



STATE OF DELAWARE

MEMORANDUM

TO: State Agencies
Delaware Technical and Community College
School Districts
Charter Schools

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DATE: November 24, 2009

SUBJECT: ARRA Internal Controls

The attached document, "American Recovery and Reinvestment Act (ARRA) of 2009 Internal Controls Guideline" has been issued to assist in the expenditure and reporting of Federal stimulus funds. This document can also be found at the following website:

<http://www.omb.delaware.gov/arra/index.shtml>



State of Delaware

American Recovery and Reinvestment Act (ARRA)
of 2009

Internal Controls Guideline

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EXECUTIVE SUMMARY

The American Recovery and Reinvestment Act (ARRA or Recovery Act) of 2009 was enacted by the U.S. Congress to preserve and create jobs and promote economic recovery; to assist those most impacted by the recession; to provide investments needed to increase economic efficiency by spurring technological advances in science and health; to invest in transportation, environmental protection, and other infrastructure that will provide long-term economic benefits; and to stabilize the State and local government budgets in order to minimize and avoid reductions in essential services and counterproductive state and local tax increases.

The U.S. Government official website, www.recovery.gov tracks and reports how funds provided through the Recovery Act are spent. The following statements are taken directly from this site.

“Taxpayer dollars spent under the Recovery Act will be subject to unprecedented transparency and accountability. To ensure that accountability requirements are being met, the Inspectors General of 28 federal agencies distributing Recovery funds continually review their agencies' management of Recovery funds. The following objectives are considered by the Inspectors General when reviewing if Recovery funds have been used and managed appropriately:

- Were the Recovery funds awarded and distributed in a prompt, fair, and reasonable manner?
- Is the public clear on the identity of the recipients and how the Recovery funds have been used?
- Are the public benefits from the use of Recovery funds being reported clearly, accurately, and in a timely manner?
- Are Recovery funds being used for authorized purposes, and are adequate steps being taken to prevent instances of fraud, waste, and abuse?
- Are Recovery projects avoiding unnecessary delays and cost overruns?
- Do Recovery programs meet specific goals and targets?”

Because of these restrictions including transparency of the reported information, it is more important than ever for Delaware organizations that receive ARRA funds to abide by and enforce strict guidelines for internal controls over those funds. In Delaware, State organizations have been designated as the prime recipients of ARRA funding and must develop an internal control plan that addresses accountability for ensuring the funds are spent properly and in a transparent manner. Each organization must:

- consider the potential for misuse and take steps to ensure there are adequate controls in place by adopting an internal control plan;
- have an acute awareness of organizational responsibilities pertaining to management of the funds;
- ensure data quality;
- perform risk assessments; and
- communicate effectively within the organization.

Because ARRA funding has in most instances been allocated to existing federal programs, this document serves as a supplemental guideline to existing internal control policies and procedures. Agencies should take the opportunity to carefully review existing internal control policies and procedures and their application to all federal funds, including ARRA funds. Those policies and procedures that are found to be deficient should be comprehensively updated and placed into operation throughout the organization.

INTRODUCTION

Why adopt an internal control plan?

- It is the law! Chapter II of the State Budget and Accounting Manual at www.budget.delaware.gov/accounting-manual/chapter-ii.pdf outlines requirements for adherence to statewide Internal Controls policy. The Budget and Accounting manual carries the force of law for adherence by all State organizations.

In addition, the Federal A-102 Common Rule and OMB Circular A-110 require that non-Federal entities receiving Federal awards establish and maintain internal controls designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements.

- To achieve operational effectiveness. All State programs must operate and resources must be used consistent with the organizations' mission and with minimal potential for waste, fraud and mismanagement. Adherence to an effective policy of internal controls provides assurance that significant weaknesses that could affect the organization's ability to meet its objectives would be prevented or detected in a timely manner. Internal control should support the effectiveness and integrity of the organization and provide continual feedback to management.

Managers should consider the appropriate balance between controls and risk. Consideration must be given to both qualitative and quantitative factors when analyzing costs against benefits. The benefits of controls should outweigh the costs.

- To ensure Financial Statements are fairly stated. The *Delaware Code* has numerous laws and regulations applicable to the management of State organizations. Managers must

have a thorough understanding of those laws and regulations specific to their organization, as well as, general statutes that govern all organizations. Internal controls must be adopted in each organization to ensure compliance with these laws and regulations. A lack of compliance with statutory requirements can be punitive. One of the key elements to assurances on the financial statements as defined by the American Institute of Public Accountants (AICPA) Professional Standards AU 314 is control procedures.

In addition, OMB Circular A-133 requires governmental entities receiving federal funds to maintain internal control over federal programs that provide reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations and the provisions of contracts or grant agreements that could have a material effect on its federal programs.

- It is necessary for audit purposes. OMB Circular A-133 requires auditors to obtain an understanding of the non-Federal entity's internal control over federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs and compliance requirements for each program. Unless internal control is likely to be ineffective, auditors must perform testing of internal controls as planned. Audits performed under the Single Audit Act (ARRA funds are required to be audited under this Act) require auditors to issue a report on their consideration of internal control over major federal programs, including tests of the controls. Their report must disclose reportable conditions and material weaknesses, if any, in internal control over major programs they identify as a result of the procedures performed.
- To mitigate risk. A risk management program must be in place and fully operational for all organizations receiving ARRA funds. Internal controls must be in place to link to and ensure the mitigation of each risk identified. Generally, there are three steps to manage risk; implementation of mitigation strategies, linking the strategies to internal control policies and follow up to ensure an assessment of risk management activities is in place and fully operational. A risk management strategy must assure the following:
 1. Management controls are operating to identify and prevent wasteful spending and minimize waste, fraud and abuse.
 2. Qualified personnel are overseeing program activities supported with ARRA funds.
 3. Competitive ARRA awards are maximized.
 4. Recognition of award dollars is timely, accurate and appropriately accounted for.
 5. Expenditures of funds are appropriately recognized, accounted for and reported.
 6. Cost overruns and improper payments are eliminated or at the very least, minimized.

In addition, the following characteristics should be taken into account when assessing risk:

1. The volume of ARRA funding being received by various programs within the organization
2. The clarity and measurability of program outputs and outcomes and the presence of tools within the program to measure them
3. The extent to which existing resources are sufficient to achieve program objectives
4. The risk profiles of the final recipient of ARRA funds (e.g., contractor, sub-contractor, locality, educational institution, etc.)
5. The presence of internal controls sufficient to mitigate the risk of waste, fraud and abuse
6. Performance issues with funding recipients
7. Availability of tools for program staff to frequently monitor ongoing program performance

Attention must focus on those risks with the highest probability of occurrence and with the greatest impact on program objectives, if not mitigated.

THE INTERNAL CONTROL PLAN

An effective system of internal controls is the first defense to prevent and detect fraud. There are five standards that need to be addressed in any internal control plan: setting up the control environment, conducting risk assessments, discussion of control activities, information and communications and monitoring to ensure the data reported meets expectations.

The organization's internal control plan for ARRA funds should supplement existing internal control guidelines. At a bare minimum, the internal control plan for ARRA funds should address the following:

1. Identify the key program (by CFDA number and title, DUNS number, and total award) and personnel involved with the program as well as their roles and responsibilities.
2. Develop a separate accountability plan for ARRA reporting that identifies internal control measures that will be taken to ensure proper implementation, accounting, and reporting of ARRA funds.
3. Develop a communications plan that describes how the organization will communicate ARRA policies and procedures to all parties involved.
4. Describe how the organization will adhere to ARRA transparency requirements.
5. Review all contracts to internal and external parties to ensure they are appropriately classified as a vendor or subrecipient and that the contract contains sufficient detail of the responsibilities of each organization to ensure timely and accurate reporting on the use of ARRA funds, compliance with grant award requirements, and State regulations, and proper reporting of the expenditure of federal dollars on the Recipient Data Elements, Grants/Loan Spreadsheet in the Delaware OMB ARRA Section 1512 Supplemental Reporting Guidance at:

http://omb.delaware.gov/arra/documents/1512_reporting_manual.pdf and the Schedule of Expenditures of Federal Awards.

6. Consider relationships with other grant programs and how they impact ARRA funding and accounting. Identify those program relationships and how to address the flow of transaction activity.
7. Develop documentation on procedures implemented to ensure compliance with program, accounting and reporting regulations and requirements.

Keep in mind that all ARRA programs are subject to an unprecedented level of scrutiny and must be administered under strict accountability and transparency guidelines. ARRA grant recipients should, therefore, ensure they are willing and able to comply with program requirements and objectives.

ORGANIZATIONAL RESPONSIBILITIES

A positive control environment is the foundation for all other organizational standards. Increased emphasis and reliance will be placed on the internal control structure to provide a framework for demonstrating accountability for monies requested, received, expended, and reported for ARRA purposes.

All organizations must adhere to ARRA Section 1512 reporting requirements and follow the federal accountability and transparency standards. Executives and managers hold ultimate responsibility and must assume ownership for internal control. All employees within the organization must support the internal control philosophy, promote compliance, and maintain control within their areas of responsibility.

Organizations must ensure accurate and complete reporting of Section 1512 data. Documentation of internal controls, as it relates to all ARRA reporting, is critical for assurance that federal control standards are met. Written documentation must be maintained for activities conducted in connection with risk assessments, internal control reviews, and follow-up actions.

Segregation of duties is a key control feature for ensuring the risk of error or fraud is minimized. No one individual should control all aspects of a transaction or event. It is management's responsibility to ensure the separation of responsibilities for authorizing transactions, processing and recording them, reviewing the transactions and the handling of all related assets. For ARRA reporting, segregation of duties further ensures transparency of the data.

Prime recipients are owners of the data submitted for ARRA reporting and therefore critical that management exercise oversight in the assurance of data quality. Management must ensure a process is in place to detect errors and mismanagement and to take appropriate action when it occurs. Timely, complete and effective reporting is a condition of receiving Recovery Act funding.

DATA QUALITY

It is imperative that State organizations constantly and consistently monitor the quality of data for ARRA reporting purposes. Federal OMB issued Memorandum M-09-21 to provide guidance for carrying out the reporting requirements included in Section 1512 of ARRA. The guidance states Federal agencies should develop internal control policies and procedures for reviewing reported data and perform limited data quality reviews intended to identify material omissions and/or significant reporting errors and notify the recipients of the need to make appropriate and timely changes. All State organizations must establish internal controls to ensure data quality, completeness, accuracy, and timely reporting of all ARRA dollars received and spent.

Most recipients of ARRA funds must submit a Section 1512 report to the Federal agency providing those funds no later than 10 days after the end of each calendar quarter (beginning the quarter ending September 30, 2009). The report must include the total amount of recovery funds received; the amount of recovery funds expended to projects and activities; a list of those projects and activities funded by name including a description, completion status, estimates of jobs both created and retained; and detailed information on any subcontracts or subgrants awarded by the recipient. The Federal agency must make the reports publicly available no later than 30 days after the end of that quarter. Guidance pertaining to 1512 reporting has been issued by both federal and state OMB. This guidance can be found at the following website: <http://www.omb.delaware.gov/arra/index.shtml>.

The Recovery Accountability and Transparency Board (Recovery Board) was established to coordinate and conduct oversight of covered funds to prevent fraud, waste, and abuse. The Board requested that the Office of the Inspector General (OIG) conduct audits to ensure that recipient organizations have a documented process for reviewing data quality and identifying whether there are any material omissions or significant reporting errors. Organizations must setup a process for review of data quality to ensure information submitted for reporting the use of ARRA funds is accurate and timely.

One way of determining the quality of the data is to setup a checklist that identifies roles and responsibilities of each individual for providing the smallest segment of the reportable information. Each element reported in the quarterly report should be checked for accuracy and completeness and list the person responsible for the data (Recipient Data Elements, Grants/Loan Spreadsheet in the Delaware OMB ARRA Section 1512 Supplemental Reporting Guidance at http://omb.delaware.gov/arra/documents/1512_reporting_manual.pdf).

The Federal agency is required to continuously monitor and evaluate the quality of the data supplied by the recipient/sub-recipient. If the Federal agency identifies any data that it has reason to believe is false or misleading that has not been corrected, the Federal agency must provide such findings to recoveryupdates@gsa.gov so the Recovery Board can make such instances public on www.recovery.gov.

If a recipient/sub-recipient demonstrates chronic reporting problems or fails to correct data or problems identified by the Federal agency, on a case-by-case basis, such behavior can result in termination of ARRA funding, initiation of suspension and debarment proceedings and in severe cases civil or criminal penalties.

RISK ASSESSMENT

Internal controls need to be monitored – a process that assesses the quality of performance over time. One of the best methods of monitoring internal controls is performance of a risk assessment.

The first step in any risk assessment process involves defining the organization's goals and objectives. After defining those objectives, management should identify the risks that could affect their ability to meet those goals and objectives. Once that is done management should design and implement internal controls to mitigate those risks.

Once the organization has determined that they have the knowledge, staff and capability to administer ARRA funding and they are able to comply with program requirements and objectives, the risk assessment process should be documented. A formal risk assessment should be developed that addresses risks, areas of concern, and a lack of information that could potentially result in non compliance of state and federal program, accounting, or reporting requirements.

Potential questions that are relevant to determining risks include:

1. Does the organization have weaknesses in internal controls related to day-to-day operations that must be corrected to administer ARRA funding?
2. Is there a senior level official in the organization who has sufficient expertise and can be designated for ARRA accountability?
3. Does the organization have adequate staff capable of complying with the grant?
4. Does the organization fully understand its responsibilities under the grant and does it have a means of communicating those responsibilities to staff?
5. Is the organization capable of tracking ARRA funds (receipts and disbursements) separately from other funds?
6. Can the organization expend the grant within the allotted timeframe(s)?
7. Can the organization meet reporting requirements?
8. How will the organization determine and track new jobs created or jobs retained?
9. How will the organization be affected once ARRA funding is no longer available?

COMMUNICATIONS

Effective communication must occur in a broad sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream.

For ARRA reporting, not only is there an increased urgency for communicating expectations to employees within the organization or correctly and timely communicating to the Federal agency, the information is reported in a transparent manner to the public on the federal (www.recovery.gov) and state (www.recovery.delaware.gov) web.

Establishing effective internal controls are simply good business practice. In order to establish integrity and confidence in reported information a system of internal controls and strict adherence to them is essential for all organizations.

REFERENCES

- www.recovery.gov Federal website for ARRA tracking
- <http://www.whitehouse.gov/omb/rewrite/circulars/a102/a102.html> Office of Management and Budget Circular A-102 Common Rule, "Grants and Cooperative Agreements with State and Local Governments"
- <http://www.whitehouse.gov/omb/rewrite/circulars/a110/a110.html> Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations
- <http://www.aicpa.org/download/members/div/auditstd/AU-00314.PDF> Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement
- <http://www.whitehouse.gov/omb/rewrite/circulars/a133/a133.html> Audits of States, Local Governments, and Non-Profit Organizations
- http://omb.delaware.gov/arra/documents/1512_reporting_manual.pdf Delaware OMB ARRA 1512 Supplemental Reporting Guidance
- http://www.whitehouse.gov/omb/assets/memoranda_fy2009/m09-10.pdf M-09-21, Memorandum from Peter R. Orszag, Director, Office of Management and Budget, Subject: Initial Implementing guidance for the American Recovery and Reinvestment Act of 2009
- http://www.whitehouse.gov/omb/assets/a133_compliance/app_7.pdf Appendix VII, Other OMB Circular A-133 Advisories of the American Recovery and Reinvestment Act
- www.recovery.delaware.gov Delaware's ARRA tracking website