



Internal Controls Over Federal and State Grants¹

Note: This document is intended to be used as a guide and does not include every federal requirement applicable to federal awards. Management is responsible for identifying the appropriate grant number (ALN), title and applicable compliance requirements for each grant. Management must develop detailed procedures and processes related to federal and state grants to ensure the above-mentioned requirements are met.

A. Uniform Guidance Definition of Internal Control over Federal Programs

For units receiving federal funding directly or through a state agency, the U.S Office of Management and Budget's ("OMB"), Part 200 *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) defines internal control over federal programs. References throughout this document refer to sections of the Uniform Guidance. The internal controls should be in compliance with guidance in "*Standards for Internal Control in the Federal Government*" (Green Book) issued by the Comptroller of the United States or the "*Internal Control Integrated Framework*" issued by the Committee on Sponsoring Organizations of the Treadway Commission (COSO). The State of Tennessee statute (T.C.A. § 9-2-102) requires written internal controls based on guidance in the Green Book.

Internal control is a process designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs Section 200.303:

1. Transactions are properly recorded and accounted for to:
 - Permit the preparation of reliable financial statements and federal reports;
 - Maintain accountability over assets; and
 - Demonstrate compliance with laws, regulations and other compliance requirements;
2. Transactions are executed in compliance with:
 - Laws, regulations and the provisions of contracts or grant agreements that could have a direct and material effect on a federal program; and
 - Any other laws 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.

B. Management Controls Requirement Under Federal or State Funding

For units receiving Federal or State funds, management is responsible for establishing effective management controls. The lack of administrative continuity in government units because of the continuing changes in elected bodies and in administrative organizations increases the need for effective management controls. Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by

¹ This document was adapted and updated by MTAS from the "Policy Manual for Local Governments, Section 80: Internal Controls," State of North Carolina (reissued in June 2011).

management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Management controls can be classified as follows:

1. Program Operations

Controls over program operations include policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

2. Validity and Reliability of data

Controls over the validity and reliability of data include policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports. These controls help assure management that it is getting valid and reliable information about whether programs are operating properly.

3. Compliance with Laws and Regulations:

Controls over compliance with laws and regulations include policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

4. Safeguarding Resources

Controls over safeguarding resources include policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

C. Financial Management System - 2 CFR 200.302

The non-federal unit must provide the following (also see 2 CFR 200.334 through 200.337 of the Uniform Guidance):

- a. Identification, in its accounts, of all federal awards received and expended and the federal programs under which they were received. Federal program identification must include the ALN title and number, federal award identification number and year, name of federal agency and name of the pass-through entity, if any.
- b. Accurate, current, and complete disclosure of financial results.
- c. Records that adequately identify the source and application of funds for federally funds activities. The records must contain information related to authorizations, financial obligations, unobligated balances, assets, expenditures, income, and interest and be supported by documentation.
- d. Effective control over and accountability for all funds, property, and other assets. Additionally, provide assurance the assets are adequately safeguarded and used only for authorized purposes.
- e. Make regular comparisons of budget to actual amounts related to federal awards.

f. Written procedures to implement the requirements.

g. Written procedures for determining the allowability of costs in accordance with the Uniform Guidance 2 CFR 200 Subpart E.

h. Written purchasing procedures that comply with the federal procurement rules of the Uniform Guidance 2 CFR 200 Subpart D

1. Conflict of Interest

a. Written standards of conduct covering conflicts of interest and governing the actions of its employees engaged in the selection, award, and administration of contracts. No employee, officer or agent may participate in the selection, award, or administration of a contact supported by a federal award if he or she has a real or apparent conflict of interest. Such a conflict of interest would arise when the employee, officer or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in or a tangible personal benefit from a firm considered for a contract. The officers, employees, and agents of the non-Federal entity may neither solicit nor accept gratuities, favors, or anything of monetary value from contractors or parties to subcontracts. However, non-Federal entities may set standards for situations in which the financial interest is not substantial, or the gift is an unsolicited item of nominal value. The standards of conduct must provide for disciplinary actions to be applied for violations of such standards by officers, employees, or agents of the non-Federal entity.

b. If the non-Federal entity has a parent, affiliate, or subsidiary organization that is not a State, local government, or Indian tribe, the non-Federal entity must also maintain written standards of conduct covering organizational conflicts of interest. Organizational conflicts of interest means that because of relationships with a parent company, affiliate, or subsidiary organization, the non-Federal entity is unable or appears to be unable to be impartial in conducting a procurement action involving a related organization.

c. T.C.A. § 8-17-103 requires municipalities to adopt a code of ethics by ordinance². The ordinance restrictions must apply to boards, commissions, authorities, corporations, and other entities created or appointed by the municipality, except the school board. The school board adopts its own code, and it may use a model provided by the Tennessee School Board Association.

² [MTAS Model Code of Ethics](#)

D. Internal Controls for Federal and State Grants and Programs

Units of government often receive federal and/or state funds to carry out specific programs and grants. These programs may be executed directly by the unit, or the unit may pass on these funds to a third party who in turn executes the program. In both cases, the unit must ensure that controls are in place to provide reasonable assurance that funds are recorded and expended in compliance with program requirements while adequately safeguarding any assets associated with the program. However, the responsibilities for compliance requirements are significantly different for direct recipients and pass-through entities with subrecipients. Finally, a unit should have controls in place to distinguish vendors from subrecipients. Vendors are not subject to compliance requirements. For a list of factors distinguishing vendors from subrecipients, refer to the Uniform Guidance, 2 CFR 200.331-.333.

The following is a discussion of the basic internal controls that are applicable to federal and state grants and programs.

1. Critical Internal Control Procedures for Monitoring Grants Expended Directly by the Unit

A responsible official should monitor activities under grant programs (draws, advances and deposit of funds; expenditures; matching of funds; and filing of financial reports) for compliance with grant contracts, applicable regulations, and matching requirements.

Monitoring, to be effective, usually requires some or all the following policies and procedures:

- a. Separate accounts for identifying receipts and expenditures by grant.
- b. Budget categories for grant receipts and expenditures by grant.
- c. Documentation of a time schedule for filing financial reports with grantors.
- d. Reconciliation of grant financial reports that have been prepared, reviewed and approved by a responsible official before filing with supporting account records.
- e. Review of eligibility determination.
- f. Written notification to employees when grant provisions or related regulations impose requirements that differ from the governmental unit's normal policies and procedures.
- g. If applicable, monitoring the indirect cost allocation plan and approval of allocations and requests for reimbursements.

2. Critical Internal Control Procedures for Monitoring Subrecipients of Grants

A pass-through entity is responsible for ensuring that subrecipients expend awards in accordance with applicable laws, regulations and provisions of contracts or grants.

OMB Uniform Guidance requires a pass-through entity to perform the following for grants to subrecipients:

- a. Identify the awards made by informing each subrecipient of the Assistance Listing Number (ALN) and title (formerly CFDA number) or State program

number, the award's name and number, the award year, whether the award is for R&D, and the name of the grantor agency. When some of this information is not available, the pass-through entity should provide the best information available to describe the award.

- b. Advise subrecipients of the requirements imposed on them by federal and state laws, regulations, and the provisions of contracts or grant agreements, as well as any supplemental requirements imposed by the pass-through entity.
- c. Monitor the activities of subrecipients, as necessary, to ensure that the awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that the performance goals are achieved.
- d. Ensure that subrecipients expending \$750,000 or more in total federal awards during the subrecipient's fiscal year have met the audit requirements of OMB Uniform Guidance for that fiscal year (Single Audit Rules apply per 2 CFR 200.501).
- e. Issue management decisions on audit findings within six months after receipt of subrecipients' audit reports and ensure that subrecipients take appropriate and timely corrective action.
- f. Keep subrecipients' report submissions (or other written notification when a subrecipient is not required to submit a reporting package) on file for three years from the date of submission of the final expenditure report.
- g. A written contract with proper approvals between the unit and subrecipient should document all the above and additional information as required by 2 CFR 200.332(a)(1).

The monitoring procedures used by the pass-through entity may include on-site visits, reviews of documentation supporting requests for reimbursement, and agreed-upon-procedures as described in 2 CFR 200.501.

The following are other monitoring procedures that a pass-through entity may perform:

- a. Reviewing grant applications submitted by subrecipients to determine that:
 - Applications are filed and approved in a timely manner.
 - Each application contains the condition that the subrecipient comply with the federal and state requirements set by the federal or state agency.
- b. Establishing internal control over compliance to provide reasonable assurance that:
 - Funds are disbursed to subrecipients only on an as-needed basis
 - Funds are disbursed to subrecipients only based on approved, properly completed reports submitted on a timely basis.
 - Refunds that are due from subrecipients are billed and collected in a timely manner
 - Subrecipients and other entities and individuals receiving federal funds meet eligibility requirements.
- c. Reviewing financial and technical reports to evaluate them for completeness and for compliance with applicable laws and regulations.

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- d. Evaluating audit findings, issuing appropriate management decisions, if necessary, and determining if an acceptable plan for corrective action has been prepared and implemented.
- e. Reviewing previously detected deficiencies and determining that corrective action was taken.