



***Statewide Financial Internal Controls  
Program***

***Internal Controls & Best Practices for  
Federal Grant Management & Monitoring***

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# INTERNAL CONTROLS & BEST PRACTICES FOR FEDERAL GRANT MANAGEMENT & MONITORING

## INTRODUCTION

As many agencies begin to receive an influx of Federal Stimulus money, as a result of the American Recovery and Reinvestment Act of 2009 (ARRA), much of this expected to be in the form of federal grants. The State Controller's Division (SCD) has created this guidance to address the need for adequate internal controls and best practices for grant management and monitoring practices.

This guide is intended to be utilized in conjunction with the following resources:

- *Techniques for Monitoring Federal Subawards, 2<sup>nd</sup> Edition* – Thompson Publishing
- *Current Topics In Grant Management: Key Issues In Managing Federal Awards* – Thompson Publishing
- *Internal Control – Integrated Framework, Guidance on Monitoring Internal Control Systems* (Introduction, Volume I: Guidance, Volume II: Application, and Volume III: Examples) – Committee of Sponsoring Organizations of the Treadway Commission (COSO)
- *Internal Controls for the American Recovery and Reinvestment Act, Self-Assessment Analysis Tool* – State Controller's Division, Statewide Internal Controls Program
- *OMB Circular A-133 Compliance Supplement Part 6, Internal Controls* – Executive Office of the President, Office of Management and Budget
- *OMB Circular A-133 Compliance Supplement Appendix VII, ARRA* – Executive Office of the President, Office of Management and Budget
- *OMB Circular A-133 Compliance Supplement Addendum #1* – Executive Office of the President, Office of Management and Budget

Please note that the information contained in this document indicates suggested controls and procedures that are recommended by several different organizations. This is not intended to be an all-inclusive list of controls or a required policy statement. This guide should be utilized to assist the organization in developing, implementing, and monitoring controls for grants management.

**INTERNAL CONTROLS & BEST PRACTICES FOR FEDERAL GRANT  
MANAGEMENT & MONITORING**

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Internal controls can help organizations meet their goals as well as prevent a loss of resources, help ensure reliable financial reporting, compliance with laws and regulations. In essence, it can help the organization meet established goals and objectives without falling victim to otherwise common mistakes in the process.

However, there are limits to what internal controls can do, and it is important to be aware of these limits. Internal controls do not provide for absolute, they can only provide a reasonable assurance to management that the organization will achieve its objectives. In addition, internal controls are a process, a means to an end; but not an end in themselves. Internal controls can also be affected by people at all levels of the organization, not merely policies and procedures.

### **Internal Control Objectives**

Internal controls over grant processes are put in place to help ensure:

1. Effectiveness and efficiency of operations; funds, property, and other assets and resources are safeguarded against loss from unauthorized use or disposition.
2. Reliability of financial reporting; transactions are accurately recorded and accounted for so that reliable financial statements and federal reports can be prepared, to ensure accountability over assets and to demonstrate compliance with laws, regulations, and other compliance requirements.
3. Compliance with applicable laws and regulations; transactions are executed in compliance with laws, regulations and provisions of contracts and grant agreements that could have a direct and material effect on a federal program.

### **Grantee Internal Controls**

OMB Circular A-102 Common Rule requires that federal grant funds be spent and accounted for in accordance with state laws and procedures in place for the expenditure of the state's own funds. In addition, there must be sufficient fiscal and accounting controls in place, for primary and subgrantees, to allow for the preparation of required reports, and allow funds to be traced to sufficiently to establish that expenditures were not in violation of any restriction or applicable statutes.

*OMB Circular A-133 Compliance Supplement, Part 6 – Internal Controls* is intended to assist federal grant recipients and their auditors in complying with the requirements of both OMB Circular A-133 and the Circular A-102 Common Rule. For each of the 13 compliance areas listed below, it describes each of the five components of the internal control system and highlights certain characteristics that may help ensure compliance with federal program requirements. This is covered separately for each of the following compliance areas:

1. Activities allowed or unallowed
2. Allowable costs and cost principles
3. Cash management
4. Davis-Bacon Act
5. Eligibility
6. Equipment and real property management
7. Matching, level of effort, earmarking

8. Period of availability of federal funds
9. procurement and suspension and debarment
10. Program Income
11. Real property acquisition and relocation assistance
12. Reporting
13. Subrecipient monitoring

## **Roles & Responsibilities**

Each party in the grant process plays an important role and has distinct important responsibilities in order to help ensure success of the grant and effected programs. It is important that these roles and responsibilities are clearly defined and understood by each of the parties involved in order to ensure success of the grant.

### Important Pass-Through Entity Responsibilities

1. Identify and provide information about federal awards to subrecipients.
2. Inform subrecipients about compliance requirements
3. Monitor subrecipient activities
4. Ensure subrecipients have single audits, if total federal awards exceed \$500,000.
5. Provide technical advice and training, when necessary and feasible.
6. Issue management decisions within six months on subrecipient single audit findings and ensure subrecipients take corrective action.
7. Consider whether pass-through entity records must be adjusted as a result of subrecipient audits.
8. Require subrecipients to permit the pass-through entity and its auditors to access their records for monitoring and audit purposes.

### Important Subrecipient Entity Responsibilities

1. Administer the grant from award to closeout.
2. Develop internal policies and systems to ensure effective management of federal funds and compliance with public policy requirements.
3. Ensure the organization has a financial management system and any other systems that are appropriate such as procurement and property management systems.
4. Establish a budget of costs required to perform the program and a method for monitoring actual costs against the budget.
5. Keep abreast of changes in policies, procedures or requirements, and advise staff of any changes.
6. Request prior approvals when necessary.
7. Make the most of site visits by the pass-through entity by showing organizational strengths and successes.
8. Prepare necessary reports.
9. Keep the pass-through entity aware and informed about subaward projects progress.

### Federal Awarding Agency Responsibilities

1. No direct contractual relationship with the pass-through entities subrecipient.
2. Confirmation that federal funds are ultimately used to meet the federal program objectives.
3. Rely on pass-through entity to monitor subrecipients and reports progress.

4. Right to review subrecipient records, although federal agencies typically do not interact with subrecipients.
5. Keep recipients and sup-recipients informed of programmatic changes.
6. Respond to questions from both the pass-through entity and the subrecipients.

### **The Subaward Agreement**

There are several important issues to take into account when considering a subaward agreement. When properly executed, the subaward agreement can be an important tool to assist the primary recipient in monitoring the activities of the subrecipient.

1. Although each subaward involves different parties and is therefore different in nature; it is beneficial to consider standardizing agreements when possible.
2. Include the scope of work and proposed budget.
3. Include relevant portions of the program's authorizing statute and policy requirements.
4. Administrative requirements describing how the subrecipient should administer the federal program.
5. Specify the types of reports that subrecipients are required to submit. This should include both financial and progress reports.
6. Specify the necessary programmatic records that sup-recipients should maintain as well as the retention requirements (in general this should be at least three years unless otherwise specified).
7. Access to records by the pass-through entity and their auditors, as well as the federal awarding agency.
8. Requirements for subrecipients to obtain prior approvals.
9. Federal, state, and programmatic regulations and requirements. This can be done by directly referencing requirements in the subaward, or by requiring a signed certification statement.
10. In general, the subaward should specify each party's responsibility for the following:
  - a. Financial management standards
  - b. Payments
  - c. Matching
  - d. Reporting and recordkeeping
  - e. Cost principles
  - f. Period of availability of funds
  - g. Procurement
  - h. Program income requirements
  - i. Real property, equipment, and supply requirements
  - j. Monitoring
  - k. Audits

### **Monitoring Procedures**

As part of the single audit, grant recipients can expect auditors to test their system for monitoring federal subawards. It is therefore increasingly important that a system for monitoring be in place prior to the subaward agreement in order to avoid audit findings. In addition, monitoring can be an effective way to follow-up on previous audit findings.

The best mix of monitoring tools will depend on the specific relationship between the pass-through entity and the subrecipient. Since resources for subrecipient monitoring are likely limited, it is important to try and find the most efficient and effective method for monitoring. It may be useful to consider risk based approach to the monitoring process.

There are various methods that can be utilized for monitoring – many of these options are not required, but can be very effective.

1. Review single audits.
2. Arrange for limited-scope audits.
3. Schedule site visits.
4. Review subrecipient reports.
5. Require prior approvals for certain activities.
6. Require third-party evaluations.
7. Provide technical assistance and training.
8. Regular communication, this can be via telephone or other means such as e-mail.
9. Stay informed of subrecipient coverage in the news.

If the subgrantee is considered “high risk,” it may be necessary to adopt special conditions.

1. Require subrecipients to be paid on a reimbursement basis.
2. Withhold the authority to proceed to the next phase of the project until the pass-through entity receives evidence of acceptable performance.
3. Require additional or more detailed financial reports.
4. Require the subrecipient to obtain technical or management assistance.
5. Establish additional prior approvals.

There are several factors to consider when assessing subrecipient risk:

1. Size of the subaward administered by the subrecipient.
2. Percentage of the pass-through entities total federal funds awarded to the subrecipient.
3. Complexity of the subaward requirements.
4. Subrecipient’s prior experience with administering a federal subaward.
5. Subrecipient’s prior monitoring and audit results.
6. Type of subaward being administered (single year vs. multi-year)

### **A-133 – Single Audit**

For those entities that are subject to the single audit requirements, it can be a very important part of the internal controls structure within the grants management processes. It can prove to be a very valuable tool in an ongoing monitoring process.

There are several important aspects to be aware of with regard to single audits. The primary recipient is responsible for ensuring a subrecipient has a single audit conducted, when required (over \$500,000 total expending in federal funds). Non-required audits are not allocable to grant funds and must be conducted at the expense of the pass-through entity or the subrecipient.

The single audit report contains valuable information about the subrecipients use of federal money and compliance with program requirements and objectives. It is

recommended that the following components of the single audit be reviewed as part of the monitoring process:

1. The auditor's opinion on the financial statements.
2. The auditor's report on internal controls – ensure all significant deficiencies and material weaknesses are corrected.
3. The auditor's report and opinion on compliance with laws and regulations that could have an effect on major programs.
4. The schedule of findings and questioned costs.
5. The subrecipient's corrective action plan.

There are several limitations to the single audit. Therefore, while it is useful to use the single audit as part of the monitoring process, it is not recommended that pass-through entities rely solely on the single audit as the only source of monitoring information.

Some of the limitations include:

1. Auditors only test subrecipients compliance with program requirements for "major programs."
2. Auditor's testing is only required to cover 50% of the subrecipients programs. Although, many times auditors testing covers up to 90% of the programs.
3. Subrecipient audit reports are not available until nine months after the end of the subrecipients fiscal year.

In general, the subrecipient is responsible for submitting the final audit report to the pass-through entity. Once the pass-through entity has received the single audit report it has six months to review it and issue a management decision regarding any findings. The management decision must include a statement whether or not the pass-through entity sustains the audit findings identified, the reason for their decision, and the corrective action the subrecipient must take. If the subrecipient has not already completed the corrective action, a timeline should be included. If necessary, the pass-through entity may request additional information from the subrecipient prior to issuing the management decision.

The subrecipient is only required to submit the audit report to the pass-through entity if the report includes audit findings related to the subaward. If the report is not being submitted, the subrecipient must send a letter to the pass-through entity stating that the subrecipient had a single audit conducted and that no findings affected the award.

A subrecipient must correct any issues resulting for the single audit in the time period specified by the pass-through entity. To demonstrate the corrective action, a subrecipient may need to:

1. Provide revised documentation or a report for the pass-through entity to review.
2. Undergo a follow-up visit by the pass-through entity.

OMB Circular A-133 provides several areas that auditors are expected to review for compliance. Grantee organizations can use this list to address areas of potential concern regarding the grant process within their organization.

Allowable costs: ensure staff have an adequate understanding of what grant funds can be used for.

1. Cash management: ensure written policies and procedures exist, and are up to date, regarding scheduling draw downs, payroll, accounts payable and special circumstances, and cash deposit requirements.

2. Davis-Bacon Act (Federally assisted construction only): internal training including procedures for communication with contractors who are responsible for records retention regarding prevailing wage information.
3. Eligibility: current documented procedures for determination of eligibility of program benefits. Identify and assess the risks of utilizing incorrect information. Ensure procedures are in place to verify information submitted by eligible parties, and access to that information is limited as necessary.
4. Equipment and real property management: standards for property management have been identified and address issues such as property records, periodic inventory, maintenance procedures, security procedures, and property disposition.
5. Matching and cost sharing, maintenance of effort and earmarking: procedures should address the methods used for matching and cost sharing (i.e. quarterly, annually, or over the period of support). Take care to address procedures address steps to avoid double counting of matching funds and accurate valuation of third-party in kind contributions.
6. Period for availability of funds: ensure staff involved in the grant program have access to grant agreements; this will enable increased awareness particularly in the area of budgeting.
7. Procurement: a documented code of conduct. Ensure this addresses what constitutes a conflict of interest and how staff should behave.
8. Program income: up to date written procedures regarding the capturing and recording of income produced as a result of grant funded activity.
9. Reporting: current documented procedures for tracking report due dates; including established processes for identifying and monitoring reporting due dates.
10. Subrecipient monitoring: monitor subawards based on the number and size of subgrants awarded using a risk-based model. Other factors to consider include the size of the subgrantee portfolio, past grant performance, and the entities stability as a going concern.

## Onsite Visits

Onsite visits can be a useful component of the monitoring process. They are most commonly used to:

1. Inspect the subrecipients facilities and operations to ensure compliance with government wide and program requirements.
2. Interview staff to ensure they are informed of and carry out program policy and regulations adequately.
3. Review documentation and records such as invoices and payrolls that support subrecipient reports.
4. View delivery of program services such as training.
5. Become familiar with subrecipient operations and staff.
6. Learn about the subrecipients progress and problems.

Onsite visits are often more costly than some of the other types of monitoring techniques because they require staff time and travel. Many pass-through entities utilize onsite visits for subawards that require closer supervision.

1. Programs with complex compliance requirements.
2. High dollar programs.

3. Programs new to the grant process.
4. Programs with prior audit or monitoring findings.
5. High profile programs in which there is a vested interest.
6. Programs administered by inexperienced subrecipients or subrecipients with inexperienced staff.
7. Programs in which the subrecipient has requested and onsite visit.
8. Subrecipient sites that have not been visited recently.

Each subaward is different in nature and will necessitate different procedures for an onsite review. However, there are several common areas that should be considered when planning an onsite visit.

1. Policies and procedures for accounting, financial management, personnel, labor, and procurement.
2. Internal control systems.
3. Program income records.
4. Inventory and property records.
5. Compliance with Americans with Disabilities Act and Section 504 of the Rehabilitation Act of 1973.
6. Eligibility determinations.
7. Other program related compliance areas that are significant to the subaward.

### **Results of Monitoring**

It is important to ensure the pass-through entity keeps accurate and complete records of the monitoring activities and other important information regarding the subaward, including:

1. Subrecipients name and address.
2. Federal program name.
3. Subrecipient contact person.
4. Subaward agreement number.
5. Date of each monitoring activity.
6. Type of monitoring conducted.
7. Purpose of monitoring (review program progress/compliance, perform follow-up, or other specific purpose).
8. Subrecipient staff contacted/interviewed.
9. Beneficiaries contacted/interviewed.
10. Related reports.
11. Monitoring results.
12. Subrecipient contact person responsible for follow-up action.
13. Pass-through entity contact person responsible for follow-up action.
14. Deadline for corrective action.

When conducting a follow-up visit, pass-through entities should look at the overall results of their previous monitoring to identify:

1. Recurring problems unique to one program of which the federal awarding agency should be informed.
2. Opportunities to better monitor funds they subaward.
3. Recurring problems with individual subrecipients.

Subrecipients should look at the overall monitoring to identify:

1. Recurring problems that affect several programs and need to be corrected.
2. Effective methods to administer subawards and comply with programs requirements that can be applied to other subawards.
3. Program-specific problems that may require a change in the way pass-through or federal agencies administer the program.

## Communication

Open, regular communication between the pass-through entity and the subrecipient can facilitate more effective risk mitigation and corrective action when necessary. In addition, it can ease tensions during onsite visits and throughout the single audit process.

It is important that pass-through entities take steps to ensure subrecipients understand relevant laws, regulations, and requirements that apply to the subaward. Many pass-through entities prepare an information packet that includes, when applicable, the following information:

1. Program authorizing legislation.
2. Applicable excerpts of program regulations.
3. Relevant public policy laws, such as Davis Bacon Act.
4. The Catalog of Federal Domestic Assistance (CFDA) program listing.
5. Applicable OMB Circulars.
6. Applicable excerpts of the Federal Acquisition Regulation.
7. Relevant state laws and regulations.
8. Guidelines developed by the pass-through entity.

## Internal Control Assessment Checklist

It is important that the pass-through entity take steps to ensure it has internal controls in place to support its subrecipients monitoring objectives. The following questions may help a pass-through entity in conducting a self-assessment. The questions are broken down according to the five interrelated components of an internal controls system: control environment, risk assessment, control activities, information and communication, and monitoring.

### Control Environment:

1. Does the tone at the top demonstrate management's commitment to monitoring subrecipients?
2. Is management intolerant of overriding established procedures to monitor subrecipients?
3. Is the entity's organizational structure and its ability to provide the necessary information flow to monitor subrecipients adequate?
4. Are sufficient resources dedicated to subrecipient monitoring?
5. Are the knowledge, skills, and abilities needed to accomplish subrecipient monitoring tasks defined?
6. Do individuals performing these tasks possess the knowledge, skills, and abilities required?
7. Do subrecipients demonstrate that:
  - a. They are willing and able to comply with the requirements of the award.

- b. They have accounting systems, including the use of applicable cost principles, and internal controls systems adequate to administer the award.
8. Are appropriate sanctions taken for subrecipient noncompliance?

#### Risk Assessment

1. Do key managers understand the subrecipients environment, systems, and controls sufficiently to identify the level and methods of monitoring required?
2. Do mechanisms exist to identify the risks arising from external sources affecting subrecipients such as risks related to:
  - a. Economic conditions
  - b. Political conditions
  - c. Regulatory changes
  - d. Unreliable information
3. Do mechanisms exist to identify and react to changes in subrecipients such as:
  - a. Financial problems that could lead to diversion of grant funds.
  - b. Loss of license or accreditation to operate the program.
  - c. Rapid growth.
  - d. New activities, products, or services.
  - e. Organizational restructuring.

#### Control Activities

1. Does an official written policy exist establishing:
  - a. Communication of federal award requirements to subrecipients.
  - f. Responsibilities for monitoring subrecipients.
  - g. Process and procedures for monitoring.
  - h. Methodology for resolving findings of subrecipient noncompliance of weakness in internal controls.
  - i. Requirements for and processing of subrecipient audits, including appropriate adjustments of pass-through entity accounts.
2. Describe how subrecipients compliance with audit requirements is monitored. The techniques that may be used include the following:
  - a. Determining by inquiry and discussion whether the subrecipient met thresholds required for an audit under Circular A-133.
  - b. If an audit is required, assuring that the subrecipient submits the report, reporting package, or they documents required by the latest circular or recipients requirements.
  - c. Follow-up on reported deficiencies related to programs funded by the recipient.
  - d. If a subrecipient was required to obtain an audit in accordance with Circular A-133 but did not do so, following up with subrecipient until the audit is completed and taking appropriate actions such as withholding further funding until he subrecipient meets the audit requirements.
3. Describe the follow-up system used to track reported subrecipient deficiencies and corrective action.
4. Describe how subrecipients compliance with federal program requirements is monitored. The following techniques may be used:
  - a. Issue timely management decision for audit and monitoring findings to inform the subrecipient whether the corrective action planned is acceptable.

- b. Maintain a system to track and follow-up on reported deficiencies related to programs funded by the recipient and ensure that timely corrective action is taken.
  - c. Contact subrecipients regularly and make appropriate inquiries concerning the federal program.
  - d. Review subrecipient reports and follow-up on areas of concern.
  - e. Monitor subrecipient budgets.
  - f. Perform visits to subrecipients to review financial and programmatic records and observe operations.
  - g. Offer subrecipient technical assistance where needed.
5. Are the federal award information and application compliance requirements identified to subrecipients?
  6. Do agreements with subrecipients specify the compliance requirements applicable to the federal program, including the audit requirements of Circular A-133?

#### Information and Communication

1. Do standard award documents used by the nonfederal entity contain:
  - a. A listing of federal requirements that the subrecipient must follow.
  - b. The description and program number for each program as stated in the CFDA.
  - c. A statement signed by an official of the subrecipient, stating that the subrecipient was informed of, understands, and agrees to comply with the application compliance requirements.
2. Is there a record-keeping system in place to ensure that documentation is retained for the time period required by the recipient?
3. Are procedures in place to provide channels for subrecipients to communicate concerns to the pass-through entity?

#### Monitoring

1. Has a tracking system been established to ensure timely submission of required reporting such as:
  - a. Financial reports
  - b. Performance reports
  - c. Audit reports
  - d. On-site monitoring reviews of subrecipients
  - e. Timely resolution of audit findings
2. Are supervisory reviews performed to determine the adequacy of subrecipient monitoring?