Strings Attached: Accounting for Intergovernmental Grants

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INTRODUCTION: THE FORT WORTH WAY
To Centralize or Not to Centralize ...?

Table I. Location of primary responsibility for grants management in 15 local jurisdictions

<table>
<thead>
<tr>
<th>Pre-Application</th>
<th>Application Development</th>
<th>Financial Management</th>
<th>Grant Compliance</th>
<th>Evaluation</th>
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<tr>
<td>Decentralized</td>
<td>Decentralized with Support</td>
<td>Decentralized with Support</td>
<td>Decentralized with Oversight</td>
<td>Decentralized with Oversight</td>
</tr>
<tr>
<td>Centralized</td>
<td>Centralized with Support</td>
<td>Combination</td>
<td></td>
<td>Centralized</td>
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Legend:
- Decentralized
- Decentralized with Support
- Decentralized with Oversight
- Centralized
- Combination of Decentralized & Centralized
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PART ONE: ACCOUNTING/FINANCIAL REPORTING
Nonexchange transactions

• What is a “transaction”?  
  • External events in which something of value (benefit) passes between two or more parties [GASB Cod. Sec. N50.512]

• What are “grants and other financial assistance”?  
  • Transactions in which one governmental entity transfers cash or other items of value to (or incurs a liability for) another governmental entity, an individual, or an organization as a means of sharing program costs, subsidizing other governments or entities, or otherwise reallocating resources to the recipients. [GASB Cod. Sec. N50.504]
Nonexchange transactions

• What are “exchange or exchange-like” transactions?
  • The difference between exchange and exchange-like transactions is a matter of degree. In contrast to a "pure" exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition. [GASB Cod. Sec. N50.503]

• What are “non-exchange” transactions?
  • A government either gives value (benefit) to another party without directly receiving equal value in exchange or receives value (benefit) from another party without directly giving equal value in exchange.
Types of nonexchange transactions

- Derived tax revenues (income/sales tax)
- Imposed nonexchange revenues (property taxes, fines/penalties)
- Government-mandated nonexchange transactions (revenue sharing, certain grants)
- Voluntary nonexchange transactions (certain grants, private donations)
Recognizing grant receivables / revenues

• Formula grants
  • When eligibility requirements (including time requirements) are met

• Expenditure-driven grants
  • When qualifying expenditures are incurred

• Notes:
  • *Purpose restrictions* do not impact recognition
  • Governmental funds defer revenue recognition until amounts are available
Uniform Guidance (2 CFR 200)

Standards for Financial Management

• Recipients must:
  • Comply with all requirements of award
  • Maintain performance measurement systems
  • Maintain financial management systems:
    • Separate identification of federal awards
    • Complete/accurate financial results
    • Support for federal draws
    • Effective control/accountability
    • Written procedures
Uniform Guidance (2 CFR 200)

Internal control over grants management

• Recipients must:
  • 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
  • “Should” be consistent with GAO Green Book / COSO (see CS Part 6)
The Green Book

- Standards for Internal Control in the Federal Government
  - Sets internal control standards for federal entities
  - May also be adopted by state and local governments and nonprofits as a framework for an internal control system
What is internal control?

• Internal control is a process used by management to help an entity achieve its objectives
  • Run its operations efficiently and effectively
  • Report reliable information about its operations
  • Comply with applicable laws and regulations
The COSO Cube

- The Components, Objectives, and Organizational Structure of Internal Control
The 17 Principles

• Each of the five components of internal control contains several principles. Principles are the requirements of each component.
COSO Components / Principles

Control Environment

- The set of standards, processes, and structures that provide the basis for carrying out internal control across the organization
  - Principle 1: Demonstrate Commitment to Integrity and Ethical Values
  - Principle 2: Exercise Oversight Responsibility
  - Principle 3: Establish Structure, Authority, and Responsibility
  - Principle 4: Demonstrate Commitment to Competence
  - Principle 5: Enforce Accountability
COSO Components / Principles

Risk Assessment

- A dynamic and iterative process for identifying and assessing the possibility that an event will occur and adversely affect the achievement of objectives

  - Principle 6: Define Objectives and Risk Tolerances
  - Principle 7: Identify, Analyze, and Respond to Risks
  - Principle 8: Assess Fraud Risk
  - Principle 9: Identify, Analyze, and Respond to Change
COSO Components / Principles

Control Activities

• The actions established through policies and procedures that help ensure that management’s directives to mitigate risks to the achievement of objectives are carried out
  • Principle 10: Design Control Activities
  • Principle 11: Design Activities for the Information System
  • Principle 12: Implement Control Activities
COSO Components / Principles

Information and Communication

• The continual, iterative process of providing, sharing, and obtaining necessary information to carry out internal control responsibilities to support the achievement of the entity’s objectives
  • Principle 13: Use Quality Information
  • Principle 14: Communicate Internally
  • Principle 15: Communicate Externally
COSO Components / Principles

Monitoring Activities

• Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of the five components of internal control, including controls to effect the principles within each component, is present and functioning
  • Principle 16: Perform Monitoring Activities
  • Principle 17: Evaluate Issues and Remediate Deficiencies
COSO
Documenting Internal Control

• Documentation is a necessary part of an effective internal control system
  • Required to demonstrate the design, implementation, and operating effectiveness of an entity’s internal control system
  • The level and nature of documentation vary based on the size of the entity and the complexity of the operational processes the entity performs (based on management judgment)
  • While smaller governments may not require as formal documentation, certain elements (such as risk assessment) cannot be performed entirely in the CFO’s head
Uniform Guidance (2 CFR 200)

Documenting IC over Compliance

• Compliance areas

A. Activities allowed or unallowed
B. Allowable costs/cost principles
C. Cash management
D. [reserved] *
E. Eligibility
F. Equipment and real property management
G. Matching, level of effort, and earmarking
H. Period of performance
I. Procurement/suspension and debarment
J. Program income
K. [reserved]
L. Reporting
M. Subrecipient monitoring
N. Special tests and provisions
High-level Controls

Granular Controls

Control Environ Info & Comm Risk Assess Monitoring Control Activities

Entity-wide controls
Program-specific controls
The GFOA recommends that governments establish processes to promote awareness throughout the government that grants normally come with significant requirements. Such processes should ensure that this awareness exists throughout the life of the grant and should address the following areas and include the following elements...
Any Questions
Strings Attached: Accounting for Intergovernmental Grants

PART TWO: COMMUNICATION IN A DECENTRALIZED ENVIRONMENT
Free Money!

Or

Strings Attached

WHAT DO YOU THINK?
So what are these “strings” of which you speak?”
... and the biggest “string” of all?
The Et cetera!
Conflict Is Natural!
Changing behavior in a decentralized organization is like ...?

SO

How do we get from here ... ... to here?
Good Communication ...

... doesn’t happen by accident!
Two Successful Fort Worth Tools ...

GRANT KICK-OFF MEETING

• Clarify Roles and Expectations
• Capital Equipment/Construction?
• Matching Requirements?
• Indirect Costs?
• Dedicated Personnel/Salaries?
• Set-Up Requirements?
• Reporting?

GRANT ROUNDTABLES (ALL-INCLUSIVE!)

• Purchasing/Legal/Records Retention
• HR/Payroll
• Subrecipient Monitoring
• Federal/State Guest Speakers
• Job Aids/Best Practices
• Training/Q&A/Open Forum
• Etc. ... but the *good* kind!
Do you have any questions?
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PART THREE: INTERNAL CONTROLS OVER COMPLIANCE
Uniform Guidance (2 CFR 200)
Internal Control over Compliance

• Compliance areas

A. Activities allowed or unallowed
B. Allowable costs/cost principles
C. Cash management
D. [reserved] *
E. Eligibility
F. Equipment and real property management
G. Matching, level of effort, and earmarking
H. Period of performance
I. Procurement/suspension and debarment
J. Program income
K. [reserved]
L. Reporting
M. Subrecipient monitoring
N. Special tests and provisions
Uniform Guidance (Subpart E)

Cost Principles

• Fundamental premises:
  • The non-Federal entity is responsible for effective/efficient administration of the federal award
  • The non-Federal entity must comply with agreements, objective, terms, and conditions of the federal award
  • The non-Federal entity has primary managerial responsibility
Uniform Guidance (Subpart E)

Cost Principles

• Fundamental premises:
  • Applying these cost principles should require no significant changes to sound internal accounting policies/procedures
  • Indirect costs should be allocated consistently with the negotiated basis
  • The non-Federal entity may not earn or keep profit resulting from Federal awards
Uniform Guidance (Subpart E)

Cost Principles

• Composition of costs:
  • The “total cost” of a Federal award is the sum of the allowable direct and allocable indirect costs less any applicable credits
Uniform Guidance (Subpart E)
Cost Principles

• “Allowable” costs:
  • Necessary and reasonable for the performance of the Federal award
  • Conform to any limitations or exclusions set forth in these principles
  • Consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity
Uniform Guidance (Subpart E)

Cost Principles

• “Allowable” costs:
  • Accorded consistent treatment (direct vs. indirect)
  • Determined in accordance with generally accepted accounting principles
  • Not included as a cost or used to meet cost sharing or matching requirements of any other federally financed program
  • Adequately documented
Uniform Guidance (Subpart E)

Cost Principles

• “Reasonable” costs:
  • A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost
Uniform Guidance (Subpart E)

Cost Principles

• “Reasonable” costs:
  • Ordinary and necessary for operations
  • Sound business practices/arm’s-length bargaining
  • Market prices for comparable goods/services for the geographic area
  • Individuals act with prudence
  • No significant deviation from established practices/policies to increase costs
Uniform Guidance (Subpart E)

Cost Principles

• “Allocable” costs:
  • Based on the relative benefits received:
    • Incurred specifically for federal award
    • Benefits both federal awards and other work (distribute proportionately)
    • Necessary for overall operation of the non-Federal entity
  • Allocable costs may not be charged to other Federal awards to overcome funding deficiencies
Uniform Guidance (Subpart E)

Cost Principles

• “Allocable” costs:
  • Use direct allocation if feasible without undue effort or cost
  • Otherwise, allocate on any reasonable documented basis
Uniform Guidance (Subpart E)

Cost Principles

• “Applicable credits”:
  • Receipts or reduction-of-expenditure-type transactions that reduce expense items allocable to a Federal award as direct or indirect costs
  • Examples: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments
Uniform Guidance (Subpart E)

Cost Principles

• Prior written approval:
  • Reasonableness and allocability can be difficult to determine
  • To avoid later disallowances or disputes, non-Federal entities may request prior written approval
Uniform Guidance (Subpart E)

Cost Principles

• Direct and indirect costs:
  • § 200.412 Classification of costs
  • There is no universal rule for classifying certain costs as either direct or indirect (F&A) under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the Federal award or other final cost objective.
Uniform Guidance (Subpart E)

Cost Principles

• Direct costs:
  • Can be identified specifically with a particular final cost objective
  • Minor items may be treated as indirect for reasons of practicality, if consistently applied
  • Unallowable costs may still be direct
Uniform Guidance (Subpart E)

Cost Principles

• Indirect (F&A) costs:
  • Classified as “facilities” (space costs) or “administration” (overhead costs)
  • Cannot be identified specifically with a particular final cost objective
Uniform Guidance (Subpart E)

Cost Principles

• Indirect (F&A) costs:
  • If there is a federally “negotiated rate”, it must be accepted by all federal agencies
  • Otherwise, use a 10% MTDC de minimus rate
  • Pass-through entities may, but are not required to, negotiate a rate with a proposed subrecipient who asks to do so (FAQ .331-6)
Uniform Guidance (Subpart E)
Cost Principles

• Indirect (F&A) costs:
  • §200.100(c)
  • The principles are designed to provide that Federal awards bear their fair share of cost recognized under these principles except where restricted or prohibited by statute.
Uniform Guidance (Subpart E)

Cost Principles

• Selected items of cost:
  • 55 specific items are included
  • Apply to both direct and indirect costs
  • Failure to mention a particular item of cost does not imply that it is either allowable or unallowable (apply general principles of allowability)
  • The provisions of a specific award always govern in the case of a discrepancy
Internal Control Examples

Activities Allowed/Allowable Costs/Cost Principles

• Control Objectives - to provide reasonable assurance that:
  • Federal awards are expended only for allowable activities
  • Costs of goods and services charged to Federal awards are allowable and in accordance with the applicable cost principles
Internal Control Examples

Activities Allowed/Allowable Costs/Cost Principles

• Control Activities
  • Adequate segregation of duties
  • Authorization is performed by a knowledgeable individual
  • Computations are checked for accuracy
  • Supporting documentation compared to list of allowable and unallowable expenditures
  • Accounting policies consistently applied
Internal Control Examples

Cash Management

• Control Objectives - to provide reasonable assurance that:
  • Drawdown of Federal cash is only for immediate needs
  • Reimbursement is requested only after costs have been incurred
  • States comply with applicable Treasury agreements
  • Recipients limit payments to subrecipients to immediate cash needs
Internal Control Examples
Cash Management

• Control Activities
  • Cash flow statements by program are prepared to determine essential cash flow needs
  • Appropriate level of supervisory review of cash management activities
  • Written policy that provides:
    • Procedures for requesting cash advances as close as is administratively possible to actual cash outlays and reimbursement only after costs have been incurred
    • Monitoring of cash management activities
    • Repayment of excess interest earnings where required
Internal Control Examples

Eligibility

• Control Objectives - to provide reasonable assurance that:
  • Only eligible individuals and organizations receive assistance under Federal award programs
  • Subawards are made only to eligible subrecipients
  • Amounts provided to or on behalf of eligible individuals or groups of individuals were calculated in accordance with program requirements
Internal Control Examples

Eligibility

• Control Activities
  • Written procedures for calculating eligibility amounts
  • Manual criteria checklists or automated process used in making eligibility determinations
  • Verification of accuracy of information used in eligibility determinations
  • Process to discontinue benefits when necessary
  • Safeguards to limit access to participant files
Internal Control Examples

Reporting

• Control Objectives - to provide reasonable assurance that:
  • Reports of Federal awards submitted to the Federal awarding agency or pass-through entity:
    • Include all activity of the reporting period
    • Are supported by underlying accounting or performance records
    • Are fairly presented in accordance with program requirements
Internal Control Examples

Reporting

• Control Activities
  • Tracking system which reminds staff when reports are due
  • The general ledger or other reliable records are the basis for reports
  • Supervisory review of reports
  • Written policies
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PART FOUR: SUBRECIPIENT MONITORING
Yes, We Have No Subrecipients?

SUBRECIPIENTS

• Subaward brings with it all responsibilities and obligations of the pass-through entity (PTE): meeting objectives, reporting, audits
• Competitive award not required
• Determines eligibility/designs project
• Little independent decision-making: providing the specific good or service by a specific date for a pre-set price
• Carries out program for public purposes specific to the award

CONTRACTORS

• Contractor simply provides goods and services (procurement process)
• Typically awarded via competition
• Typically sells to many customers and operates outside the federal/state program
• Little independent decision-making: providing the specific good or service by a specific date for a pre-set price
Okay, so I’ve got one ... Now what do I do with it?
A subrecipient is a big responsibility, son!

I promise, mommy. I’ll take good care of him. I’ll walk him every day. I’ll feed him and clean up after him and ...
Assessing subrecipient risk

THINGS TO LOOK AT:

- Management Experience
- Management Stability (Turnover)
- Organizational Track Record
- Audit History
- Unallowable Costs
- Written Policies & Procedures
- Internal Controls

• The federal Uniform Guidance (2 CFR 200.331b) requires IU to “evaluate each subrecipient’s risk of noncompliance with Federal statutes, regulations, and the terms and conditions of the subaward for purposes of determining the appropriate subrecipient monitoring.”
Now Comes the Hard Part: Subrecipient Monitoring!
If you didn't document it, it didn't happen
“I had a great plan. I executed the plan. The subrecipient still made mistakes ...
“No battle plan ever survives contact with the enemy.”

*Helmuth von Moltke the Elder*

Prussian general

born October 26, 1800
ANY QUESTIONS