The Basics of Federal Grants Compliance

Carol Barnard, CPA, CFE, MBA
Learning Objectives

- Learn how the 2019 Compliance Supplement affects you and your audit.
- Understand the 12 compliance areas in the 2019 Supplement.
- Apply the principles to your internal control policies and procedures.
The Supplement: *It’s Required*

- The Compliance Supplement is a document released annually by the Office of Management and Budget (OMB) and has key details about audit expectations and requirements.
- It is **mandatory** that auditors review the Compliance Supplement to check for inclusion of the major programs being tested.
- Part 2 is the Matrix of Compliance Requirements, listed by CFDA number that will dictate which of the 12 compliance areas are applicable to your major program.
Part 1: Background

“This document serves to identify existing important compliance requirements that the Federal Government expects to be considered as part of an audit required by the 1996 Amendments. Without the Supplement, auditors would need to research many laws and regulations for each program under audit to determine which compliance requirements are important to the Federal Government and could have a direct and material effect on a program. Providing the Supplement is a more efficient and cost-effective approach to performing this research. For the programs contained herein, the Supplement provides a source of information for auditors to understand the Federal program’s objectives, procedures, and compliance requirements relevant to the audit as well as audit objectives and suggested audit procedures for determining compliance with these requirements.”
Responsibilities of Agencies

“Federal agencies are responsible for annually informing the OMB of any updates needed to the Supplement and working with OMB to ensure that the Supplement focuses the auditor to test the compliance requirements most likely to cause improper payments, fraud, waste, abuse or generate audit findings for which the Federal awarding agency will take sanctions.”
Key Information

- The Office of Management and Budget (OMB) released the final 2019 Compliance Supplement on July 1, 2019.
- Unlike the 2018 Supplement, the 2019 is a stand-alone document.
- It is effective for years **beginning** after June 30, 2018.
- After AICPA released a letter noting all of the inconsistencies in the supplement, OMB re-released the 2019 Compliance Supplement with revisions on September 20, 2019. Significant changes were made to update Part 2, Part 4 and Part 6.
Parts of the Compliance Supplement

- Part 1 – Background, Purpose, and Applicability
- Part 2 - Matrix of Compliance Requirements (look here first)
- Part 3 – Compliance Requirements (12 areas)
- Part 4 – Agency Program Requirements (look here if your major program is included in Part 2)
- Part 5 – Cluster of Programs (R&D located at 5-2-1)
- Part 6 – Internal Control (extensive changes since 2017)
- Part 7 – Guidance for Auditing Programs Not Included in This Compliance Supplement (no changes from prior supplements)
- Part 8 – Appendices (V – List of Changes for the 2019 Compliance Supplement, i.e. CFDA numbers added/deleted, VI – Program-Specific Audit Guides, VII – Other Audit Advisories)
6-Requirement Mandate

• New in 2019, the OMB required agencies to limit the compliance requirements subject to testing in the audit to just **six per program**.

• **IMPORTANT NOTE:** The “Pick 6” mandate only applies to CFDA numbers that are listed in the Matrix in Part 2. If the major program you are testing is NOT in the Matrix then all applicable areas must be tested as they have in years past and the auditor is not allowed to limit their selection to six if more areas apply.
Yes & No

• In Part 2, Matrix of Compliance Requirements, the programs are listed by agency and CFDA number. **Y** indicates that compliance requirement is subject to audit, however, it may not apply at a particular non-Federal entity either because that organization does not have that activity or the activity could not have a direct and material effect on a major program.

• When the matrix shows a compliance area as **N**, that means it is not subject to audit and auditors are not expected to test requirements however the auditor is not prohibited from expanding audit procedures if the terms of the grant award specify an area is material or if the auditor is aware of additional information that indicates an increased risk of fraud, waste, or abuse.
## The Matrix

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<th>Requirement</th>
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Programmatic Changes

• Several CFDA programs have been added or deleted in Part 2 so just because your major program wasn’t listed last year doesn’t mean it won’t be listed this year.

• Per Appendix VII – If there was an audit finding in the prior year on a compliance area that is no longer required, the finding must continue to be reported in the schedule of prior audit findings and follow-up status must be reported.

• If there is a compliance area added as a requirement that was previously not required, the auditors are not expected to have tested for that requirement in the prior year.
Part 3 – The 12 Areas of Compliance

• This part of the Supplement addresses 12 areas of compliance and the related audit objectives that the auditor must consider, as applicable, in performing a Single Audit. An organization with federal grants needs to ensure that there are sufficient internal controls in each of these areas.

• Part 3 still has a break-out between:
  – Part 3.1 - applicable to Federal awards made prior to December 26, 2014 which require application of old OMB Circulars A-102, A-110 and A-133
  – Part 3.2 – applicable to Federal awards and incremental funding made on or after December 26, 2014 which require Uniform Guidance 2 CFR Part 200
12 Areas of Compliance – 1 & 2

1. **Activities Allowed or Unallowed** – Activities charged to a federal grant must be reasonable for the performance of the award and conform to any limitations or exclusions noted in the award. Activities must also conform to generally accepted accounting principles (GAAP) and be adequately documented. Poor or lacking documentation can lead to questioned costs.

2. **Allowable Costs & Cost Principles** – Both direct and indirect costs must be reasonable for the performance of the award, conform to any limitations or exclusions noted in the award, conform to GAAP, and be adequately documented. Cost principles are detailed in 2 CFR part 215.27 or OMB Circular A-110. Allowability of costs is detailed in 2 CFR part 230 or OMB Circular A-122. The organization needs to have policies and procedures in place that would prevent an unallowable cost from being charged through to the federal grant.
3. **Cash Management** – Organizations that are recipients of federal funding must minimize the time federal funds are held in advances. Many grants are cost-reimbursement only, requiring the organization to spend money upfront. If advances are allowed, the organization should have controls in place to ensure that the funds are expended in a reasonable amount of time, generally 30 days. A grant may require that advance funds be placed in an interest-bearing account and the interest should either be paid back to the government or spent towards the program objective.

4. **Eligibility** – Individuals, groups, or sub-recipients to whom organizations may provide scholarships, subgrants, financial awards, or services must not be barred from receiving federal funding and must fit the parameters as defined in the grant award.
12 Areas of Compliance – 5 & 6

5. **Equipment & Real Property Management** – Equipment purchased with federal funds must be tracked and inventoried. The award document will generally specify if equipment purchases are allowed and whether the asset vests with the recipient or the government when the project is complete.

6. **Matching, Level of Effort, Earmarking** – An award may require an organization to contribute its own resources to the grant program in a specified dollar or ratio. An auditor is going to look at how matching requirements are met and tracked, and how the organization ensures that the funds are not from federal funding.
**Period of Performance of Federal Funds** – Expenditures must occur during the specified award period. Any pre-award costs or carryover balances must be specifically authorized by the federal awarding agency.

- Unless the federal awarding agency or pass-through entity authorizes an extension, a nonfederal entity must liquidate all obligations incurred under the federal award not later than 90 calendar days after the end date of the period of performance as specified in the terms and conditions of the federal award [2 CFR section 200.343(b)].
12 Areas of Compliance - 8

8 Procurement, Suspension & Debarment —

(1) Recipients must establish procedures to ensure that materials and services are obtained in an effective manner. Appropriate bidding is required and must be documented.

(2) Procurement procedures must incorporate reviewing potential contracting parties in the System for Award Management (sam.gov) to ensure that federal funding is not being passed to debarred or suspended people or entities.
Changes to Procurement

- Part 3, *Compliance Requirements* has been updated to address the impact of the National Defense Authorization Acts (NDAA) and the OMB Memorandum M-18-18 which increased the micro-purchase and simplified acquisition thresholds to $10,000 and $250,000, respectively.
  - Per Appendix VII - Due to the confusion over the timing of the effective date of the higher thresholds and whether official approval from the cognizant agency was required, auditors are NOT expected to develop audit findings for grant recipients that have implemented the increase after June 30, 2018, as long as the organization documented the decision in their internal procurement policies.
  - The thresholds apply to the aggregate dollar amount by vendor.
Thresholds

Micro-purchase
- <$10,000
- No quotations
- Equitable distribution
- Reasonable

Small Purchase
- >$10K but <$250K
- Price or rate quotations must be obtained

Simplified Acquisition
- >$250,000
- Sealed bids
- Competitive proposals

Sole Source
- Unique
- Public emergency
- Authorized by agency

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Formalize Your Procurement Policy

• Procurement policies need to be formalized in a written policy manual.

• In accordance with 2 CFR 200.318 General Procurement Standards, the policy should address:
  – Avoiding acquisition of unnecessary or duplicative items.
  – Consideration of contractor integrity, compliance, past performance, and technical resources.
  – Records must be maintained in sufficient detail including:
    • Justification of the need for the work.
    • Comparison to different vendors.
    • Documentation of the vendor’s specialized skills or knowledge.
    • Justification if sole source procurement.
    • Payment rates, with justification.
12 Areas of Compliance – 9 & 10

9 Program Income – Any program income earned during the project period must be retained by the recipient and used in accordance with the terms and conditions of the award.

10 Reporting – Every award has specific reporting requirements that may vary. Some will require quarterly financial and progress reports and others may only require close-out reports. It is the organization’s responsibility to ensure that reporting requirements are understood and met in accordance with deadlines.
12 Areas of Compliance – 11 & 12

**11 Subrecipient Monitoring** – Recipients must have robust monitoring over entities it grants subawards and a follow-up system for any identified audit issues at the subgrantee organization.

A pass-through entity must:

- Identify the award and applicable requirements.
- Evaluate risk of subrecipient’s noncompliance.
- Monitor – includes reviewing financial and programmatic reports and issuing a management decision for audit findings pertaining to the federal award provided by the pass-through entity.

**12 Special Tests and Provisions** – This is a catch-all compliance area that would address any specific requirements detailed in the grant, or in Part 4, that may be unique to the program or organization.
Part 4 – Agency Program Requirements

• If a program is listed in Part 2 – the Matrix, then additional detail is found here in Part 4 which provides both I. Program Objectives and II. Program Procedures as well as information about compliance requirements specific to a listed program.
Part 5 – Cluster of Programs

- Part 5 identifies those programs that are considered to be clusters of Federal programs. As defined by 2 CFR section 200.17, a cluster of programs means a grouping of closely related programs that share common compliance requirements. The clusters of programs included in this Part are research and development (R&D) and student financial assistance (SFA), as well as certain other programs.

- A cluster of programs must be considered as one program for determining major programs.
• **NEW – Not Subject to Audit** for Period Covered under 2019 Compliance Supplement
  – Eligibility
  – Matching, Level of Effort, Earmarking
  – Program Income
  – Reporting

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</table>
| Yes | Yes | Yes | No | Yes | No | Yes | Yes | Yes | No | No | Yes | Yes

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Part 6 – Internal Controls

• The GAQC (Government Audit Quality Center of the AICPA) worked collaboratively with the OMB to enhance Part 6, *Internal Control* to more closely align it with how auditors consider internal control over compliance and provide examples.

• Part 6 was not included in the 2018 version of the supplement, leaving agencies to try to provide specific guidance and reliance on previous guidance from the 2017 version and A-110, Administrative Requirements.

• The new Part 6 includes a summary of requirements for internal controls, important internal control concepts and appendices that include illustrations both entity-wide and specific to each type of compliance requirement.
Part 6 and the Green Book

• Part 6 addresses the objectives, principles, and components of internal control based on the “Standards for Internal Control in the Federal Government” or the Green Book issued by the GAO and the Internal Control Integrated Framework – revised in 2013 as issued by the Committee of Sponsoring Organizations of the Treadway Commission.

• Auditors are required to obtain an understanding of the organization’s internal controls sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs and plan the testing of internal controls to support a low assessed level of control risk for the assertions relevant.
Objectives of Internal Control as listed in Part 6

The objectives of internal control over compliance (2 CFR 200.62) are as follows:

1. Transactions are properly recorded and accounted for in order to:
   a) Permit the preparation of reliable financial statements and Federal reports;
   b) Maintain accountability over assets; and
   c) Demonstrate compliance with Federal statutes, regulations, and the terms and conditions of the Federal award;

2. Transactions are executed in compliance with:
   a) Federal statutes, regulations, and the terms and conditions of the Federal award that could have a direct and material effect on a Federal program; and
   b) Any other Federal Statutes and regulations that are identified in the Compliance Supplement; and

3. Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.
Judgment

- FAQ 200.303-3 notes that non-Federal entities and their auditors will need to exercise judgment in determining the most appropriate and cost-effective internal control in a given environment or circumstance to provide reasonable assurance for compliance with Federal program requirements.
Green Book Principles as listed in Part 6

- The Green Book includes a description of the 5 components of internal control (COSO) and their related principles of which there are 17.

Source: GAO. | GAO-14-704G
# Summary of Green Book and COSO Components and Principles of Internal Control

<table>
<thead>
<tr>
<th>Components of Internal Control</th>
<th>Principles</th>
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| Control Environment           | 1. Demonstrate Commitment to Integrity and Ethical Values  
                                 2. Exercise Oversight Responsibility  
                                 3. Establish Structure, Responsibility and Authority  
                                 4. Demonstrate Commitment to Competence  
                                 5. Enforce Accountability |
| Risk Assessment                | 6. Define Objectives and Risk Tolerances  
                                 7. Identify, Analyze, and Respond to Risks  
                                 8. Assess Fraud Risk  
                                 9. Identify, Analyze, and Respond to Change |
| Control Activities             | 10. Design Control Activities  
                                 11. Design Activities for the Information System  
                                 12. Implement Control Activities |
| Information and Communication  | 13. Use Quality Information  
                                 14. Communicate Internally  
                                 15. Communicate Externally |
| Monitoring                     | 16. Perform Monitoring Activities  
                                 17. Evaluate Issues and RemEDIATE Deficiencies |
Guidance on Control Activities per 2017

Guidance per the 2017 Compliance Supplement was very limited. The following is an example from 2017 regarding Control Activities:

C. Control Activities. The actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity’s information system.

- Adequate segregation of duties is provided between performance, review, and recordkeeping of a task. [Principle 10]
- Computer and program controls include [Principle 11]:
  - Data entry controls, e.g., edit checks.
  - Exception reporting.
  - Access controls.
  - Reviews of input and output data.
  - Computer general controls and security controls.
Illustrative Specific Controls in 2019 - 2 Appendices

Guidance in the 2019 Compliance Supplement is much more detailed with an example as follows:

Illustrative Specific Controls - Control Activities (excerpted from Greenbook)

| Principle 10. Design Control Activities: management should design control activities to achieve objectives and respond to risks. |
|---|---|---|---|
| A. ACTIVITIES ALLOWED OR UNALLOWED | C. CASH MANAGEMENT | E. ELIGIBILITY | F. EQUIPMENT AND REAL PROPERTY MANAGEMENT |
| Management identifies and puts into effect actions needed to carry out specific responses to risks identified in the risk assessment process such as miscoding, inappropriate cost transfers, budget overages, segregation of duties concerns, unauthorized changes to system configurations, fraud, unauthorized payments, etc. | Management identifies and puts into effect actions needed to carry out specific responses to risks identified in the risk assessment process such as time lapses between funds transfer and disbursement, fraud, liquidity pressures, inherent risks with subrecipients, etc. | Management identifies and puts into effect actions needed to carry out specific responses to risks identified in the risk assessment process such as providing benefits to ineligible individuals, calculating amounts to be received for or on behalf of individuals incorrectly, unauthorized changes to system configurations, fraud, unauthorized payments, etc. | Management identifies and puts into effect actions needed to carry out specific responses to risks identified in the risk assessment process for equipment and real property such as inaccurate or incomplete recordkeeping, inappropriate use, unidentified dispositions, segregation of duties concerns, fraud, loss, damage, theft, etc. |
Example: Specific Controls Over Allowability

This is an example of the control suggestions in Part 6:

• On a monthly basis, the grant supervisor reviews the budget vs. actual report investigating unusual or unexpected variances.
• Journal entries to transfer costs from one project to another are reviewed for appropriateness and approved.
• Individuals who initiate transactions are different than those approving the transactions and those recording the transactions in the general ledger.
• Where segregation of duties is not practical, management selects and develops alternative control activities.
Part 7 – Guidance for Auditing Programs Not Included

• 2 CFR section 200.514(d)(3) states that for those Federal programs not covered in the compliance supplement, the auditor must use the types of compliance requirements contained in the compliance supplement as guidance for identifying the types of compliance requirements to test, and determine the requirements governing the Federal program by reviewing the provisions of the Federal award, and the laws and regulations referred in such awards.

• The purpose of Part 7 is to provide the auditor with guidance on how to identify the applicable compliance requirements for programs not specifically included in the Supplement.
Appendix VII – Other Audit Advisories

• If a compliance requirement was removed from a program in the Part 2 matrix but there was an audit finding related to that compliance requirement in the prior year, that finding must continue to be reported and followed up on.

• National Science Foundation (NSF) and National Institutes of Health (NIH) awards all meet the definition of Research and Development.

• Reminder that AU-C 530, Audit Sampling, contains requirements and guidance on sampling and that failure to follow the standards may result in the audit being considered nonconforming.
Key Take-Aways

• The Compliance Supplement is required to be used by auditors and is also useful guidance to federal grant recipients.
• Part 2 has some dramatic changes in terms of which programs are listed and which compliance areas apply.
• Part 3 did not change but these are the compliance areas to focus internal controls on.
• Part 5 had changes to what compliance areas are applicable for R&D clusters.
• Part 6 was overhauled to provide specific examples of internal control activities by compliance area.
Any Questions?
Thank you for your time.
Carol Barnard, CPA, CFE, MBA

Director

Carol Barnard, CPA, CFE, MBA, is a director in Aronson’s Nonprofit & Association Services Group. With more than 15 years of public accounting experience, Carol has focused her career exclusively on nonprofit audit and accounting issues, including federal funding and related Single Audit requirements, compliance issues, and the changes brought about by Uniform Guidance.

As an active thought leader within the nonprofit industry, Carol continuously shares her expertise through nationally broadcasted webinars, internal training sessions, and other speaking opportunities.

Carol is a CPA licensed in Virginia and Maryland. She earned her MBA in Accounting in 2003 and her Certified Fraud Examiner designation in 2012.

Publications:
The Financial Management Handbook for Associations and Nonprofits, by the American Society of Association Executives: Contributing Author and Editor