets separately (don't use one lump category for all real property or equipment)
 - ❑ All federal assets must be separately identifiable

9. Schedule of Expenditures of Federal Awards (SEFA) (financial reporting)



Schedule of Expenditures of Federal Awards (SEFA)

- *All local governments* must prepare a SEFA
 - ▣ Requirement in the BARS Manual and School Accounting Manual
- Include all expenditures from:
 - ▣ Awards **direct** from a federal agency
 - ▣ **Indirect** (pass-through) awards
- Indicate in footnote how much of the direct and indirect awards expended was passed on to subrecipients

What are “federal awards expended”?

- Grants
- Indirect cost recoveries
- Grant funding *disbursed* to subrecipients
- Loans
- Equipment and supplies
- Program income
- Commodities and vaccines
- Interest subsidies on loans
- Value of federal insurance

Reporting loans

1. Amount of new loan proceeds used during the fiscal year
PLUS
2. Balance of prior-year loans (if the lender imposes
“continuing compliance requirements” pertaining to the
balance)
PLUS
3. Any interest subsidy, cash or administrative money received

NOTE: There are exceptions to the Rule!

Exception to the rule

EPA Drinking Water / Clean Water State Revolving Fund (CFDA 66.468/66.458)

1. Amount of new loan proceeds used during the fiscal year
PLUS
2. Any interest subsidy, cash or administrative money received

Don't include

~~Balance of prior year loans~~ (EPA says no continuing compliance requirements)

Exception to the rule

Water and Waste Disposal Systems (CFDA 10.760)

Community Facilities Loans and Grants (CFDA 10.766)

1. Amount of new loan proceeds used during the fiscal year

PLUS

2. Any interest subsidy, cash or administrative money received

Don't include

~~Balance of prior year loans~~ (USDA says no continuing compliance requirements)

ALSO

This is USDA Interim Financing: Expenditures from commercial loans (to be repaid from a USDA loan) should be reported on the SEFA

Equipment, supplies and other non-cash assistance

- Report the value of the equipment and supplies in the year they were received
- Report the fair market value or price of the items *as determined by the grantor*
- Report any helpful details in the notes to the SEFA



Key do's and don'ts

- Do identify all federal funding sources vs. state and local sources
- Do make sure you know which programs provide partial federal and state funding
 - ▣ Example: Federal = 70% of the grant, state = 30%
- Do report non-cash items received from federal sources
 - ▣ Ask state or local governments if the items they give you were purchased with federal funds
- Don't fail to prepare a SEFA because federal funds are less than \$750,000 (*It's still required annually!*)

10. Internal controls



What are internal controls?

Federal regulations define internal controls as a process, implemented by a non-federal entity, designed to provide reasonable assurance of achievement in:

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

Internal control responsibilities

- Establish and maintain effective internal controls over the award that provide reasonable assurance you are meeting federal requirements and the award's terms and conditions
- Comply with federal requirements and award's terms and conditions
- Evaluate and monitor compliance with federal regulations and award's terms and conditions
- Take prompt action when instances of noncompliance are identified
- Take reasonable measures to safeguard protected or sensitive information

Internal controls

- Federal regulations state that non-federal entities' internal controls “should” comply with guidance in the Green Book or the COSO framework
- Both have 5 components and 17 principles, but the Green Book is adapted for a government environment



Internal controls

Control Environment

1. The oversight body and management should demonstrate a commitment to integrity and ethical values.
2. The oversight body should oversee the entity's internal control system.
3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.
4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.
5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

Risk Assessment

6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.
7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.
8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.
9. Management should identify, analyze, and respond to significant changes that could impact the internal control system.

Control Activities

10. Management should design control activities to achieve objectives and respond to risks.
11. Management should design the entity's information system and related control activities to achieve objectives and respond to risks.
12. Management should implement control activities through policies.

Information and Communication

13. Management should use quality information to achieve the entity's objectives.
14. Management should internally communicate the necessary quality information to achieve the entity's objectives.
15. Management should externally communicate the necessary quality information to achieve the entity's objectives.

Monitoring

16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.
17. Management should remediate identified internal control deficiencies on a timely basis.

Source: GAO. | GAO-14-704G

Key do's and don'ts

- Do ensure internal controls are an integral part of all aspects of a federally funded program
- Do use external resources, if needed, to get ideas as to what components make for a good internal control environment
- Don't implement too many controls
- Don't mistake a process for an internal control

Section C



What if we receive a finding?

What if we receive a finding?

Your entity must prepare a **Corrective Action Plan** (template provided by auditor) during the audit, which includes:

- Name of a contact person
- Course of action planned
- Anticipated date of completion
- If you do not agree with the finding, include an explanation in the plan

Who responds?

Awarding agencies must issue a “**management decision**” letter within **6 months** of the Federal Audit Clearinghouse acceptance date.

What if we receive a finding?

Why are we getting a repeat finding?

Auditors are *required* to follow up on prior audit findings and *continue* to issue a finding for internal control deficiencies until they are corrected.

Why did our entity received a finding when others have not?

Auditors are *required* to evaluate internal control deficiencies and non-compliance for each entity *separately*. Factors considered:

- ❑ Each entity's individual internal control system
- ❑ Amount of the federal award or non-compliance
- ❑ Non-monetary considerations


Resources

- **BARS Manual** (Internal Controls and SEFA preparation)
- **Federal Green Book or COSO** (Internal Controls)
- **OMB Compliance Supplement:**
 - ❑ Part 3 – Compliance Requirements (12)
 - Part 3.1 contains the compliance requirements under the OMB Circulars
 - Part 3.2 contains the compliance requirements under Uniform Guidance
 - ❑ Part 4 – Agency Program Requirements (for those included)
 - ❑ Part 5 – Clusters of Programs
 - ❑ Part 6 – Internal Control

Washington State Auditor's Office website

[About Us](#) [Local Government](#) [State Government](#) [Investigations](#) [Resources](#) [Search Reports](#)

Auditing Resources : Single Audits



Resources

Public Records

Local Government Resources

Media Resources

Auditing Resources

- [Financial Audits](#)
- [Accountability Audits](#)
- [Single Audits](#)
- [Performance Audits](#)
- [Fraud](#)
- [State Agencies](#)

Non-federal government organizations are required to provide a separate accounting for receipts and expenditures of federal financial assistance in their financial records. As described in the state [BARS manual](#), management is responsible for preparing a schedule of expenditures of federal awards (Schedule 16), which is used to determine whether the \$500,000 threshold for a single audit (\$750,000 for years beginning after 12/26/2014) has been met. If it has, governments will be required to provide detailed information on transactions involving federal money and other evidence to show compliance with federal grant requirements.

Primary resources on the Internet

[Grant Writing and Administration](#) - This page on the Municipal Research and Services Center (MRSC) of Washington website can help local governments locate and obtain federal, state and private foundation grants. It includes resources on grant writing and grant administration as well as general information sources.

[Suspension and Debarment List](#) - This page on the federal System for Award Management (SAM) website can help local governments find out if a vendor or subrecipient is suspended or debarred from participating in federal awards.

[Code of Federal Regulations](#) - This page on the U.S. Government Printing Office's website allows local governments to research the Code of Federal Regulations (CFR). The Code is updated annually, with different sections address each quarter.

[Federal Circulars](#) - This page on the U.S. Office of Management and Budget (OMB) website provides grants management circulars with information on a broad range of rules and cost principles, including: A-87 (Cost Principles); A-102 (The Common Rule), and A-133 (Audits of Federal Awards).

Need more detailed information?

Explore additional information on the [basics of federal grant programs](#), [internal control checklists](#), and [developing indirect cost rates](#).

Guidance is relevant to [Local Governments : Single Audits](#)

Guidance is relevant to [State Government : Single Audits](#)

Washington State Auditor's Office contacts

Pat McCarthy

State Auditor

(360) 902-0360

Pat.McCarthy@sao.wa.gov

Scott DeViney, CPA

Audit Manager

(360) 260-6408 x112

Scott.Deviney@sao.wa.gov

Cavan Busch

Assistant Audit Manager

(360) 725-5578

Cavan.Busch@sao.wa.gov

Felicia Den Adel

Single Audit Specialist

(360) 481-9040

Felicia.Denadel@sao.wa.gov