

State of Washington

General

Code: S1Washington-SA22
Name: State of Washington
Group: Single Audit
Type: S1-Agency, Commission, or Board
Location: State
Scope:

Team

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Manager: Michael Hutchinson

Procedures

C.6.PR.G - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: A-B. Overview - Activities Allowed/Cost Principles - Controls
Prepared By: AWW, 12/30/2022
Reviewed By: ACS, 1/18/2023

Purpose/Conclusion.

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Purpose: To provide an overview of Material Expenditure activities for the the Activities Allowed compliance requirement.

Source:

AFRS
Compliance Supplement
SEFA

Conclusion:

We have provided an overview of material expenditure activities for the Activities Allowed compliance requirement.

Testing Strategy:

A-B. Activities Allowed/Cost Principles - **Post Uniform Guidance Awards**

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the *Inherent and Internal Control Risk Guidance* that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review scope of work

Allowable Activities - Determine which activities and types of costs are specifically allowed or unallowed, by reviewing the following:

1. Award agreement or approved application for scope of work, terms and conditions, and approved budget.
2. Part 4 of the Compliance Supplement that applies to your audit period.
3. Available program guidelines or handbooks. (Ex. WSDOT's LAG Manual)
4. If above information is not available, look to the federal regulations (contact the single audit specialist if you need assistance with this).

Requirements for Cost Principles are found as follows:

Pre-UG: OMB Circular A-87

UG: 2 CFR 200, Subpart E.

Please be familiar with these requirements as not all are listed below; only parts emphasized in the Compliance Supplement are listed below.

Quantitatively Material

Identify the expenditure activities that are directly charged to the program and are quantitatively material (more than 5%).

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Direct Costs

Payroll Expenditures: When payroll costs are selected for our single audit, our focus is on whether the portion of payroll charged to the program (allocation) is supported by appropriate time and effort and meets the cost principles. Note that awarding agencies may require specific forms of documentation to support payroll charged to its award.

Compensated Absences (leave cash-outs or accrual): The entity may include employees' use of leave (which is included in their regular salary payments). If the entity charges any **leave cash-outs** or the **accrual of leave** to the grant, there are special rules, see extra guidance in the policy tab. There is a high risk the costs are unallowable.

Non-Payroll Expenditures: Generally, auditors should test internal controls and compliance for non-payroll expenditures when those costs are quantitatively material (5%) to the program.

Automated Controls: If you identify key internal controls that are automated, consult with the SWSA Supervisor or SWSA AIC to determine whether to request automated control work from Team IT audit.

Indirect Costs

Determine whether the agency has recovered indirect costs via an indirect cost rate or cost allocation plan and, if so, how much was expended. If indirect costs are material to the program the auditor must test the internal controls (and compliance) over them when those costs are quantitatively material (5%) to the program.

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement. These are discussed in the **policy tab** in further detail, for when indirect costs are material to the program.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

Special – Review In-process Proposals: If the entity is preparing an Indirect Cost Rate Proposal during the audit period in order to submit it to the federal cognizant agency, we are required to review the accuracy of the base data and calculations.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's*

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written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) Activities Allowed: grant funds are used only for allowable activities (this may include review of expenditures, program monitoring, preparing the reimbursement requests, establishment of programs);

(b) Cost Principles: direct and indirect costs charged to the grant comply with the cost principles set forth in 2 CFR 200 Subpart E (this may or may not be the same control activity for (a))

(c) Activities Allowed-Indirect Costs: if material (5%), the entity uses the proper indirect cost rate (per approved plan or rate, de minimis only when it is applicable, or another rate established by contract). Controls should also focus on how the entity properly calculates the direct cost base that the indirect rate is applied to. For instance, the controls should ensure that they are using only allowable types of costs in the MTDC or other direct base as applicable, that those costs are not used twice or that they occurred during the contract's period of performance. Note: These controls are likely **different** than those in (a) and possibly (b).

Evaluation of Results: Did you identify any control deficiencies? If yes, you must:

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as "LOW" when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

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Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Basic Cost Principles (2 CFR 200.402 – 409)

DEFINITIONS

Cost means an amount as determined on a cash, accrual, or other basis of accounting acceptable to the Federal awarding or cognizant agency.

Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are needed and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

Direct costs are those that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization). Examples of Direct Costs: payroll costs of employees who perform work that is directly related to the grant program; the cost of supplies and materials used for the purpose of the grant; equipment and other approved capital expenditures made for the grant; or professional services contracted to accomplish specific grant/contract objectives.

Indirect costs are those costs incurred for a common or institution-wide objective that benefits more than one grant program or project. Such costs are not readily assignable to the cost objective specifically benefited. Examples of Indirect Costs: depreciation and use allowances of non-federal equipment and buildings; facility operation and maintenance (lights, heat, phone, janitorial, grounds, etc); and general administrative expenses such as accounting, payroll, legal and data processing expenses.

GENERAL COST PRINCIPLES AFFECTING ALLOWABILITY OF COSTS (2 CFR 200.403)

- (a) Be **necessary** and **reasonable** for the performance of the Federal award and be allocable thereto under these principles.
- (b) Conform to any **limitations** or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- (c) Be **consistent** with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.

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- (d) Be **accorded consistent treatment**. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.
- (f) **Not be included as a cost or used to meet cost sharing or matching requirements** of any other federally-financed program in either the current or a prior period. See also §200.306 Cost sharing or matching paragraph (b).
- (g) Be **adequately documented**. See also §§200.300 Statutory and national policy requirements through 200.309 Period of performance of this part.

What is a Reasonable Cost (§200.404)? (cost principles)

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.

Other factors that must be considered in determining whether a cost is reasonable are:

whether the cost is generally considered as ordinary and necessary to the operation of the grantee or the performance of the federal award/program;

the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, federal, state and other laws and regulations, and terms and conditions of other federal awards, or sponsored agreements;

market prices for comparable goods and services;

whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the grantee, its employees, where applicable its students or membership, the public at large, and the federal government;

whether the grantee significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal awards costs.

EXAMPLES:

1. A grantee is planning to purchase computers and printers with federal funds. The purchasing agent obtained phone quotes from three contractors. One contractor has a direct family relationship with the grantee's purchasing agent. It so happens that this contractor's quote was 20% higher than the other two. The grantee should not contract with this contractor because the price is unreasonable and has a conflict of

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interest (regardless of the price).

2. A grantee has been permitted in its grant contract to lease a vehicle so that it can travel within its region to deliver grant-related services to clients. The grantee has obtained quotes for a standard 4-door sedan and a luxury 4-wheel drive SUV that is twice the cost of the sedan. Which vehicle should the grantee choose? This is not to say a 4-wheel drive is not necessary or reasonable, but the price may dictate the type or model of vehicle.

What is an Allocable Cost (§200.405)? (cost principles)

A cost is considered allocable if the goods or services involved are chargeable or assignable to the federal award or cost objective (i.e., a specific function, project, sponsored agreement, service, or grant) in accordance with the relative benefits received.

Any cost allocable to a particular federal award may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by federal statutes, regulations, or terms and conditions of federal awards, or for other reasons.

If a grantee intends to recover the portion of its indirect costs (overhead, central administration, etc.) that relates to its grant programs, Uniform Guidance requires the grantee to develop a central service cost allocation plan and/or indirect cost rate proposal. Requirements pertaining to central service cost allocation plans and indirect cost proposals are found in Appendix III-VII to Part 200 (Uniform Guidance).

EXAMPLES:

1. An employee works on two different federal grant projects. The time spent on each project varies from day to day. This employee must keep monthly time and effort records that account for actual time spent on each project. By tracking actual effort, each grant will be charged its fair share of the costs.
2. A grantee held a training workshop for its employees. Included in the cost of the workshop was room rental, food, and travel. The workshop included a session that was specific to a federal program and a session that covered general personnel and human effectiveness training. The grantee should allocate the cost of the training among all programs/divisions that benefited from the training. Next, it should charge the allocated amount only to those awards that specifically allow for this type of cost.

Applicable Credits (§200.406) (cost principles)

A "credit" means a receipt or reduction in expenditures that offset or reduce direct or indirect cost items. Examples include:

- purchase discounts;
- rebates or allowances;
- recoveries or indemnities on losses;
- insurance refunds or rebates; and
- adjustments of overpayments or erroneous charges.

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When such credits are applicable to allowable costs, they must be credited to the federal award either as a cost reduction or a cash refund. In some instances, the amounts received from the federal government to finance a grantee's activities or service operations should be treated as applicable credits.

EXAMPLE:

A grantee paid a contractor for materials it needed for a project. It was determined later that the vendor had over-billed the grantee and was issuing a refund check. This refund should be netted against the total amount charged to the grant as a cost reduction. If the grant project had already been closed out, the refund should be remitted to the grantor agency that sponsored the project. Consult with the grantor agency in such a case.

Prior written approval (§200.407) (cost principles)

Under any given Federal award, the reasonableness and allocability of certain items of costs may be difficult to determine. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, the non-Federal entity may seek the prior written approval of the cognizant agency for indirect costs or the Federal awarding agency in advance of the incurrence of special or unusual costs. Prior written approval should include the timeframe or scope of the agreement. The absence of prior written approval on any element of cost will not, in itself, affect the reasonableness or allocability of that element, unless prior approval is specifically required for allowability as described under certain circumstances in the following sections of this part:

- (a) §200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts, paragraph (b)(5);
- (b) §200.306 Cost sharing or matching;
- (c) §200.307 Program income;
- (d) §200.308 Revision of budget and program plans;
- (e) §200.311 Real property;
- (f) §200.313 Equipment;
- (g) §200.332 Fixed amount subawards;
- (h) §200.413 Direct costs, paragraph (c);
- (i) §200.430 Compensation—personal services, paragraph (h);
- (j) §200.431 Compensation—fringe benefits;
- (k) §200.438 Entertainment costs;
- (l) §200.439 Equipment and other capital expenditures;
- (m) §200.440 Exchange rates;
- (n) §200.441 Fines, penalties, damages and other settlements;
- (o) §200.442 Fund raising and investment management costs;
- (p) §200.445 Goods or services for personal use;
- (q) §200.447 Insurance and indemnification;

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- (r) §200.454 Memberships, subscriptions, and professional activity costs, paragraph (c);
- (s) §200.455 Organization costs;
- (t) §200.456 Participant support costs;
- (u) §200.458 Pre-award costs;
- (v) §200.462 Rearrangement and reconversion costs;
- (w) §200.467 Selling and marketing costs;
- (x) §200.470 Taxes (including Value Added Tax); and
- (y) §200.474 Travel costs.

Consistency (2 CFR §200.403(d) (cost principles)

A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

EXAMPLE:

A grantee has five departments. It allocates the cost of its basic telephone service to each department based on the number of telephones in each department. Each department should treat the telephone cost consistently for all grants it administers. That is, if a department has 3 grant programs, that department should treat this telephone cost as either a direct cost or indirect cost for all 3 grants, but not a mix of each. Next, if treated as a direct cost, a department should only request reimbursement for this type of cost if permitted under the terms of its grant agreement(s).

Grant Agreement Limitations (§200.408) (cost principles)

To be allowable, the cost being charged must conform to any limitations or exclusions set forth in the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

EXAMPLE:

A grantee paid for a television advertisement to promote its new grant-funded health program. However, the approved grant contract limited the cost of advertising to brochures and radio ads. Therefore, the grantee should not include the cost of the television advertisement in its request for reimbursement even though "advertising" is an otherwise allowable cost according to Circular A-87.

Adequate Supporting Documentation (2 CFR §200.403(g) (cost principles)

Amounts charged to federal awards must be supported by source documentation, including:

- payroll reports
- time and attendance records
- invoice vouchers from subrecipients
- receiving reports

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- original vendor invoices
- cost allocation plans

(Documentation may be in an electronic form, but make sure the integrity of the electronic documentation can be maintained for the duration of the applicable record retention period).

EXAMPLE:

A grantee made a year-end adjustment to a federal award using a journal voucher entry. The accounting entry must be supported by adequate documentation that demonstrates both allowability and allocability.

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

ADDITIONAL TESTING SELECTION INFO & EXAMPLES

<i>Selection Options</i>		
Method	Process	Next Steps

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Sampling	This is the preferred method for large populations (over 365). Use sampling tool from teammate.	Get the sample tool from Teammate. Take the sampling training if needed.
Haphazard Selection	May use for populations less than 365. Auditor haphazardly picks transactions. It feels random but only true "random" samples can be done by the computer in the sampling method.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab)
Judgmental Selection	May use for populations less than 365. The auditor has a specific reason, associated with a risk, to pick certain or certain transactions. Explain risks in the ROWD and how transactions not selected are lower risk.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab). See examples there.
Judgmental Population	First, the auditor has a specific reason, associated with a risk, to pick certain types of transactions (judgmental population). Explain risks in the ROWD and how populations not selected are lower risk (you can refer to the testing strategy if we have done this for you already). Next, the auditor selects transaction from the judgmental population using the sampling method above.	Get sample tool from Teammate. Take training for the form if needed.
All quantitatively material transactions	Use only when a few very large transactions make up the majority of grant activity. You will test all of these material transactions.	Keep in mind: If 10% or more of the population is made up of <i>other</i> types of costs, those transactions should be tested in some way, as well.

DUAL PURPOSE TESTING EXAMPLE

For allowable costs the key control is, "The Business Manager reviews the reimbursement request, reconciling the items requested to invoices to determine they are supported and allowable." You will test it by reperforming the Business Manager's review to determine if it is effective in preventing and detecting noncompliance. You may check the requests to see if they have the Business Manager's signature of approval but that will only tell you if they consistently do it, which is important. However, you should reperform the control.

To complete compliance testing you are tracing expenditures from the requests to support to determine if they are supported and allowable per the program.

In this case, for testing both controls and compliance you are completing the same process. However, you need to document that you tested both and clearly show the conclusion of each even though they are related. Control testing should conclude whether the control was effective in preventing or detecting noncompliance and compliance testing whether the entity was in compliance.

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INDIRECT COST UNDERSTANDING OF RATES/ALLOCATIONS

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

1. Rate Provided by Grantor: The federal grantor or PTE can give the entity an indirect cost rate in the award, usually outlined in the budget section and based on the availability of funding. There is no separate or formal rate agreement and it is not considered negotiated.

2. Use PTE Negotiated Rate: The federal grantor, PTE or federal guidance can require the entity to use PTE's negotiated indirect cost rate. This requirement can be found in the Compliance Supplement and federal pass-through guidance. The PTE will place the rate in their award with the entity. This is common for school districts.

3. De Minimis Indirect Cost Rate: If the entity elects to use the de minimis rate, a flat 10% (of Modified Total Direct Costs), in their grant application, no direct or pass-through grantor can deny its use so long as the entity qualifies.

Restrictions: The entity can use the method so long as they have **never** had a negotiated indirect cost rate or allocation plan approved by the federal cognizant agency **or** the PTE.

UPDATED GUIDANCE: Federal guidance now clarifies that negotiated rates and allocation plans negotiated by **PTEs** can prevent the use of the de minimis rate.

Consistency: If used, the entity must use the de minimis method for all of their Uniform Guidance federal programs that allow indirect costs.

Rate: Indirect costs are calculated as base costs multiplied by a flat 10% rate that does not require a true-up to actual indirect expenses.

Base Used: The 10% is multiplied by the modified total direct costs (MTDC) base.

<i>MTDC Base</i>	
Includes	Excludes
Direct Salaries & Wages	Equipment & Capital Expenditures
Direct Fringe Benefits	Charges for Patient Care

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Materials & Supplies	Participant Support Costs
Services	Rental Costs
Travel	Tuition remission, Scholarships & Fellowships
Up to \$25,000 of <i>each</i> subaward (regardless of the period of performance)	The portion of each subaward in excess of \$25,000

4. Negotiated Rates & Allocation Plans – Cognizant Agency: Only major governments are required to obtain a cognizant agency approved negotiated rate or allocation plan. Smaller governments can opt to do so. The “cognizant agency for indirect costs” is designated as:

For central service cost allocation plans: the federal agency with the largest dollar value of *total* federal awards

For indirect cost rates and cost allocation plans: the federal agency with the largest dollar value of *direct* federal awards

Once designated, the federal entity remains the cognizant agency for five years. Under this method, the entity will be awarded a formal contract for the rate/allocation. All awarding agencies must accept the rate/allocation plan when the entity elects to use it in their program application.

Various allocation plans can be approved, but there are four types of rates:

1. **Provisional:** The provisional rate is temporary and expires upon the completion of the federal award. It requires a true-up to actual expenditures by the end of the project or whenever the entity obtains a final rate. The rate is adjusted by using the final rate.
2. **Final:** The rate is permanent and is calculated after the actual costs are known (i.e. at the conclusion of the federal project). It is used to adjust the indirect costs from the provisional rate.
3. **Predetermined:** This is a permanent rate and is calculated using actual costs from previous periods. It does not require a true-up to correspond with actual current year costs. The rate is effective between two to five years.
4. **Fixed:** This is a permanent rate and is calculated using actual costs from previous periods. It requires a true-up to correspond with actual current year costs. The variance between the costs used to create the rate and the actual costs incurred during the year the rate was used is carried-forward as an adjustment to the current rate. The entity will either recover or “pay back” the variance going forward. The rate is effective for two years and then can be annually renewed.

5. Negotiated Rates & Allocation Plans – PTE: Indirect Cost Rate Proposals and Cost Allocation Plans are not required by UG to be submitted to/approved by PTE's, but the PTEs may require it. Usually a formal contract for the rate/allocation is not issued and they just review and/or approve the plan instead. Other pass-through entities are not required accept the rate/allocation plan but they can choose to accept it.

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METHODS OF INDIRECT COST RATE CALCULATION

(1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:

(a) *Simplified Method* – This method is applicable where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

Multiple Allocation Base Method – This method is applicable where a governmental unit's department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)

(c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)

(d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a State or local government or unit's department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency's Federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP must be either submitted to the cognizant agency for indirect cost for review, negotiation

Record of Work Done:

Inherent Risk of Noncompliance

Step 1

We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review scope of work

We reviewed the scope of work per the grant agreement, Part 4 of the Compliance Supplement, and program guidelines to determine which activities and costs

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are allowed or unallowed. Expenditure materiality determinations are detailed below.

We also identified GARVEE bonds were reported on the SEFA, therefore this material expenditure will be included as part of our Activities Allowed review: \$99,619,938.00 or 13.9 percent of total expenditures.

- *CFDA 20.205 - Highway Planning and Construction Program allows for state-initiated construction bonds for highway projects to be financed by Federal sources. In Washington State, approximately \$100 million in Highway Planning and Construction Cluster expenditures were reported on the SFY 2022 SEFA for agency 010 - Bond Retirement and Interest (BRI), which represents the amount paid in principal and interest from the program on GARVEE bonds - GARVEE stands for Grant Anticipation Revenue Vehicle. These bonds are issued by a state or state infrastructure bank under the guidelines of the National Highway System Designation Act of 1995. The Department of Transportation is responsible for payment on these bonds.*
- Criteria: 23 USC §122 - Payments to States for bond and other debt instrument financing.
 - (a) Definition of Eligible Debt Financing Instrument.
In this section, the term “eligible debt financing instrument” means a bond or other debt financing instrument, including a note, certificate, mortgage, or lease agreement, issued by a State or political subdivision of a State or a public authority, the proceeds of which are used for an eligible project under this title.
 - (b) Federal reimbursement. Subject to subsections (c) and (d), the Secretary may reimburse a State for expenses and costs incurred by the State or a political subdivision of the State and reimburse a public authority for expenses and costs incurred by the public authority for -
 - (1) interest payments under an eligible debt financing instrument;
 - (2) the retirement of principal of an eligible debt financing instrument

Indirect Costs

The Department's Audit Liaison confirmed that they did cost allocate expenditures and do not charge an indirect rate for the program, we reviewed the expenditures/revenue report and found the following.

We reviewed the Expenditure report for Indirect Rates by utilizing the Departments Chart of Accounts. We found that no indirect rate was claimed during the audit period. We confirmed with the Department that costs are cost allocated. We confirmed the Document number with the Audit Liaison that relate to cost allocated expenditures. The following 4 methodologies/coding is used for Cost Allocation at the Department:

Project Office Charges (POC): JV405CA

Fixed Distribution: JV405CN

Distribution to Projects (DPS): JV405CD

Maintenance Distribution: JV405CM

Material Expenditures

We identified the following expenditure activities that are directly charged to the program and are quantitatively material (more than 5%) Highway Planning and Construction - Final FY22 Expenditures and Revenue (from TRAINS):

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- Garvee Bonds [Federal-aid reimbursements for debt-related costs incurred] (no subobject) = \$99,619,938.00, or 13.9 percent of total expenditures Highway Planning and Construction - Final FY22 Expenditures and Revenue (from TRAINS). See here for the process understanding: A-B. (GARVEE Bonds) Activities Allowed/Cost Principles - Controls
- Salaries and Wages (subobject TA) = \$68,143,704 or 9.5% of total expenditures Highway Planning and Construction - Final FY22 Expenditures and Revenue (from TRAINS). DOTtime charges are characterized by JV pattern JV*AQP01XX. We obtained a list of transactions that supported Subobject TA's expenditures and filtered to JV pattern JV*AQPXXXX, which had total expenditures of \$59,956,811.84, or 8.4 percent of total expenditures. We removed the pattern JV*AQP33XX, Suspense Runs, which together totalled \$1,218,979.37, or 0.1 percent of total expenditures. See process understanding here: A-B. (Payroll) Activities Allowed/Cost Principles - Controls.
- Highway Construction [payments to contractors] (subobject JG) = \$253,447,337, or 35.4 percent of total expenditures Highway Planning and Construction - Final FY22 Expenditures and Revenue (from TRAINS). See here for the process understanding: A-B. (Contractor Payments) Activities Allowed/Cost Principles - Controls.
- Federal Pass Through Grants [to subrecipients] (subobject NZ) = \$248,050,450 or 34.7 percent of total expenditures Highway Planning and Construction - Final FY22 Expenditures and Revenue (from TRAINS). See here for the process understanding: A-B. Local Programs Activities Allowed/Cost Principles - Controls.

C.6.PR.G - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: A-B. (GARVEE Bonds) Activities Allowed/Cost Principles - Controls

Prepared By: AWW, 7/19/2022

Reviewed By: ACS, 8/1/2022

Purpose/Conclusion:

Purpose:

To gain an understanding of the internal controls the agency has in place to provide reasonable assurance that Federal awards are expended only for allowable activities and that expenditures charged to the Federal award are allowable and in accordance with the applicable cost principles.

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal award requirements related to allowable activities and cost principles.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Nguyen Dang, Assistant Director of Financial Planning

State of Washington

Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Activities Allowed and Cost Principles, we assessed preliminary control risk as low.

Testing Strategy:

A-B. Activities Allowed/Cost Principles - **Post Uniform Guidance Awards**

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review scope of work

Allowable Activities - Determine which activities and types of costs are specifically allowed or unallowed, by reviewing the following:

1. Award agreement or approved application for scope of work, terms and conditions, and approved budget.
2. Part 4 of the Compliance Supplement that applies to your audit period.
3. Available program guidelines or handbooks. (Ex. WSDOT's LAG Manual)
4. If above information is not available, look to the federal regulations (contact the single audit specialist if you need assistance with this).

Requirements for Cost Principles are found as follows:

Pre-UG: OMB Circular A-87

UG: 2 CFR 200, Subpart E.

Please be familiar with these requirements as not all are listed below; only parts emphasized in the Compliance Supplement are listed below.

Quantitatively Material

Identify the expenditure activities that are directly charged to the program and are quantitatively material (more than 5%).

Direct Costs

Payroll Expenditures: When payroll costs are selected for our single audit, our focus is on whether the portion of payroll charged to the program (allocation) is supported by appropriate time and effort and meets the cost principles. Note that awarding agencies may require specific forms of documentation to support payroll charged to its award.

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Compensated Absences (leave cash-outs or accrual): The entity may include employees' use of leave (which is included in their regular salary payments). If the entity charges any **leave cash-outs** or the **accrual of leave** to the grant, there are special rules, see extra guidance in the policy tab. There is a high risk the costs are unallowable.

Non-Payroll Expenditures: Generally, auditors should test internal controls and compliance for non-payroll expenditures when those costs are quantitatively material (5%) to the program.

Automated Controls: If you identify key internal controls that are automated, consult with the SWSA Supervisor or SWSA AIC to determine whether to request automated control work from Team IT audit.

Indirect Costs

Determine whether the agency has recovered indirect costs via an indirect cost rate or cost allocation plan and, if so, how much was expended. If indirect costs are material to the program the auditor must test the internal controls (and compliance) over them when those costs are quantitatively material (5%) to the program.

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement. These are discussed in the **policy tab** in further detail, for when indirect costs are material to the program.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

Special – Review In-process Proposals: If the entity is preparing an Indirect Cost Rate Proposal during the audit period in order to submit it to the federal cognizant agency, we are required to review the accuracy of the base data and calculations.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the

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document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) Activities Allowed: grant funds are used only for allowable activities (this may include review of expenditures, program monitoring, preparing the reimbursement requests, establishment of programs);

(b) Cost Principles: direct and indirect costs charged to the grant comply with the cost principles set forth in 2 CFR 200 Subpart E (this may or may not be the same control activity for (a))

(c) Activities Allowed-Indirect Costs: if material (5%), the entity uses the proper indirect cost rate (per approved plan or rate, de minimis only when it is applicable, or another rate established by contract). Controls should also focus on how the entity properly calculates the direct cost base that the indirect rate is applied to. For instance, the controls should ensure that they are using only allowable types of costs in the MTDC or other direct base as applicable, that those costs are not used twice or that they occurred during the contract's period of performance. Note: These controls are likely **different** than those in (a) and possibly (b).

Evaluation of Results: Did you identify any control deficiencies? If yes, you must:

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as **"LOW"** when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

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Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Basic Cost Principles (2 CFR 200.402 – 409)

DEFINITIONS

Cost means an amount as determined on a cash, accrual, or other basis of accounting acceptable to the Federal awarding or cognizant agency.

Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are needed and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

Direct costs are those that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization). Examples of Direct Costs: payroll costs of employees who perform work that is directly related to the grant program; the cost of supplies and materials used for the purpose of the grant; equipment and other approved capital expenditures made for the grant; or professional services contracted to accomplish specific grant/contract objectives.

Indirect costs are those costs incurred for a common or institution-wide objective that benefits more than one grant program or project. Such costs are not readily assignable to the cost objective specifically benefited. Examples of Indirect Costs: depreciation and use allowances of non-federal equipment and buildings; facility operation and maintenance (lights, heat, phone, janitorial, grounds, etc); and general administrative expenses such as accounting, payroll, legal and data processing expenses.

GENERAL COST PRINCIPLES AFFECTING ALLOWABILITY OF COSTS (2 CFR 200.403)

- (a) Be **necessary** and **reasonable** for the performance of the Federal award and be allocable thereto under these principles.
- (b) Conform to any **limitations** or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- (c) Be **consistent** with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- (d) Be **accorded consistent treatment**. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.

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(f) **Not be included as a cost or used to meet cost sharing or matching requirements** of any other federally-financed program in either the current or a prior period. See also §200.306 Cost sharing or matching paragraph (b).

(g) Be **adequately documented**. See also §§200.300 Statutory and national policy requirements through 200.309 Period of performance of this part.

What is a Reasonable Cost (§200.404)? (cost principles)

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.

Other factors that must be considered in determining whether a cost is reasonable are:

whether the cost is generally considered as ordinary and necessary to the operation of the grantee or the performance of the federal award/program;

the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, federal, state and other laws and regulations, and terms and conditions of other federal awards, or sponsored agreements;

market prices for comparable goods and services;

whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the grantee, its employees, where applicable its students or membership, the public at large, and the federal government;

whether the grantee significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal awards costs.

EXAMPLES:

1. A grantee is planning to purchase computers and printers with federal funds. The purchasing agent obtained phone quotes from three contractors. One contractor has a direct family relationship with the grantee's purchasing agent. It so happens that this contractor's quote was 20% higher than the other two. The grantee should not contract with this contractor because the price is unreasonable and has a conflict of interest (regardless of the price).

2. A grantee has been permitted in its grant contract to lease a vehicle so that it can travel within its region to deliver grant-related services to clients. The grantee has obtained quotes for a standard 4-door sedan and a luxury 4-wheel drive SUV that is twice the cost of the sedan. Which vehicle should the grantee choose? This is not to say a 4-wheel drive is not necessary or reasonable, but the price may dictate the type or model.

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of vehicle.

What is an Allocable Cost (§200.405)? (cost principles)

A cost is considered allocable if the goods or services involved are chargeable or assignable to the federal award or cost objective (i.e., a specific function, project, sponsored agreement, service, or grant) in accordance with the relative benefits received.

Any cost allocable to a particular federal award may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by federal statutes, regulations, or terms and conditions of federal awards, or for other reasons.

If a grantee intends to recover the portion of its indirect costs (overhead, central administration, etc.) that relates to its grant programs, Uniform Guidance requires the grantee to develop a central service cost allocation plan and/or indirect cost rate proposal. Requirements pertaining to central service cost allocation plans and indirect cost proposals are found in Appendix III-VII to Part 200 (Uniform Guidance).

EXAMPLES:

1. An employee works on two different federal grant projects. The time spent on each project varies from day to day. This employee must keep monthly time and effort records that account for actual time spent on each project. By tracking actual effort, each grant will be charged its fair share of the costs.
2. A grantee held a training workshop for its employees. Included in the cost of the workshop was room rental, food, and travel. The workshop included a session that was specific to a federal program and a session that covered general personnel and human effectiveness training. The grantee should allocate the cost of the training among all programs/divisions that benefited from the training. Next, it should charge the allocated amount only to those awards that specifically allow for this type of cost.

Applicable Credits (§200.406) (cost principles)

A "credit" means a receipt or reduction in expenditures that offset or reduce direct or indirect cost items. Examples include:

- purchase discounts;
- rebates or allowances;
- recoveries or indemnities on losses;
- insurance refunds or rebates; and
- adjustments of overpayments or erroneous charges.

When such credits are applicable to allowable costs, they must be credited to the federal award either as a cost reduction or a cash refund. In some instances, the amounts received from the federal government to finance a grantee's activities or service operations should be treated as applicable credits.

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EXAMPLE:

A grantee paid a contractor for materials it needed for a project. It was determined later that the vendor had over-billed the grantee and was issuing a refund check. This refund should be netted against the total amount charged to the grant as a cost reduction. If the grant project had already been closed out, the refund should be remitted to the grantor agency that sponsored the project. Consult with the grantor agency in such a case.

Prior written approval (§200.407) (cost principles)

Under any given Federal award, the reasonableness and allocability of certain items of costs may be difficult to determine. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, the non-Federal entity may seek the prior written approval of the cognizant agency for indirect costs or the Federal awarding agency in advance of the incurrence of special or unusual costs. Prior written approval should include the timeframe or scope of the agreement. The absence of prior written approval on any element of cost will not, in itself, affect the reasonableness or allocability of that element, unless prior approval is specifically required for allowability as described under certain circumstances in the following sections of this part:

- (a) §200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts, paragraph (b)(5);
- (b) §200.306 Cost sharing or matching;
- (c) §200.307 Program income;
- (d) §200.308 Revision of budget and program plans;
- (e) §200.311 Real property;
- (f) §200.313 Equipment;
- (g) §200.332 Fixed amount subawards;
- (h) §200.413 Direct costs, paragraph (c);
- (i) §200.430 Compensation—personal services, paragraph (h);
- (j) §200.431 Compensation—fringe benefits;
- (k) §200.438 Entertainment costs;
- (l) §200.439 Equipment and other capital expenditures;
- (m) §200.440 Exchange rates;
- (n) §200.441 Fines, penalties, damages and other settlements;
- (o) §200.442 Fund raising and investment management costs;
- (p) §200.445 Goods or services for personal use;
- (q) §200.447 Insurance and indemnification;
- (r) §200.454 Memberships, subscriptions, and professional activity costs, paragraph (c);
- (s) §200.455 Organization costs;
- (t) §200.456 Participant support costs;
- (u) §200.458 Pre-award costs;
- (v) §200.462 Rearrangement and reconversion costs;

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- (w) §200.467 Selling and marketing costs;
- (x) §200.470 Taxes (including Value Added Tax); and
- (y) §200.474 Travel costs.

Consistency (2 CFR §200.403(d) (cost principles)

A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

EXAMPLE:

A grantee has five departments. It allocates the cost of its basic telephone service to each department based on the number of telephones in each department. Each department should treat the telephone cost consistently for all grants it administers. That is, if a department has 3 grant programs, that department should treat this telephone cost as either a direct cost or indirect cost for all 3 grants, but not a mix of each. Next, if treated as a direct cost, a department should only request reimbursement for this type of cost if permitted under the terms of its grant agreement(s).

Grant Agreement Limitations (§200.408) (cost principles)

To be allowable, the cost being charged must conform to any limitations or exclusions set forth in the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

EXAMPLE:

A grantee paid for a television advertisement to promote its new grant-funded health program. However, the approved grant contract limited the cost of advertising to brochures and radio ads. Therefore, the grantee should not include the cost of the television advertisement in its request for reimbursement even though "advertising" is an otherwise allowable cost according to Circular A-87.

Adequate Supporting Documentation (2 CFR §200.403(g) (cost principles)

Amounts charged to federal awards must be supported by source documentation, including:

- payroll reports
- time and attendance records
- invoice vouchers from subrecipients
- receiving reports
- original vendor invoices
- cost allocation plans

(Documentation may be in an electronic form, but make sure the integrity of the electronic documentation can be maintained for the duration of the applicable record retention period).

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EXAMPLE:

A grantee made a year-end adjustment to a federal award using a journal voucher entry. The accounting entry must be supported by adequate documentation that demonstrates both allowability and allocability.

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

ADDITIONAL TESTING SELECTION INFO & EXAMPLES

<i>Selection Options</i>		
Method	Process	Next Steps
Sampling	This is the preferred method for large populations (over 365). Use sampling tool from teammate.	Get the sample tool from Teammate. Take the sampling training if needed.
Haphazard Selection	May use for populations less than 365. Auditor haphazardly picks transactions. It feels random but only true "random" samples can be done by the computer in the sampling method.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab)

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Judgmental Selection	May use for populations less than 365. The auditor has a specific reason, associated with a risk, to pick certain or certain transactions. Explain risks in the ROWD and how transactions not selected are lower risk.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab). See examples there.
Judgmental Population	First, the auditor has a specific reason, associated with a risk, to pick certain types of transactions (judgmental population). Explain risks in the ROWD and how populations not selected are lower risk (you can refer to the testing strategy if we have done this for you already). Next, the auditor selects transaction from the judgmental population using the sampling method above.	Get sample tool from Teammate. Take training for the form if needed.
All quantitatively material transactions	Use only when a few very large transactions make up the majority of grant activity. You will test all of these material transactions.	Keep in mind: If 10% or more of the population is made up of <i>other</i> types of costs, those transactions should be tested in some way, as well.

DUAL PURPOSE TESTING EXAMPLE

For allowable costs the key control is, "The Business Manager reviews the reimbursement request, reconciling the items requested to invoices to determine they are supported and allowable." You will test it by reperforming the Business Manager's review to determine if it is effective in preventing and detecting noncompliance. You may check the requests to see if they have the Business Manager's signature of approval but that will only tell you if they consistently do it, which is important. However, you should reperform the control.

To complete compliance testing you are tracing expenditures from the requests to support to determine if they are supported and allowable per the program.

In this case, for testing both controls and compliance you are completing the same process. However, you need to document that you tested both and clearly show the conclusion of each even though they are related. Control testing should conclude whether the control was effective in preventing or detecting noncompliance and compliance testing whether the entity was in compliance.

INDIRECT COST UNDERSTANDING OF RATES/ALLOCATIONS

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method

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4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

1. Rate Provided by Grantor: The federal grantor or PTE can give the entity an indirect cost rate in the award, usually outlined in the budget section and based on the availability of funding. There is no separate or formal rate agreement and it is not considered negotiated.

2. Use PTE Negotiated Rate: The federal grantor, PTE or federal guidance can require the entity to use PTE's negotiated indirect cost rate. This requirement can be found in the Compliance Supplement and federal pass-through guidance. The PTE will place the rate in their award with the entity. This is common for school districts.

3. De Minimis Indirect Cost Rate: If the entity elects to use the de minimis rate, a flat 10% (of Modified Total Direct Costs), in their grant application, no direct or pass-through grantor can deny its use so long as the entity qualifies.

Restrictions: The entity can use the method so long as they have **never** had a negotiated indirect cost rate or allocation plan approved by the federal cognizant agency **or** the PTE.

UPDATED GUIDANCE: Federal guidance now clarifies that negotiated rates and allocation plans negotiated by **PTEs** can prevent the use of the de minimis rate.

Consistency: If used, the entity must use the de minimis method for all of their Uniform Guidance federal programs that allow indirect costs.

Rate: Indirect costs are calculated as base costs multiplied by a flat 10% rate that does not require a true-up to actual indirect expenses.

Base Used: The 10% is multiplied by the modified total direct costs (MTDC) base.

<i>MTDC Base</i>	
Includes	Excludes
Direct Salaries & Wages	Equipment & Capital Expenditures
Direct Fringe Benefits	Charges for Patient Care
Materials & Supplies	Participant Support Costs
Services	Rental Costs
Travel	Tuition remission, Scholarships & Fellowships

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Up to \$25,000 of <i>each</i> subaward (regardless of the period of performance)	The portion of each subaward in excess of \$25,000
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4. Negotiated Rates & Allocation Plans – Cognizant Agency: Only major governments are required to obtain a cognizant agency approved negotiated rate or allocation plan. Smaller governments can opt to do so. The “cognizant agency for indirect costs” is designated as:

For central service cost allocation plans: the federal agency with the largest dollar value of ***total*** federal awards

For indirect cost rates and cost allocation plans: the federal agency with the largest dollar value of ***direct*** federal awards

Once designated, the federal entity remains the cognizant agency for five years. Under this method, the entity will be awarded a formal contract for the rate/allocation. All awarding agencies must accept the rate/allocation plan when the entity elects to use it in their program application.

Various allocation plans can be approved, but there are four types of rates:

1. **Provisional:** The provisional rate is temporary and expires upon the completion of the federal award. It requires a true-up to actual expenditures by the end of the project or whenever the entity obtains a final rate. The rate is adjusted by using the final rate.
2. **Final:** The rate is permanent and is calculated after the actual costs are known (i.e. at the conclusion of the federal project). It is used to adjust the indirect costs from the provisional rate.
3. **Predetermined:** This is a permanent rate and is calculated using actual costs from previous periods. It does not require a true-up to correspond with actual current year costs. The rate is effective between two to five years.
4. **Fixed:** This is a permanent rate and is calculated using actual costs from previous periods. It requires a true-up to correspond with actual current year costs. The variance between the costs used to create the rate and the actual costs incurred during the year the rate was used is carried-forward as an adjustment to the current rate. The entity will either recover or “pay back” the variance going forward. The rate is effective for two years and then can be annually renewed.

5. Negotiated Rates & Allocation Plans – PTE: Indirect Cost Rate Proposals and Cost Allocation Plans are not required by UG to be submitted to/approved by PTE’s, but the PTEs may require it. Usually a formal contract for the rate/allocation is not issued and they just review and/or approve the plan instead. Other pass-through entities are not required accept the rate/allocation plan but they can choose to accept it.

METHODS OF INDIRECT COST RATE CALCULATION

(1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:

- (a) **Simplified Method** – This method is applicable where a governmental unit’s department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the

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computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

Multiple Allocation Base Method – This method is applicable where a governmental unit's department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)

(c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)

(d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a State or local government or unit's department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency's Federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP must be either submitted to the cognizant agency for indirect cost for review, negotiation

Record of Work Done.

For steps one and two, please see: [A-B. Overview - Activities Allowed/Cost Principles - Controls](#).

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

We requested the Department's written policies and procedures related to GARVEE Bonds as part of gaining an understanding of internal controls. We were provided the following:

[GARVEE Master Bond Reimbursement - Transfer Procedure](#), GARVEE fund transfer procedure

[FHWA Federal Agreements GARVEE Reimbursement](#), GARVEE reimbursement procedure

[Monthly Federal Comparison Operating Procedure](#), GARVEE monthly reconciliation procedure

On June 27, 2022 we received a copy of the Department's current key internal controls over Activities Allowed or Unallowed / Cost Principles – GARVEE Bonds (see [FY22 Internal Controls - Activities Allowed_Final](#)).

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On July 7, 2022, we met with the Department staff to gain an understanding of how principal and interest is paid on GARVEE bonds from Highway Planning and Construction Cluster funds:

- Nguyen Dang, Assistant Director of Financial Planning
- Jesse Daniels, External Audit Liaison

We were informed that Debt service schedules are maintained by Leslie Yonkers, Debt Financial Officer for the Office of the State Treasurer.

The Department's Financial Office's primary roles are:

1. Ensure compliance with the memorandum of understanding (MOU) in place between the Department and Federal Highways Administration (FHWA) for issuing debt,
2. Contact Rick Judd, FHWA Region Administrator, to request money from the federal grantor to pay the principal and interest owed, and
3. Work with the Office of the State Treasurer (OST) to use those federal funds to make payments on the debt to the bondholders and honor their bond resolutions.

Grant Anticipation Revenue Vehicle (GARVEE) is a type of bond, or similar financing method issued by a state or state infrastructure bank under the guidelines of the National Highway System Designation Act of 1995, eventually made permanent in section 122 of Title 23 of the United States Code. States must repay the bonds using federal funds expected to be received in the future. A GARVEE is a type of anticipation vehicle, which are securities (debt instruments) issued when moneys are anticipated from a specific source to advance the upfront funding of a particular need. In the case of transportation finance, the anticipation vehicles' revenue source is expected Federal-aid grants.

The Department enters into a MOU with FHWA which describes the general procedures to process GARVEE transactions (see SR 520 GARVEE MOU - September 23 2013 with R-2022E). Principal and interest owed on the bonds are paid in September of every year, with a second interest-only payment occurring in March. The Department's Financial Planning Office (FPO) monitors the timing of the debt service payments. **Key Internal Control #1 - When a payment due date is approaching, Financial Planning staff reviews the debt service schedule to determine the next amount to be paid and the correct timing of payment according to the MOU . (Control Activities)** FPO will send an email notification to FHWA if the reimbursement request needs to be processed early to meet the agreement requirements for OST receiving the funds. Staff then confirm funds are available for billing on the GARVEE project, and if so process the journal voucher. If there are inadequate funds, FPO contacts the Capital Program Development and Management Federal Funds Manager for assistance.

Key Control #2 - The Assistant Director of Financial Planning sends an email to FHWA to request reimbursement for debt service with the amount and date of reimbursement. Once FHWA concurs Financial Planning requests Accounting and Financial Services create a journal voucher in TRAINS. (Control Activities/ Information & Communication)

Key Control #3 - Project Support and Receivables sends copies of the journal vouchers to the tolling team, requesting a transfer be made from FHWA to account 16J, and informs Financial Planning when the wire payment is received from FHWA. (Information & Communication)

Key Control #4 - After payment is received, the Tolling Financial Consultant creates a journal voucher to move the GARVEE payment from equity

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9234 to 923D, and another journal voucher to transfer funds from account 16J to 389. After the entries process correctly the next day, Financial Planning sends copies of the approved journal vouchers to OST, so OST can create an entry to reserve fund balances and make payments to bond holders from 389. (Control Activities/ Information & Communication)

Summary of Key Controls

Key Internal Control #1 - When a payment due date is approaching, Financial Planning reviews the debt service schedule to determine the next amount to be paid and the correct timing of payment according to the MOU. (Control Activities)

Key Control #2 - The Assistant Director of Financial Planning sends an email to FHWA to request reimbursement for debt service with the amount and date of reimbursement. Once FHWA concurs Financial Planning requests Accounting and Financial Services create a journal voucher in TRAINS. (Control Activities/ Information & Communication)

Key Control #3 - Project Support and Receivables sends copies of the journal vouchers to the tolling team, requesting a transfer be made from FHWA to account 16J, and informs Financial Planning when the wire payment is received from FHWA. (Information & Communication)

Key Control #4 - After payment is received, the Tolling Financial Consultant creates a journal voucher to move the GARVEE payment from equity 9234 to 923D, and another journal voucher to transfer funds from account 16J to 389. After the entries process correctly the next day, Financial Planning sends copies of the approved journal vouchers to OST, so OST can create an entry to reserve fund balances and make payments to bond holders from 389. (Control Activities/ Information & Communication)

Evaluation of Results: We did not identify any control deficiencies.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.6.PRG - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: A-B. (Payroll) Activities Allowed/Cost Principles - Controls

Prepared By: AWW, 12/29/2022

Reviewed By: ACS, 1/6/2023

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Purpose/Conclusion.

Purpose:

To gain an understanding of the internal controls the agency has in place to provide reasonable assurance that Federal awards are expended only for allowable activities and that expenditures charged to the Federal award are allowable and in accordance with the applicable cost principles.

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal award requirements related to allowable activities and cost principles.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Rachel Rodgers, Payroll Payment & Deductions Unit Supervisor

Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Activities Allowed and Cost Principles, we assessed preliminary control risk as low.

Testing Strategy.

A-B. Activities Allowed/Cost Principles - **Post Uniform Guidance Awards**

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review scope of work

Allowable Activities - Determine which activities and types of costs are specifically allowed or unallowed, by reviewing the following:

1. Award agreement or approved application for scope of work, terms and conditions, and approved budget.
2. Part 4 of the Compliance Supplement that applies to your audit period.
3. Available program guidelines or handbooks. (Ex. WSDOT's LAG Manual)
4. If above information is not available, look to the federal regulations (contact the single audit specialist if you need assistance with this).

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Requirements for Cost Principles are found as follows:

Pre-UG: OMB Circular A-87

UG: 2 CFR 200, Subpart E.

Please be familiar with these requirements as not all are listed below; only parts emphasized in the Compliance Supplement are listed below.

Quantitatively Material

Identify the expenditure activities that are directly charged to the program and are quantitatively material (more than 5%).

Direct Costs

Payroll Expenditures: When payroll costs are selected for our single audit, our focus is on whether the portion of payroll charged to the program (allocation) is supported by appropriate time and effort and meets the cost principles. Note that awarding agencies may require specific forms of documentation to support payroll charged to its award.

Compensated Absences (leave cash-outs or accrual): The entity may include employees' use of leave (which is included in their regular salary payments). If the entity charges any **leave cash-outs** or the **accrual of leave** to the grant, there are special rules, see extra guidance in the policy tab. There is a high risk the costs are unallowable.

Non-Payroll Expenditures: Generally, auditors should test internal controls and compliance for non-payroll expenditures when those costs are quantitatively material (5%) to the program.

Automated Controls: If you identify key internal controls that are automated, consult with the SWSA Supervisor or SWSA AIC to determine whether to request automated control work from Team IT audit.

Indirect Costs

Determine whether the agency has recovered indirect costs via an indirect cost rate or cost allocation plan and, if so, how much was expended. If indirect costs are material to the program the auditor must test the internal controls (and compliance) over them when those costs are quantitatively material (5%) to the program.

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement. These are discussed in the **policy tab** in further detail, for when indirect costs are material to the program.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

Special – Review In-process Proposals: If the entity is preparing an Indirect Cost Rate Proposal during the audit period in order to submit it to the federal

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cognizant agency, we are required to review the accuracy of the base data and calculations.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) Activities Allowed: grant funds are used only for allowable activities (this may include review of expenditures, program monitoring, preparing the reimbursement requests, establishment of programs);

(b) Cost Principles: direct and indirect costs charged to the grant comply with the cost principles set forth in 2 CFR 200 Subpart E (this may or may not be the same control activity for (a))

(c) Activities Allowed-Indirect Costs: if material (5%), the entity uses the proper indirect cost rate (per approved plan or rate, de minimis only when it is applicable, or another rate established by contract). Controls should also focus on how the entity properly calculates the direct cost base that the indirect rate is applied to. For instance, the controls should ensure that they are using only allowable types of costs in the MTDC or other direct base as applicable, that those costs are not used twice or that they occurred during the contract's period of performance. Note: These controls are likely **different** than those in (a) and possibly (b).

Evaluation of Results: Did you identify any control deficiencies? If yes, you must:

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as “**LOW**” when:

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1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Basic Cost Principles (2 CFR 200.402 – 409)

DEFINITIONS

Cost means an amount as determined on a cash, accrual, or other basis of accounting acceptable to the Federal awarding or cognizant agency.

Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are needed and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

Direct costs are those that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization). Examples of Direct Costs: payroll costs of employees who perform work that is directly related to the grant program; the cost of supplies and materials used for the purpose of the grant; equipment and other approved capital expenditures made for the grant; or professional services contracted to accomplish specific grant/contract objectives.

Indirect costs are those costs incurred for a common or institution-wide objective that benefits more than one grant program or project. Such costs are not readily assignable to the cost objective specifically benefited. Examples of Indirect Costs: depreciation and use allowances of non-federal equipment and buildings; facility operation and maintenance (lights, heat, phone, janitorial, grounds, etc); and general administrative expenses such as accounting, payroll, legal and data processing expenses.

GENERAL COST PRINCIPLES AFFECTING ALLOWABILITY OF COSTS (2 CFR 200.403)

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- (a) Be **necessary** and **reasonable** for the performance of the Federal award and be allocable thereto under these principles.
- (b) Conform to any **limitations** or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- (c) Be **consistent** with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- (d) Be **accorded consistent treatment**. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.
- (f) **Not be included as a cost or used to meet cost sharing or matching requirements** of any other federally-financed program in either the current or a prior period. See also §200.306 Cost sharing or matching paragraph (b).
- (g) Be **adequately documented**. See also §§200.300 Statutory and national policy requirements through 200.309 Period of performance of this part.

What is a Reasonable Cost (§200.404)? (cost principles)

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.

Other factors that must be considered in determining whether a cost is reasonable are:

whether the cost is generally considered as ordinary and necessary to the operation of the grantee or the performance of the federal award/program;

the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, federal, state and other laws and regulations, and terms and conditions of other federal awards, or sponsored agreements;

market prices for comparable goods and services;

whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the grantee, its employees, where applicable its students or membership, the public at large, and the federal government;

whether the grantee significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal awards costs.

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EXAMPLES:

1. A grantee is planning to purchase computers and printers with federal funds. The purchasing agent obtained phone quotes from three contractors. One contractor has a direct family relationship with the grantee's purchasing agent. It so happens that this contractor's quote was 20% higher than the other two. The grantee should not contract with this contractor because the price is unreasonable and has a conflict of interest (regardless of the price).
2. A grantee has been permitted in its grant contract to lease a vehicle so that it can travel within its region to deliver grant-related services to clients. The grantee has obtained quotes for a standard 4-door sedan and a luxury 4-wheel drive SUV that is twice the cost of the sedan. Which vehicle should the grantee choose? This is not to say a 4-wheel drive is not necessary or reasonable, but the price may dictate the type or model of vehicle.

What is an Allocable Cost (§200.405)? (cost principles)

A cost is considered allocable if the goods or services involved are chargeable or assignable to the federal award or cost objective (i.e., a specific function, project, sponsored agreement, service, or grant) in accordance with the relative benefits received.

Any cost allocable to a particular federal award may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by federal statutes, regulations, or terms and conditions of federal awards, or for other reasons.

If a grantee intends to recover the portion of its indirect costs (overhead, central administration, etc.) that relates to its grant programs, Uniform Guidance requires the grantee to develop a central service cost allocation plan and/or indirect cost rate proposal. Requirements pertaining to central service cost allocation plans and indirect cost proposals are found in Appendix III-VII to Part 200 (Uniform Guidance).

EXAMPLES:

1. An employee works on two different federal grant projects. The time spent on each project varies from day to day. This employee must keep monthly time and effort records that account for actual time spent on each project. By tracking actual effort, each grant will be charged its fair share of the costs.
2. A grantee held a training workshop for its employees. Included in the cost of the workshop was room rental, food, and travel. The workshop included a session that was specific to a federal program and a session that covered general personnel and human effectiveness training. The grantee should allocate the cost of the training among all programs/divisions that benefited from the training. Next, it should charge the allocated amount only to those awards that specifically allow for this type of cost.

Applicable Credits (§200.406) (cost principles)

A "credit" means a receipt or reduction in expenditures that offset or reduce direct or indirect cost items. Examples include:

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purchase discounts;
rebates or allowances;
recoveries or indemnities on losses;
insurance refunds or rebates; and
adjustments of overpayments or erroneous charges.

When such credits are applicable to allowable costs, they must be credited to the federal award either as a cost reduction or a cash refund. In some instances, the amounts received from the federal government to finance a grantee's activities or service operations should be treated as applicable credits.

EXAMPLE:

A grantee paid a contractor for materials it needed for a project. It was determined later that the vendor had over-billed the grantee and was issuing a refund check. This refund should be netted against the total amount charged to the grant as a cost reduction. If the grant project had already been closed out, the refund should be remitted to the grantor agency that sponsored the project. Consult with the grantor agency in such a case.

Prior written approval (§200.407) (cost principles)

Under any given Federal award, the reasonableness and allocability of certain items of costs may be difficult to determine. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, the non-Federal entity may seek the prior written approval of the cognizant agency for indirect costs or the Federal awarding agency in advance of the incurrence of special or unusual costs. Prior written approval should include the timeframe or scope of the agreement. The absence of prior written approval on any element of cost will not, in itself, affect the reasonableness or allocability of that element, unless prior approval is specifically required for allowability as described under certain circumstances in the following sections of this part:

- (a) §200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts, paragraph (b)(5);
- (b) §200.306 Cost sharing or matching;
- (c) §200.307 Program income;
- (d) §200.308 Revision of budget and program plans;
- (e) §200.311 Real property;
- (f) §200.313 Equipment;
- (g) §200.332 Fixed amount subawards;
- (h) §200.413 Direct costs, paragraph (c);
- (i) §200.430 Compensation—personal services, paragraph (h);
- (j) §200.431 Compensation—fringe benefits;
- (k) §200.438 Entertainment costs;
- (l) §200.439 Equipment and other capital expenditures;

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- (m) §200.440 Exchange rates;
- (n) §200.441 Fines, penalties, damages and other settlements;
- (o) §200.442 Fund raising and investment management costs;
- (p) §200.445 Goods or services for personal use;
- (q) §200.447 Insurance and indemnification;
- (r) §200.454 Memberships, subscriptions, and professional activity costs, paragraph (c);
- (s) §200.455 Organization costs;
- (t) §200.456 Participant support costs;
- (u) §200.458 Pre-award costs;
- (v) §200.462 Rearrangement and reconversion costs;
- (w) §200.467 Selling and marketing costs;
- (x) §200.470 Taxes (including Value Added Tax); and
- (y) §200.474 Travel costs.

Consistency (2 CFR §200.403(d) (cost principles)

A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

EXAMPLE:

A grantee has five departments. It allocates the cost of its basic telephone service to each department based on the number of telephones in each department. Each department should treat the telephone cost consistently for all grants it administers. That is, if a department has 3 grant programs, that department should treat this telephone cost as either a direct cost or indirect cost for all 3 grants, but not a mix of each. Next, if treated as a direct cost, a department should only request reimbursement for this type of cost if permitted under the terms of its grant agreement(s).

Grant Agreement Limitations (§200.408) (cost principles)

To be allowable, the cost being charged must conform to any limitations or exclusions set forth in the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

EXAMPLE:

A grantee paid for a television advertisement to promote its new grant-funded health program. However, the approved grant contract limited the cost of advertising to brochures and radio ads. Therefore, the grantee should not include the cost of the television advertisement in its request for reimbursement even though "advertising" is an otherwise allowable cost according to Circular A-87.

Adequate Supporting Documentation (2 CFR §200.403(g) (cost principles)

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Amounts charged to federal awards must be supported by source documentation, including:

- payroll reports
- time and attendance records
- invoice vouchers from subrecipients
- receiving reports
- original vendor invoices
- cost allocation plans

(Documentation may be in an electronic form, but make sure the integrity of the electronic documentation can be maintained for the duration of the applicable record retention period).

EXAMPLE:

A grantee made a year-end adjustment to a federal award using a journal voucher entry. The accounting entry must be supported by adequate documentation that demonstrates both allowability and allocability.

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

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ADDITIONAL TESTING SELECTION INFO & EXAMPLES

<i>Selection Options</i>		
Method	Process	Next Steps
Sampling	This is the preferred method for large populations (over 365). Use sampling tool from teammate.	Get the sample tool from Teammate. Take the sampling training if needed.
Haphazard Selection	May use for populations less than 365. Auditor haphazardly picks transactions. It feels random but only true "random" samples can be done by the computer in the sampling method.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab)
Judgmental Selection	May use for populations less than 365. The auditor has a specific reason, associated with a risk, to pick certain or certain transactions. Explain risks in the ROWD and how transactions not selected are lower risk.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab). See examples there.
Judgmental Population	First, the auditor has a specific reason, associated with a risk, to pick certain types of transactions (judgmental population). Explain risks in the ROWD and how populations not selected are lower risk (you can refer to the testing strategy if we have done this for you already). Next, the auditor selects transaction from the judgmental population using the sampling method above.	Get sample tool from Teammate. Take training for the form if needed.
All quantitatively material transactions	Use only when a few very large transactions make up the majority of grant activity. You will test all of these material transactions.	Keep in mind: If 10% or more of the population is made up of <i>other</i> types of costs, those transactions should be tested in some way, as well.

DUAL PURPOSE TESTING EXAMPLE

For allowable costs the key control is, "The Business Manager reviews the reimbursement request, reconciling the items requested to invoices to determine they are supported and allowable." You will test it by reperforming the Business Manager's review to determine if it is effective in preventing and detecting noncompliance. You may check the requests to see if they have the Business Manager's signature of approval but that will only tell you if they consistently do it, which is important. However, you should reperform the control.

To complete compliance testing you are tracing expenditures from the requests to support to determine if they are supported and allowable per the program.

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In this case, for testing both controls and compliance you are completing the same process. However, you need to document that you tested both and clearly show the conclusion of each even though they are related. Control testing should conclude whether the control was effective in preventing or detecting noncompliance and compliance testing whether the entity was in compliance.

INDIRECT COST UNDERSTANDING OF RATES/ALLOCATIONS

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

1. Rate Provided by Grantor: The federal grantor or PTE can give the entity an indirect cost rate in the award, usually outlined in the budget section and based on the availability of funding. There is no separate or formal rate agreement and it is not considered negotiated.

2. Use PTE Negotiated Rate: The federal grantor, PTE or federal guidance can require the entity to use PTE's negotiated indirect cost rate. This requirement can be found in the Compliance Supplement and federal pass-through guidance. The PTE will place the rate in their award with the entity. This is common for school districts.

3. De Minimis Indirect Cost Rate: If the entity elects to use the de minimis rate, a flat 10% (of Modified Total Direct Costs), in their grant application, no direct or pass-through grantor can deny its use so long as the entity qualifies.

Restrictions: The entity can use the method so long as they have **never** had a negotiated indirect cost rate or allocation plan approved by the federal cognizant agency **or** the PTE.

UPDATED GUIDANCE: Federal guidance now clarifies that negotiated rates and allocation plans negotiated by **PTEs** can prevent the use of the de minimis rate.

Consistency: If used, the entity must use the de minimis method for all of their Uniform Guidance federal programs that allow indirect costs.

Rate: Indirect costs are calculated as base costs multiplied by a flat 10% rate that does not require a true-up to actual indirect expenses.

Base Used: The 10% is multiplied by the modified total direct costs (MTDC) base.

MTDC Base	
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Includes	Excludes
Direct Salaries & Wages	Equipment & Capital Expenditures
Direct Fringe Benefits	Charges for Patient Care
Materials & Supplies	Participant Support Costs
Services	Rental Costs
Travel	Tuition remission, Scholarships & Fellowships
Up to \$25,000 of <i>each</i> subaward (regardless of the period of performance)	The portion of each subaward in excess of \$25,000

4. Negotiated Rates & Allocation Plans – Cognizant Agency: Only major governments are required to obtain a cognizant agency approved negotiated rate or allocation plan. Smaller governments can opt to do so. The “cognizant agency for indirect costs” is designated as:

For central service cost allocation plans: the federal agency with the largest dollar value of ***total*** federal awards

For indirect cost rates and cost allocation plans: the federal agency with the largest dollar value of ***direct*** federal awards

Once designated, the federal entity remains the cognizant agency for five years. Under this method, the entity will be awarded a formal contract for the rate/allocation. All awarding agencies must accept the rate/allocation plan when the entity elects to use it in their program application.

Various allocation plans can be approved, but there are four types of rates:

1. **Provisional:** The provisional rate is temporary and expires upon the completion of the federal award. It requires a true-up to actual expenditures by the end of the project or whenever the entity obtains a final rate. The rate is adjusted by using the final rate.
2. **Final:** The rate is permanent and is calculated after the actual costs are known (i.e. at the conclusion of the federal project). It is used to adjust the indirect costs from the provisional rate.
3. **Predetermined:** This is a permanent rate and is calculated using actual costs from previous periods. It does not require a true-up to correspond with actual current year costs. The rate is effective between two to five years.
4. **Fixed:** This is a permanent rate and is calculated using actual costs from previous periods. It requires a true-up to correspond with actual current year costs. The variance between the costs used to create the rate and the actual costs incurred during the year the rate was used is carried-forward as an adjustment to the current rate. The entity will either recover or “pay back” the variance going forward. The rate is effective for two years and then can be annually renewed.

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5. Negotiated Rates & Allocation Plans – PTE: Indirect Cost Rate Proposals and Cost Allocation Plans are not required by UG to be submitted to/approved by PTE's, but the PTEs may require it. Usually a formal contract for the rate/allocation is not issued and they just review and/or approve the plan instead. Other pass-through entities are not required accept the rate/allocation plan but they can choose to accept it.

METHODS OF INDIRECT COST RATE CALCULATION

(1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:

(a) *Simplified Method* – This method is applicable where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

Multiple Allocation Base Method – This method is applicable where a governmental unit's department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)

(c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)

(d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a State or local government or unit's department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency's Federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP must be either submitted to the cognizant agency for indirect cost for review, negotiation

Record of Work Done.*

For steps one and two, see: A-B. Overview - Activities Allowed/Cost Principles - Controls.

Note: This step was originally completed and reviewed on August 16th, 2022. However, during our testing, we received information from the Department indicating an internal control design failure, which prompted the Department to review and revise the description of a key internal control in order for us to be able to test it. Subsequent sign-offs by the AIC and audit supervisor reflect these changes.

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Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

On July 26, 2022 we received a copy of the Department's current key internal controls over Activities Allowed or Unallowed/ Cost Principles (see Internal Control request letter (with agency response) - Activities Allowed-Cost Principles (BASED ON PRELIMINARY EXPENDITURE ANALYSIS)).

On August 2, 2022, we met with Rachel Rodgers, Payroll Payment & Deductions Unit Supervisor, and Jesse Daniels, External Audit Liaison, to gain an understanding of the internal controls over Activities Allowed/Cost Principles requirements is outlined below. We confirmed the Department's written policies and procedures, and internal controls related to Activities Allowed as part of gaining an understanding of internal controls. The Department's documentation includes the Department's Payroll Manual (Payroll Manual_04.2021), Human Resources Manual chapter 21 (HR-Compensation-Manual-Chapter-21.pdf), Chart of Accounts (Chart of Accounts (July 2021 update)), and TRAINS Pre-edit Reference Guide (TRAINS Pre-Edit Reference Guide).

All payroll expenditures are tracked using the Department's electronic Time & Attendance system (DOTtime), and financial reporting system (TRAINS). All employees must submit a time sheet electronically using DOTtime, listing their time spent working on a specific project. The frequency of time sheet entries is dependent on the type of work being performed and the number of projects an employee works on. In most cases, time entries are recorded daily, but at a minimum, time sheets are completed each pay period.

Employees key in their time sheets electronically in the DOTtime system, which is submitted to their supervisor for approval. **Key Control #1: To ensure hours are recorded to the correct work order and are for allowable activities, time sheet hours recorded and the projects charged are reviewed and approved by the direct supervisor of the employee in DOTtime. (Control Activities)** Approved time sheets are maintained in the system. Once leave is approved in DOTtime by the supervisor, it is electronically transferred to the employee's timesheet. During payroll processing, the leave hours are exported with the payroll files into HRMS every day during the cutoff period.

Each Region assigns a Timekeeper that works with a regional Headquarters (HQ) contact. The Regional Timekeepers or Organization ("Org") run payroll related reports and review for exceptions. To ensure leave is accurately recorded, the Regional Timekeeper can review leave reports each pay period. At any given time, preliminary reports can be run in DOTtime by the timekeeper or employee supervisor for review.

The Regional Timekeeper reviews the following reports:

1. Unsubmitted unapproved time off request,
2. Unsubmitted time sheet,
3. Unapproved time sheet,
4. Time sheet exceptions within date range (shows if assigned hours do not match employees schedule, coding for an employee so it can be corrected if wrong, etc. – reviewed through the Labor Distribution Detail and Labor Distribution Detail by Work Order reports), and

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5. The amended time sheet currently open – (shows if the amended timesheet hasn't been submitted by employee and/or approved by the supervisor)- if an amendment is necessary, the employee has to recall, amend the prior timesheet, update and resubmit for approval from their supervisor.

DOTtime automatically uploads into TRAINS as *AQ and *M1 transactions, which splits payroll costs to the appropriate work order and project, and the State/Federal split is based on the work order accounting codes charged by the employee and is allowable based on the unique account coding listed in TRAINS.

During days two and three of the payroll cutoff period Rachel Rodgers, Payroll Payment & Deductions Unit Supervisor, runs reports including an employee salary overpayment report. If an employee payroll overpayment is identified, Rachel works with the appropriate regional representative to compose and send out an overpayment letter to the employee. The employee's payroll will be reduced the subsequent period by the amount overpaid. After payroll has been processed, supervisors receive a payroll journal from HQ payroll detailing the amounts paid to each employee by organization code. **Key Control #2: To ensure employees are paid according to their hours worked, supervisors review each line item in the payroll journal, and once approved, sign and send back to HQ payroll to be filed within two weeks of receiving the payroll journal from headquarters Payroll staff. (Monitoring)** Per the Department's Payroll manual section 2, Payroll staff are responsible for distribution of payroll journals, the Regional Timekeepers must ensure the payroll journals have the appropriate signatures and are returned to the headquarters office, and supervisors to review and sign the payroll journal. In our review of the Department's payroll and human resources documentation we found no mention of the timing of the payroll journals being sent to the regions, and when they were supposed to be signed and returned. We inquired with the Department regarding policy and practices with payroll journals. Rachel explained that the journals are created and sent out on day four or five of payroll processing, the day after final payroll is ran and the regions have two weeks to sign and return the journal, which falls on the same period of the following month (see WSDOT Payroll Journal Discussion). Per Rachel, "Example: For the current pay period 11/16-30/2022 we will process final payroll on 12/6/2022. The payroll journals for the pay date of 12/9/2022 will be sent out between 12/7 & 12/8." The Region timekeeper would need to turn in the signed journals on January 10, 2023. Rachel further explained that during calendar year 2021 the Department switched to using electronic signatures using Adobe, which sends a daily reminder until the journal is signed. Prior to this time, wet signatures were used along with staff-initiated reminders, such as email. She further explained that the Department uses calendar year-based timekeeper calendars that are provided to payroll staff and Regional Timekeepers to communicate the days journals are sent and due (see for 2021 Timekeeper Calendar Updated 2021 and for 2022 Timekeeper Calendar - Updated 2022). Per our discussion with the Department we agree that the signing of payroll journals is a detective control, as it is not done prior to the posting of payroll, and would not stop unauthorized transactions. The process allows the Regional Timekeeper or Supervisor to detect errors and follow up with Payroll so any proper corrections can be made.

Summary of Key Controls

Key Control #1: To ensure hours are recorded to the correct work order and are for allowable activities, time sheet hours recorded and the projects charged are reviewed and approved by the direct supervisor of the employee in DOTtime. (Control Activities)

Key Control #2: To ensure employees are paid according to their hours worked, supervisors review each line item in the payroll journal, and once approved, sign and send back to HQ payroll to be filed within two weeks of receiving the payroll journal from headquarters Payroll staff. (Monitoring)

Evaluation of Results: We did not identify any control deficiencies in the design of the key internal controls.

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Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.6.PR.G - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: A-B. (Contractor Payments) Activities Allowed/Cost Principles - Controls

Prepared By: AWW, 7/28/2022

Reviewed By: ACS, 8/1/2022

Purpose/Conclusion.*

Purpose:

To gain an understanding of the internal controls the agency has in place to provide reasonable assurance that Federal awards are expended only for allowable activities and that expenditures charged to the Federal award are allowable and in accordance with the applicable cost principles.

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal award requirements related to allowable activities and cost principles.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Heidi Jensen, State Documentation Construction Engineer

Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Activities Allowed and Cost Principles, we assessed preliminary control risk as low.

Testing Strategy.*

A-B. Activities Allowed/Cost Principles - **Post Uniform Guidance Awards**

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

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See steps to assess risk and risk factor considerations are listed in the **Inherent and Internal Control Risk Guidance** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review scope of work

Allowable Activities - Determine which activities and types of costs are specifically allowed or unallowed, by reviewing the following:

1. Award agreement or approved application for scope of work, terms and conditions, and approved budget.
2. Part 4 of the Compliance Supplement that applies to your audit period.
3. Available program guidelines or handbooks. (Ex. WSDOT's LAG Manual)
4. If above information is not available, look to the federal regulations (contact the single audit specialist if you need assistance with this).

Requirements for Cost Principles are found as follows:

Pre-UG: OMB Circular A-87

UG: 2 CFR 200, Subpart E.

Please be familiar with these requirements as not all are listed below; only parts emphasized in the Compliance Supplement are listed below.

Quantitatively Material

Identify the expenditure activities that are directly charged to the program and are quantitatively material (more than 5%).

Direct Costs

Payroll Expenditures: When payroll costs are selected for our single audit, our focus is on whether the portion of payroll charged to the program (allocation) is supported by appropriate time and effort and meets the cost principles. Note that awarding agencies may require specific forms of documentation to support payroll charged to its award.

Compensated Absences (leave cash-outs or accrual): The entity may include employees' use of leave (which is included in their regular salary payments). If the entity charges any **leave cash-outs** or the **accrual of leave** to the grant, there are special rules, see extra guidance in the policy tab. There is a high risk the costs are unallowable.

Non-Payroll Expenditures: Generally, auditors should test internal controls and compliance for non-payroll expenditures when those costs are quantitatively material (5%) to the program.

Automated Controls: If you identify key internal controls that are automated, consult with the SWSA Supervisor or SWSA AIC to determine whether to request automated control work from Team IT audit.

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Indirect Costs

Determine whether the agency has recovered indirect costs via an indirect cost rate or cost allocation plan and, if so, how much was expended. If indirect costs are material to the program the auditor must test the internal controls (and compliance) over them when those costs are quantitatively material (5%) to the program.

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement. These are discussed in the **policy tab** in further detail, for when indirect costs are material to the program.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

Special – Review In-process Proposals: If the entity is preparing an Indirect Cost Rate Proposal during the audit period in order to submit it to the federal cognizant agency, we are required to review the accuracy of the base data and calculations.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) **Activities Allowed:** grant funds are used only for allowable activities (this may include review of expenditures, program monitoring, preparing the reimbursement requests, establishment of programs);

(b) **Cost Principles:** direct and indirect costs charged to the grant comply with the cost principles set forth in 2 CFR 200 Subpart E (this may or may not be the same control activity for (a))

(c) **Activities Allowed-Indirect Costs:** if material (5%), the entity uses the proper indirect cost rate (per approved plan or rate, de minimis only when it is

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applicable, or another rate established by contract). Controls should also focus on how the entity properly calculates the direct cost base that the indirect rate is applied to. For instance, the controls should ensure that they are using only allowable types of costs in the MTDC or other direct base as applicable, that those costs are not used twice or that they occurred during the contract's period of performance. Note: These controls are likely **different** than those in (a) and possibly (b).

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as "**LOW**" when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria.:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Basic Cost Principles (2 CFR 200.402 – 409)

DEFINITIONS

Cost means an amount as determined on a cash, accrual, or other basis of accounting acceptable to the Federal awarding or cognizant agency.

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Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are needed and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

Direct costs are those that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization). Examples of Direct Costs: payroll costs of employees who perform work that is directly related to the grant program; the cost of supplies and materials used for the purpose of the grant; equipment and other approved capital expenditures made for the grant; or professional services contracted to accomplish specific grant/contract objectives.

Indirect costs are those costs incurred for a common or institution-wide objective that benefits more than one grant program or project. Such costs are not readily assignable to the cost objective specifically benefited. Examples of Indirect Costs: depreciation and use allowances of non-federal equipment and buildings; facility operation and maintenance (lights, heat, phone, janitorial, grounds, etc);and general administrative expenses such as accounting, payroll, legal and data processing expenses.

GENERAL COST PRINCIPLES AFFECTING ALLOWABILITY OF COSTS (2 CFR 200.403)

- (a) Be **necessary** and **reasonable** for the performance of the Federal award and be allocable thereto under these principles.
- (b) Conform to any **limitations** or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- (c) Be **consistent** with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- (d) Be **accorded consistent treatment**. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.
- (f) **Not be included as a cost or used to meet cost sharing or matching requirements** of any other federally-financed program in either the current or a prior period. See also §200.306 Cost sharing or matching paragraph (b).
- (g) Be **adequately documented**. See also §§200.300 Statutory and national policy requirements through 200.309 Period of performance of this part.

What is a Reasonable Cost (§200.404)? (cost principles)

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.

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Other factors that must be considered in determining whether a cost is reasonable are:

whether the cost is generally considered as ordinary and necessary to the operation of the grantee or the performance of the federal award/program;

the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, federal, state and other laws and regulations, and terms and conditions of other federal awards, or sponsored agreements;

market prices for comparable goods and services;

whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the grantee, its employees, where applicable its students or membership, the public at large, and the federal government;

whether the grantee significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal awards costs.

EXAMPLES:

1. A grantee is planning to purchase computers and printers with federal funds. The purchasing agent obtained phone quotes from three contractors. One contractor has a direct family relationship with the grantee's purchasing agent. It so happens that this contractor's quote was 20% higher than the other two. The grantee should not contract with this contractor because the price is unreasonable and has a conflict of interest (regardless of the price).

2. A grantee has been permitted in its grant contract to lease a vehicle so that it can travel within its region to deliver grant-related services to clients. The grantee has obtained quotes for a standard 4-door sedan and a luxury 4-wheel drive SUV that is twice the cost of the sedan. Which vehicle should the grantee choose? This is not to say a 4-wheel drive is not necessary or reasonable, but the price may dictate the type or model of vehicle.

What is an Allocable Cost (§200.405)? (cost principles)

A cost is considered allocable if the goods or services involved are chargeable or assignable to the federal award or cost objective (i.e., a specific function, project, sponsored agreement, service, or grant) in accordance with the relative benefits received.

Any cost allocable to a particular federal award may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by federal statutes, regulations, or terms and conditions of federal awards, or for other reasons.

If a grantee intends to recover the portion of its indirect costs (overhead, central administration, etc.) that relates to its grant programs, Uniform

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Guidance requires the grantee to develop a central service cost allocation plan and/or indirect cost rate proposal. Requirements pertaining to central service cost allocation plans and indirect cost proposals are found in Appendix III-VII to Part 200 (Uniform Guidance).

EXAMPLES:

1. An employee works on two different federal grant projects. The time spent on each project varies from day to day. This employee must keep monthly time and effort records that account for actual time spent on each project. By tracking actual effort, each grant will be charged its fair share of the costs.
2. A grantee held a training workshop for its employees. Included in the cost of the workshop was room rental, food, and travel. The workshop included a session that was specific to a federal program and a session that covered general personnel and human effectiveness training. The grantee should allocate the cost of the training among all programs/divisions that benefited from the training. Next, it should charge the allocated amount only to those awards that specifically allow for this type of cost.

Applicable Credits (§200.406) (cost principles)

A "credit" means a receipt or reduction in expenditures that offset or reduce direct or indirect cost items. Examples include:

- purchase discounts;
- rebates or allowances;
- recoveries or indemnities on losses;
- insurance refunds or rebates; and
- adjustments of overpayments or erroneous charges.

When such credits are applicable to allowable costs, they must be credited to the federal award either as a cost reduction or a cash refund. In some instances, the amounts received from the federal government to finance a grantee's activities or service operations should be treated as applicable credits.

EXAMPLE:

A grantee paid a contractor for materials it needed for a project. It was determined later that the vendor had over-billed the grantee and was issuing a refund check. This refund should be netted against the total amount charged to the grant as a cost reduction. If the grant project had already been closed out, the refund should be remitted to the grantor agency that sponsored the project. Consult with the grantor agency in such a case.

Prior written approval (§200.407) (cost principles)

Under any given Federal award, the reasonableness and allocability of certain items of costs may be difficult to determine. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, the non-Federal entity may seek the prior written approval of the cognizant agency for indirect costs or the Federal awarding agency in advance of the incurrence of special or unusual costs. Prior written

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approval should include the timeframe or scope of the agreement. The absence of prior written approval on any element of cost will not, in itself, affect the reasonableness or allocability of that element, unless prior approval is specifically required for allowability as described under certain circumstances in the following sections of this part:

- (a) §200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts, paragraph (b)(5);
- (b) §200.306 Cost sharing or matching;
- (c) §200.307 Program income;
- (d) §200.308 Revision of budget and program plans;
- (e) §200.311 Real property;
- (f) §200.313 Equipment;
- (g) §200.332 Fixed amount subawards;
- (h) §200.413 Direct costs, paragraph (c);
- (i) §200.430 Compensation—personal services, paragraph (h);
- (j) §200.431 Compensation—fringe benefits;
- (k) §200.438 Entertainment costs;
- (l) §200.439 Equipment and other capital expenditures;
- (m) §200.440 Exchange rates;
- (n) §200.441 Fines, penalties, damages and other settlements;
- (o) §200.442 Fund raising and investment management costs;
- (p) §200.445 Goods or services for personal use;
- (q) §200.447 Insurance and indemnification;
- (r) §200.454 Memberships, subscriptions, and professional activity costs, paragraph (c);
- (s) §200.455 Organization costs;
- (t) §200.456 Participant support costs;
- (u) §200.458 Pre-award costs;
- (v) §200.462 Rearrangement and reconversion costs;
- (w) §200.467 Selling and marketing costs;
- (x) §200.470 Taxes (including Value Added Tax); and
- (y) §200.474 Travel costs.

Consistency (2 CFR §200.403(d) (cost principles)

A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

EXAMPLE:

A grantee has five departments. It allocates the cost of its basic telephone service to each department based on the number of telephones in each

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department. Each department should treat the telephone cost consistently for all grants it administers. That is, if a department has 3 grant programs, that department should treat this telephone cost as either a direct cost or indirect cost for all 3 grants, but not a mix of each. Next, if treated as a direct cost, a department should only request reimbursement for this type of cost if permitted under the terms of its grant agreement(s).

Grant Agreement Limitations (§200.408) (cost principles)

To be allowable, the cost being charged must conform to any limitations or exclusions set forth in the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

EXAMPLE:

A grantee paid for a television advertisement to promote its new grant-funded health program. However, the approved grant contract limited the cost of advertising to brochures and radio ads. Therefore, the grantee should not include the cost of the television advertisement in its request for reimbursement even though "advertising" is an otherwise allowable cost according to Circular A-87.

Adequate Supporting Documentation (2 CFR §200.403(g) (cost principles)

Amounts charged to federal awards must be supported by source documentation, including:

- payroll reports
- time and attendance records
- invoice vouchers from subrecipients
- receiving reports
- original vendor invoices
- cost allocation plans

(Documentation may be in an electronic form, but make sure the integrity of the electronic documentation can be maintained for the duration of the applicable record retention period).

EXAMPLE:

A grantee made a year-end adjustment to a federal award using a journal voucher entry. The accounting entry must be supported by adequate documentation that demonstrates both allowability and allocability.

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

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Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

ADDITIONAL TESTING SELECTION INFO & EXAMPLES

<i>Selection Options</i>		
Method	Process	Next Steps
Sampling	This is the preferred method for large populations (over 365). Use sampling tool from teammate.	Get the sample tool from Teammate. Take the sampling training if needed.
Haphazard Selection	May use for populations less than 365. Auditor haphazardly picks transactions. It feels random but only true "random" samples can be done by the computer in the sampling method.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab)
Judgmental Selection	May use for populations less than 365. The auditor has a specific reason, associated with a risk, to pick certain or certain transactions. Explain risks in the ROWD and how transactions not selected are lower risk.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab). See examples there.

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Judgmental Population	First, the auditor has a specific reason, associated with a risk, to pick certain types of transactions (judgmental population). Explain risks in the ROWD and how populations not selected are lower risk (you can refer to the testing strategy if we have done this for you already). Next, the auditor selects transaction from the judgmental population using the sampling method above.	Get sample tool from Teammate. Take training for the form if needed.
All quantitatively material transactions	Use only when a few very large transactions make up the majority of grant activity. You will test all of these material transactions.	Keep in mind: If 10% or more of the population is made up of <i>other</i> types of costs, those transactions should be tested in some way, as well.

DUAL PURPOSE TESTING EXAMPLE

For allowable costs the key control is, "The Business Manager reviews the reimbursement request, reconciling the items requested to invoices to determine they are supported and allowable." You will test it by reperforming the Business Manager's review to determine if it is effective in preventing and detecting noncompliance. You may check the requests to see if they have the Business Manager's signature of approval but that will only tell you if they consistently do it, which is important. However, you should reperform the control.

To complete compliance testing you are tracing expenditures from the requests to support to determine if they are supported and allowable per the program.

In this case, for testing both controls and compliance you are completing the same process. However, you need to document that you tested both and clearly show the conclusion of each even though they are related. Control testing should conclude whether the control was effective in preventing or detecting noncompliance and compliance testing whether the entity was in compliance.

INDIRECT COST UNDERSTANDING OF RATES/ALLOCATIONS

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

1. Rate Provided by Grantor: The federal grantor or PTE can give the entity an indirect cost rate in the award, usually outlined in the budget

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section and based on the availability of funding. There is no separate or formal rate agreement and it is not considered negotiated.

2. Use PTE Negotiated Rate: The federal grantor, PTE or federal guidance can require the entity to use PTE's negotiated indirect cost rate. This requirement can be found in the Compliance Supplement and federal pass-through guidance. The PTE will place the rate in their award with the entity. This is common for school districts.

3. De Minimis Indirect Cost Rate: If the entity elects to use the de minimis rate, a flat 10% (of Modified Total Direct Costs), in their grant application, no direct or pass-through grantor can deny its use so long as the entity qualifies.

Restrictions: The entity can use the method so long as they have **never** had a negotiated indirect cost rate or allocation plan approved by the federal cognizant agency **or** the PTE.

UPDATED GUIDANCE: Federal guidance now clarifies that negotiated rates and allocation plans negotiated by **PTEs** can prevent the use of the de minimis rate.

Consistency: If used, the entity must use the de minimis method for all of their Uniform Guidance federal programs that allow indirect costs.

Rate: Indirect costs are calculated as base costs multiplied by a flat 10% rate that does not require a true-up to actual indirect expenses.

Base Used: The 10% is multiplied by the modified total direct costs (MTDC) base.

<i>MTDC Base</i>	
Includes	Excludes
Direct Salaries & Wages	Equipment & Capital Expenditures
Direct Fringe Benefits	Charges for Patient Care
Materials & Supplies	Participant Support Costs
Services	Rental Costs
Travel	Tuition remission, Scholarships & Fellowships
Up to \$25,000 of <i>each</i> subaward (regardless of the period of performance)	The portion of each subaward in excess of \$25,000

4. Negotiated Rates & Allocation Plans – Cognizant Agency: Only major governments are required to obtain a cognizant agency approved negotiated rate or allocation plan. Smaller governments can opt to do so. The "cognizant agency for indirect costs" is designated as:

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For central service cost allocation plans: the federal agency with the largest dollar value of **total** federal awards

For indirect cost rates and cost allocation plans: the federal agency with the largest dollar value of **direct** federal awards

Once designated, the federal entity remains the cognizant agency for five years. Under this method, the entity will be awarded a formal contract for the rate/allocation. All awarding agencies must accept the rate/allocation plan when the entity elects to use it in their program application.

Various allocation plans can be approved, but there are four types of rates:

1. **Provisional**: The provisional rate is temporary and expires upon the completion of the federal award. It requires a true-up to actual expenditures by the end of the project or whenever the entity obtains a final rate. The rate is adjusted by using the final rate.
2. **Final**: The rate is permanent and is calculated after the actual costs are known (i.e. at the conclusion of the federal project). It is used to adjust the indirect costs from the provisional rate.
3. **Predetermined**: This is a permanent rate and is calculated using actual costs from previous periods. It does not require a true-up to correspond with actual current year costs. The rate is effective between two to five years.
4. **Fixed**: This is a permanent rate and is calculated using actual costs from previous periods. It requires a true-up to correspond with actual current year costs. The variance between the costs used to create the rate and the actual costs incurred during the year the rate was used is carried-forward as an adjustment to the current rate. The entity will either recover or “pay back” the variance going forward. The rate is effective for two years and then can be annually renewed.

5. Negotiated Rates & Allocation Plans – PTE: Indirect Cost Rate Proposals and Cost Allocation Plans are not required by UG to be submitted to/approved by PTE's, but the PTEs may require it. Usually a formal contract for the rate/allocation is not issued and they just review and/or approve the plan instead. Other pass-through entities are not required accept the rate/allocation plan but they can choose to accept it.

METHODS OF INDIRECT COST RATE CALCULATION

(1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:

(a) *Simplified Method* – This method is applicable where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

Multiple Allocation Base Method – This method is applicable where a governmental unit's department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the

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relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)

(c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)

(d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a State or local government or unit's department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency's Federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP must be either submitted to the cognizant agency for indirect cost for review, negotiation

Record of Work Done.

We reviewed Part 4 of the Compliance Supplement, and identified the relevant compliance requirements for Activities Allowed or Unallowed, and Allowable Costs/Cost Principles for the program, which are as follows:

A. Activities Allowed or Unallowed

1. Federal funds can be used only to reimburse costs that are:
 - (a) incurred subsequent to the date of authorization to proceed, except for certain property acquisition costs permitted under 23 USC 108, certain emergency repair work under 23 USC 125, and preliminary engineering under Section 1440 of the FAST Act (23 USC 121 note);
 - (b) in accordance with the conditions contained in the project agreement and the plans, specifications, and estimates (PS&E);
 - (c) allocable to a specific project; and
 - (d) claimed for reimbursement subsequent to the date of the project agreement (23 CFR sections 1.9, 630.106, 630.205, and 635.112). The authorization to proceed date is the same as the authorization date of the project agreement except for instances when the project needs to advance before the project agreement can be completed.
2. Federal funds can be used for administrative settlement costs incurred in defending contract claim proceedings before arbitration boards or state courts only if approved by FHWA for state-aid projects. If special counsel is used, it must be recommended by the State Attorney or State Department of Transportation (State DOT) legal counsel and approved in advance by FHWA (23 CFR section 140.505).
3. ADHS funds may be used only for work included in the ADHS cost estimate approved by the ARC.
4. FLTTP funds may be used for work on projects that provide access to or within federal or tribal lands (23 USC 201 through 202, and 25 CFR part 170).

Understanding of Internal Controls

Step 3

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In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

On June 27, 2022 we received a copy of the Department's current key internal controls over Activities Allowed or Unallowed/ Cost Principles (see [Internal Control request letter \(with agency response\) - Activities Allowed-Cost Principles \(BASED ON PRELIMINARY EXPENDITURE ANALYSIS\)](#)).

On July 28, 2022 we met with Heidi Jensen, State Documentation Construction Engineer, and Jesse Daniels, External Audit Liaison, to gain an understanding of the internal controls over Activities Allowed or Unallowed/ Cost Principles – Contractor Payments.

The payment process for contractors is a component of the Construction and Contract Administration and Payment System (CAPS) manual. The Construction manual is available via the Department's website at <https://www.wsdot.wa.gov/publications/manuals/fulltext/M41-01/Construction.pdf>, while the CAPS manual is stored on the Department's intranet. A copy of the CAPS manual was provided by Jesse Daniels and can be seen at [CAPS Manual](#). The CAPS manual section "Estimate Payments" states *"The Headquarters Contract Payment unit is responsible for ensuring that Headquarters finals and supplemental finals are processed on a timely basis when received. Posting of items for payment are processed in the Project Ledger section."* The Construction manual is compiled by WSDOT and approved by FHWA. Payment for work performed by the Contractor and for materials on hand must be made in accordance with Construction Manual Chapter 1, SS 1-09.9, Payments.

The Department administers two different categories of construction projects: Design-Build, and Design-Bid Build. Design-build projects are awarded a single contract to a vendor/firm with both Preliminary Engineering & Design expertise, as well as Construction management experience. In essence, the contractor performs both the design and construction phases of the project. Under the Design-Bid build model, the Department designs the scope of the project, either with in-house engineers or working with a consultant to determine the scope of the project. Based on their cost estimate, a solicitation is made to pre-qualified construction contractors to submit bids responsive to the Department's request. Projects are then awarded to contractor(s) who will perform and/or oversee construction work (should they utilize subcontractors).

Project payments are referred to by contractors, project office staff, and construction HQ staff as "pay estimates," but the amounts are not literally estimated amounts being claimed - an "estimate" is just what the documentation submitted to be paid is called; it is an accounting of costs incurred representative of the value received by Department for the work done on the project to date (progress billing) (See Standard Specifications for Municipal, Road and Bridge Construction - Section 1-04.8 for further details at <https://www.wsdot.wa.gov/publications/manuals/fulltext/M41-10/SS.pdf>). For the purposes of this understanding and to avoid any unnecessary confusion, the auditor will henceforth refer to "estimates" as "payment requests."

The process for submitting a payment request on a construction project works as follows: Any relevant documentation related to a project payment that provides detail and support demonstrating compliance with the contract for the services provided and costs incurred is compiled at the region in the project office. This documentation may include field notes, progress estimates, item quantity lists, force accounts for labor worked, etc. Design-build projects use an invoice submitted by the contractor to the Department, while Design-bid contracts utilize Department inspectors to confirm work has met predetermined goals typically denoted in defined measurements in cubic feet or yards. **Key Control #1: Supporting documentation is reviewed, signed, and dated by various project office staff/managers and inspectors in the field to certify that the work was performed per specifications, all calculations are correct, and all work paid for was complete. (Control Activities)**

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For example, on a field note record, the calculated amount of materials, the confirmation that the calculation is correct, the inspection of the materials, and the completion of the work are all performed by separate people on the project; their review and approval is indicated by their signatures and dates on the supporting documents related to either the invoice, or pay estimate, depending upon the project type.

Key Control #2: Documentation is reviewed by both the Project Engineer and Office Engineer, who then signs the invoices and/or pay estimates as approval for the expenditure to be processed for payment. (Control Activities) Expenditures are entered into CAPS by project office staff and reviewed in the financial services office. CAPS is centrally overseen by HQ staff located in the Accounting & Financial Services Division of WSDOT. CAPS transactions automatically interface to the Department's internal accounting system the Transportation Reporting and Accounting Information System (commonly known as TRAINS) as *SEC1 Code *AK* transactions.

Summary of Key Controls

Key Control #1: Supporting documentation is reviewed, signed, and dated by various project office staff/managers and inspectors in the field to certify that the work was performed per specifications, all calculations are correct, and all work paid for was complete. (Control Activities)

Key Control #2: Documentation is reviewed by both the Project Engineer and Office Engineer, who then signs the invoices and/or pay estimates as approval for the expenditure to be processed for payment. (Control Activities)

Evaluation of Results: We did not identify any control deficiencies.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.6.PRG - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: A-B. Local Programs Activities Allowed/Cost Principles - Controls

Prepared By: AWW, 7/28/2022

Reviewed By: ACS, 8/1/2022

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Purpose/Conclusion.*

Purpose:

To gain an understanding of the internal controls the agency has in place to provide reasonable assurance that Federal awards are expended only for allowable activities and that expenditures charged to the Federal award are allowable and in accordance with the applicable cost principles.

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal award requirements related to allowable activities and cost principles.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Stephanie Tax, Local Programs Program Manager

Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Activities Allowed and Cost Principles, we assessed preliminary control risk as low.

Testing Strategy.*

A-B. Activities Allowed/Cost Principles - **Post Uniform Guidance Awards**

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review scope of work

Allowable Activities - Determine which activities and types of costs are specifically allowed or unallowed, by reviewing the following:

1. Award agreement or approved application for scope of work, terms and conditions, and approved budget.
2. Part 4 of the Compliance Supplement that applies to your audit period.
3. Available program guidelines or handbooks. (Ex. WSDOT's LAG Manual)
4. If above information is not available, look to the federal regulations (contact the single audit specialist if you need assistance with this).

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Requirements for Cost Principles are found as follows:

Pre-UG: OMB Circular A-87

UG: 2 CFR 200, Subpart E.

Please be familiar with these requirements as not all are listed below; only parts emphasized in the Compliance Supplement are listed below.

Quantitatively Material

Identify the expenditure activities that are directly charged to the program and are quantitatively material (more than 5%).

Direct Costs

Payroll Expenditures: When payroll costs are selected for our single audit, our focus is on whether the portion of payroll charged to the program (allocation) is supported by appropriate time and effort and meets the cost principles. Note that awarding agencies may require specific forms of documentation to support payroll charged to its award.

Compensated Absences (leave cash-outs or accrual): The entity may include employees' use of leave (which is included in their regular salary payments). If the entity charges any **leave cash-outs** or the **accrual of leave** to the grant, there are special rules, see extra guidance in the policy tab. There is a high risk the costs are unallowable.

Non-Payroll Expenditures: Generally, auditors should test internal controls and compliance for non-payroll expenditures when those costs are quantitatively material (5%) to the program.

Automated Controls: If you identify key internal controls that are automated, consult with the SWSA Supervisor or SWSA AIC to determine whether to request automated control work from Team IT audit.

Indirect Costs

Determine whether the agency has recovered indirect costs via an indirect cost rate or cost allocation plan and, if so, how much was expended. If indirect costs are material to the program the auditor must test the internal controls (and compliance) over them when those costs are quantitatively material (5%) to the program.

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement. These are discussed in the **policy tab** in further detail, for when indirect costs are material to the program.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

Special – Review In-process Proposals: If the entity is preparing an Indirect Cost Rate Proposal during the audit period in order to submit it to the federal

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cognizant agency, we are required to review the accuracy of the base data and calculations.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) Activities Allowed: grant funds are used only for allowable activities (this may include review of expenditures, program monitoring, preparing the reimbursement requests, establishment of programs);

(b) Cost Principles: direct and indirect costs charged to the grant comply with the cost principles set forth in 2 CFR 200 Subpart E (this may or may not be the same control activity for (a))

(c) Activities Allowed-Indirect Costs: if material (5%), the entity uses the proper indirect cost rate (per approved plan or rate, de minimis only when it is applicable, or another rate established by contract). Controls should also focus on how the entity properly calculates the direct cost base that the indirect rate is applied to. For instance, the controls should ensure that they are using only allowable types of costs in the MTDC or other direct base as applicable, that those costs are not used twice or that they occurred during the contract's period of performance. Note: These controls are likely **different** than those in (a) and possibly (b).

Evaluation of Results: Did you identify any control deficiencies? If yes, you must:

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as “**LOW**” when:

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1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Basic Cost Principles (2 CFR 200.402 – 409)

DEFINITIONS

Cost means an amount as determined on a cash, accrual, or other basis of accounting acceptable to the Federal awarding or cognizant agency.

Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are needed and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

Direct costs are those that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization). Examples of Direct Costs: payroll costs of employees who perform work that is directly related to the grant program; the cost of supplies and materials used for the purpose of the grant; equipment and other approved capital expenditures made for the grant; or professional services contracted to accomplish specific grant/contract objectives.

Indirect costs are those costs incurred for a common or institution-wide objective that benefits more than one grant program or project. Such costs are not readily assignable to the cost objective specifically benefited. Examples of Indirect Costs: depreciation and use allowances of non-federal equipment and buildings; facility operation and maintenance (lights, heat, phone, janitorial, grounds, etc);and general administrative expenses such as accounting, payroll, legal and data processing expenses.

GENERAL COST PRINCIPLES AFFECTING ALLOWABILITY OF COSTS (2 CFR 200.403)

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- (a) Be **necessary** and **reasonable** for the performance of the Federal award and be allocable thereto under these principles.
- (b) Conform to any **limitations** or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- (c) Be **consistent** with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- (d) Be **accorded consistent treatment**. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.
- (f) **Not be included as a cost or used to meet cost sharing or matching requirements** of any other federally-financed program in either the current or a prior period. See also §200.306 Cost sharing or matching paragraph (b).
- (g) Be **adequately documented**. See also §§200.300 Statutory and national policy requirements through 200.309 Period of performance of this part.

What is a Reasonable Cost (§200.404)? (cost principles)

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.

Other factors that must be considered in determining whether a cost is reasonable are:

whether the cost is generally considered as ordinary and necessary to the operation of the grantee or the performance of the federal award/program;

the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, federal, state and other laws and regulations, and terms and conditions of other federal awards, or sponsored agreements;

market prices for comparable goods and services;

whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the grantee, its employees, where applicable its students or membership, the public at large, and the federal government;

whether the grantee significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal awards costs.

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EXAMPLES:

1. A grantee is planning to purchase computers and printers with federal funds. The purchasing agent obtained phone quotes from three contractors. One contractor has a direct family relationship with the grantee's purchasing agent. It so happens that this contractor's quote was 20% higher than the other two. The grantee should not contract with this contractor because the price is unreasonable and has a conflict of interest (regardless of the price).
2. A grantee has been permitted in its grant contract to lease a vehicle so that it can travel within its region to deliver grant-related services to clients. The grantee has obtained quotes for a standard 4-door sedan and a luxury 4-wheel drive SUV that is twice the cost of the sedan. Which vehicle should the grantee choose? This is not to say a 4-wheel drive is not necessary or reasonable, but the price may dictate the type or model of vehicle.

What is an Allocable Cost (§200.405)? (cost principles)

A cost is considered allocable if the goods or services involved are chargeable or assignable to the federal award or cost objective (i.e., a specific function, project, sponsored agreement, service, or grant) in accordance with the relative benefits received.

Any cost allocable to a particular federal award may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by federal statutes, regulations, or terms and conditions of federal awards, or for other reasons.

If a grantee intends to recover the portion of its indirect costs (overhead, central administration, etc.) that relates to its grant programs, Uniform Guidance requires the grantee to develop a central service cost allocation plan and/or indirect cost rate proposal. Requirements pertaining to central service cost allocation plans and indirect cost proposals are found in Appendix III-VII to Part 200 (Uniform Guidance).

EXAMPLES:

1. An employee works on two different federal grant projects. The time spent on each project varies from day to day. This employee must keep monthly time and effort records that account for actual time spent on each project. By tracking actual effort, each grant will be charged its fair share of the costs.
2. A grantee held a training workshop for its employees. Included in the cost of the workshop was room rental, food, and travel. The workshop included a session that was specific to a federal program and a session that covered general personnel and human effectiveness training. The grantee should allocate the cost of the training among all programs/divisions that benefited from the training. Next, it should charge the allocated amount only to those awards that specifically allow for this type of cost.

Applicable Credits (§200.406) (cost principles)

A "credit" means a receipt or reduction in expenditures that offset or reduce direct or indirect cost items. Examples include:

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purchase discounts;
rebates or allowances;
recoveries or indemnities on losses;
insurance refunds or rebates; and
adjustments of overpayments or erroneous charges.

When such credits are applicable to allowable costs, they must be credited to the federal award either as a cost reduction or a cash refund. In some instances, the amounts received from the federal government to finance a grantee's activities or service operations should be treated as applicable credits.

EXAMPLE:

A grantee paid a contractor for materials it needed for a project. It was determined later that the vendor had over-billed the grantee and was issuing a refund check. This refund should be netted against the total amount charged to the grant as a cost reduction. If the grant project had already been closed out, the refund should be remitted to the grantor agency that sponsored the project. Consult with the grantor agency in such a case.

Prior written approval (§200.407) (cost principles)

Under any given Federal award, the reasonableness and allocability of certain items of costs may be difficult to determine. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, the non-Federal entity may seek the prior written approval of the cognizant agency for indirect costs or the Federal awarding agency in advance of the incurrence of special or unusual costs. Prior written approval should include the timeframe or scope of the agreement. The absence of prior written approval on any element of cost will not, in itself, affect the reasonableness or allocability of that element, unless prior approval is specifically required for allowability as described under certain circumstances in the following sections of this part:

- (a) §200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts, paragraph (b)(5);
- (b) §200.306 Cost sharing or matching;
- (c) §200.307 Program income;
- (d) §200.308 Revision of budget and program plans;
- (e) §200.311 Real property;
- (f) §200.313 Equipment;
- (g) §200.332 Fixed amount subawards;
- (h) §200.413 Direct costs, paragraph (c);
- (i) §200.430 Compensation—personal services, paragraph (h);
- (j) §200.431 Compensation—fringe benefits;
- (k) §200.438 Entertainment costs;
- (l) §200.439 Equipment and other capital expenditures;

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- (m) §200.440 Exchange rates;
- (n) §200.441 Fines, penalties, damages and other settlements;
- (o) §200.442 Fund raising and investment management costs;
- (p) §200.445 Goods or services for personal use;
- (q) §200.447 Insurance and indemnification;
- (r) §200.454 Memberships, subscriptions, and professional activity costs, paragraph (c);
- (s) §200.455 Organization costs;
- (t) §200.456 Participant support costs;
- (u) §200.458 Pre-award costs;
- (v) §200.462 Rearrangement and reconversion costs;
- (w) §200.467 Selling and marketing costs;
- (x) §200.470 Taxes (including Value Added Tax); and
- (y) §200.474 Travel costs.

Consistency (2 CFR §200.403(d) (cost principles)

A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

EXAMPLE:

A grantee has five departments. It allocates the cost of its basic telephone service to each department based on the number of telephones in each department. Each department should treat the telephone cost consistently for all grants it administers. That is, if a department has 3 grant programs, that department should treat this telephone cost as either a direct cost or indirect cost for all 3 grants, but not a mix of each. Next, if treated as a direct cost, a department should only request reimbursement for this type of cost if permitted under the terms of its grant agreement(s).

Grant Agreement Limitations (§200.408) (cost principles)

To be allowable, the cost being charged must conform to any limitations or exclusions set forth in the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

EXAMPLE:

A grantee paid for a television advertisement to promote its new grant-funded health program. However, the approved grant contract limited the cost of advertising to brochures and radio ads. Therefore, the grantee should not include the cost of the television advertisement in its request for reimbursement even though "advertising" is an otherwise allowable cost according to Circular A-87.

Adequate Supporting Documentation (2 CFR §200.403(g) (cost principles)

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Amounts charged to federal awards must be supported by source documentation, including:

- payroll reports
- time and attendance records
- invoice vouchers from subrecipients
- receiving reports
- original vendor invoices
- cost allocation plans

(Documentation may be in an electronic form, but make sure the integrity of the electronic documentation can be maintained for the duration of the applicable record retention period).

EXAMPLE:

A grantee made a year-end adjustment to a federal award using a journal voucher entry. The accounting entry must be supported by adequate documentation that demonstrates both allowability and allocability.

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

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ADDITIONAL TESTING SELECTION INFO & EXAMPLES

<i>Selection Options</i>		
Method	Process	Next Steps
Sampling	This is the preferred method for large populations (over 365). Use sampling tool from teammate.	Get the sample tool from Teammate. Take the sampling training if needed.
Haphazard Selection	May use for populations less than 365. Auditor haphazardly picks transactions. It feels random but only true "random" samples can be done by the computer in the sampling method.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab)
Judgmental Selection	May use for populations less than 365. The auditor has a specific reason, associated with a risk, to pick certain or certain transactions. Explain risks in the ROWD and how transactions not selected are lower risk.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab). See examples there.
Judgmental Population	First, the auditor has a specific reason, associated with a risk, to pick certain types of transactions (judgmental population). Explain risks in the ROWD and how populations not selected are lower risk (you can refer to the testing strategy if we have done this for you already). Next, the auditor selects transaction from the judgmental population using the sampling method above.	Get sample tool from Teammate. Take training for the form if needed.
All quantitatively material transactions	Use only when a few very large transactions make up the majority of grant activity. You will test all of these material transactions.	Keep in mind: If 10% or more of the population is made up of <i>other</i> types of costs, those transactions should be tested in some way, as well.

DUAL PURPOSE TESTING EXAMPLE

For allowable costs the key control is, "The Business Manager reviews the reimbursement request, reconciling the items requested to invoices to determine they are supported and allowable." You will test it by reperforming the Business Manager's review to determine if it is effective in preventing and detecting noncompliance. You may check the requests to see if they have the Business Manager's signature of approval but that will only tell you if they consistently do it, which is important. However, you should reperform the control.

To complete compliance testing you are tracing expenditures from the requests to support to determine if they are supported and allowable per the program.

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In this case, for testing both controls and compliance you are completing the same process. However, you need to document that you tested both and clearly show the conclusion of each even though they are related. Control testing should conclude whether the control was effective in preventing or detecting noncompliance and compliance testing whether the entity was in compliance.

INDIRECT COST UNDERSTANDING OF RATES/ALLOCATIONS

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

1. Rate Provided by Grantor: The federal grantor or PTE can give the entity an indirect cost rate in the award, usually outlined in the budget section and based on the availability of funding. There is no separate or formal rate agreement and it is not considered negotiated.

2. Use PTE Negotiated Rate: The federal grantor, PTE or federal guidance can require the entity to use PTE's negotiated indirect cost rate. This requirement can be found in the Compliance Supplement and federal pass-through guidance. The PTE will place the rate in their award with the entity. This is common for school districts.

3. De Minimis Indirect Cost Rate: If the entity elects to use the de minimis rate, a flat 10% (of Modified Total Direct Costs), in their grant application, no direct or pass-through grantor can deny its use so long as the entity qualifies.

Restrictions: The entity can use the method so long as they have **never** had a negotiated indirect cost rate or allocation plan approved by the federal cognizant agency **or** the PTE.

UPDATED GUIDANCE: Federal guidance now clarifies that negotiated rates and allocation plans negotiated by **PTEs** can prevent the use of the de minimis rate.

Consistency: If used, the entity must use the de minimis method for all of their Uniform Guidance federal programs that allow indirect costs.

Rate: Indirect costs are calculated as base costs multiplied by a flat 10% rate that does not require a true-up to actual indirect expenses.

Base Used: The 10% is multiplied by the modified total direct costs (MTDC) base.

MTDC Base	
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Includes	Excludes
Direct Salaries & Wages	Equipment & Capital Expenditures
Direct Fringe Benefits	Charges for Patient Care
Materials & Supplies	Participant Support Costs
Services	Rental Costs
Travel	Tuition remission, Scholarships & Fellowships
Up to \$25,000 of <i>each</i> subaward (regardless of the period of performance)	The portion of each subaward in excess of \$25,000

4. Negotiated Rates & Allocation Plans – Cognizant Agency: Only major governments are required to obtain a cognizant agency approved negotiated rate or allocation plan. Smaller governments can opt to do so. The “cognizant agency for indirect costs” is designated as:

For central service cost allocation plans: the federal agency with the largest dollar value of ***total*** federal awards

For indirect cost rates and cost allocation plans: the federal agency with the largest dollar value of ***direct*** federal awards

Once designated, the federal entity remains the cognizant agency for five years. Under this method, the entity will be awarded a formal contract for the rate/allocation. All awarding agencies must accept the rate/allocation plan when the entity elects to use it in their program application.

Various allocation plans can be approved, but there are four types of rates:

1. **Provisional:** The provisional rate is temporary and expires upon the completion of the federal award. It requires a true-up to actual expenditures by the end of the project or whenever the entity obtains a final rate. The rate is adjusted by using the final rate.
2. **Final:** The rate is permanent and is calculated after the actual costs are known (i.e. at the conclusion of the federal project). It is used to adjust the indirect costs from the provisional rate.
3. **Predetermined:** This is a permanent rate and is calculated using actual costs from previous periods. It does not require a true-up to correspond with actual current year costs. The rate is effective between two to five years.
4. **Fixed:** This is a permanent rate and is calculated using actual costs from previous periods. It requires a true-up to correspond with actual current year costs. The variance between the costs used to create the rate and the actual costs incurred during the year the rate was used is carried-forward as an adjustment to the current rate. The entity will either recover or “pay back” the variance going forward. The rate is effective for two years and then can be annually renewed.

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5. Negotiated Rates & Allocation Plans – PTE: Indirect Cost Rate Proposals and Cost Allocation Plans are not required by UG to be submitted to/approved by PTE's, but the PTEs may require it. Usually a formal contract for the rate/allocation is not issued and they just review and/or approve the plan instead. Other pass-through entities are not required accept the rate/allocation plan but they can choose to accept it.

METHODS OF INDIRECT COST RATE CALCULATION

(1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:

(a) *Simplified Method* – This method is applicable where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

Multiple Allocation Base Method – This method is applicable where a governmental unit's department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)

(c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)

(d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a State or local government or unit's department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency's Federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP must be either submitted to the cognizant agency for indirect cost for review, negotiation

Record of Work Done.*

For steps one and two, please see: [A-B. Overview - Activities Allowed/Cost Principles - Controls](#).

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control

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environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

On June 27, 2022 we received a copy of the Department's current key internal controls over Activities Allowed or Unallowed/ Cost Principles (see Internal Control request letter (with agency response) - Activities Allowed-Cost Principles (BASED ON PRELIMINARY EXPENDITURE ANALYSIS)).

On July 28, 2022 we met with Stephanie Tax, Local Programs Manager, and Jesse Daniels, External Audit Liaison, to gain an understanding of the internal controls over Activities Allowed or Unallowed/ Cost Principles - Local Passthrough.

All requests for reimbursement must be signed by the subrecipient and submitted directly to the Department's Local Programs Headquarters (HQ) Office via the billing email for review and processing. The request for reimbursement is submitted on a "Local Programs Progress Billing" form, and includes summary details of what was paid on the reimbursement, prior billings and expenditures to date, and remaining funds available. The accountant at the local agency (or other designated staff responsible for preparing the reimbursement request) is required to include a statement with the billing certifying that expenditures are accurate, complete, and were actually incurred. One example of the language that was included with the reimbursement request is: *"By signing this report, I certify to the best of my knowledge and belief that the report is true, complete, and accurate, and the expenditures, disbursements, and cash receipts are for the purposes and objectives set forth in the terms and conditions of the Federal award. I am aware that any false, fictitious, or fraudulent information, or the omission of any material fact, may subject me to criminal, civil, or administrative penalties for fraud, false statements, false claims, or otherwise. (US Code Title 18, Section 1001 and Title 31. Sections 3729-3730 and 3801-3812)."*

Another example: *"Submission of this request for payment certifies that in accordance with the laws of the State of Washington and under the conditions of approval for the project identified above, actual costs claimed have been incurred and are eligible for the purposes identified."*

Local programs staff review the request for reasonableness and completeness, to make sure it aligns with the project contract and past reimbursement requests, and to ensure funds are still available prior to entering the amount into Local Program's Statewide Project Oversight Report & Tracking system (SPORT), which uploads to TRAINS nightly creating a payment voucher (PV). **Key Control #1: To ensure that all requirements for the subaward project are met, a Progress Billing Review Checklist or Final Voucher Spreadsheet is completed to identify all aspects of a payment (reimbursement) that must be agreed upon prior to reimbursement authorization. (Control Activities)** A project-specific progress billing is tracked by progress billing number which is identified on the "Local Programs Progress Billing" form, the review checklist or final voucher spreadsheet, and PV to help ensure the accuracy of the related documentation. Stephanie informed us that in SFY22, Local Programs moved to a digital version of the review checklist, when before it was a paper form.

Key Control #2: Local Programs staff review the payment voucher and then initial the payment voucher to indicate they performed the review of the request and the payment voucher. (Control Activities) Local Programs tends to get multiple billing submissions from local agencies around the same time, and Local Programs staff works the related email inbox in a first in, first out fashion. Staff work to get all requests reviewed and submitted to Stephanie before 30 days as required by prompt payment laws.

Key Control #3: The reimbursement request is reviewed and approved (with signature or email approval) by the Local Programs Program Manager. (Key Control #3 - Control Activities) Stephanie reviews and approves the request, and then submits the payment voucher to be processed for payment by the Payments and Receipt unit within Accounting and Financial Services (AFS). Stephanie explained she generally sets aside one day each week to review reimbursement requests.

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Summary of Key Controls

Key Control #1: To ensure that all requirements for the subaward project are met, a Progress Billing Review Checklist or Final Voucher Spreadsheet is completed to identify all aspects of a payment (reimbursement) that must be agreed upon prior to reimbursement authorization. (Control Activities)

Key Control #2: Local Programs staff review the payment voucher and then initial the payment voucher to indicate they performed the review of the request and the payment voucher. (Control Activities)

Key Control #3: The reimbursement request is reviewed and approved (with signature or email approval) by the Local Programs Program Manager. (Control Activities)

Evaluation of Results: Did you identify any control deficiencies? No control deficiencies were identified.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing below to determine if we can place reliance on the controls.

C.6.PR.G - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: I. Procurement/Suspension and Debarment - Controls

Prepared By: AWW, 11/7/2022

Reviewed By: ACS, 11/14/2022

Purpose/Conclusion.*

Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance that procurement of goods and services are made in compliance with state law and the Common Rule and that covered transactions are not made with a debarred or suspended party.

To identify key internal controls the agency has established to prevent or detect noncompliance with procurement, suspension and debarment requirements.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

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Jenna Fettig, Contract Ad and Award Manager
Heidi Jensen, State Documentation Construction Engineer
Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Procurement/Suspension and Debarment, we assessed preliminary control risk as low.

Testing Strategy:

Procurement/Suspension and Debarment - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Written Procurement Policies and Procedures

When procuring property and services under a Federal award, a state must follow the same policies and procedures it uses for procurements from its non-Federal funds. The state will comply with § 200.322 Procurement of recovered materials and ensure that every purchase order or other contract includes any clauses required by section § 200.326 Contract provisions.

Aggregate vs. Per-unit Cost to Determine Threshold

Note that the cost thresholds are not limited to each individual item purchased. The cost threshold will also apply to many like-kind items. For instance, an entity may purchase 500 tablets over 70 transactions during the year. Each tablet or transaction may be less than the lowest competitive threshold, but the aggregate purchase of tablets should be the dollar value used to determine which threshold applies. For example, if the 500 tablets cost \$200,000, the grantee should complete the procurement procedures required by this aggregate amount.

Contracts Must Include All Required Provisions

In addition to other provisions required by the Federal agency or non-Federal entity, all contracts made by the non-Federal entity under the Federal award must contain provisions as applicable (see Policies/Standards tab for list of required provisions).

Interlocal Agreements: Transactions between governments are exempt

When one government uses federal grant funds to pay for professional services provided by another government, it is not expected to obtain quotes or seek competition. If the grantee purchases equipment or other goods directly from another local government, these transactions are exempt from competitive procurement (does not apply to piggy-backing purchases). This is because federal procurement standards (2 CFR section 200.318(e)) encourages governmental

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entities to enter into interlocal agreements to maximize economy and efficiency. It assumes the economic benefit and efficiency has or will be achieved. RCW 39.34.030 sets forth the standards for interlocal agreements – the form of the agreement or contract may vary so long as it contains the necessary information. This exemption does not include purchases made from a third party vendor, such as a purchasing co-op, or piggy-backing off another government's bid for equipment, materials or services.

Purchasing from a Master Contract - DES has performed the procurement process

State agencies make purchases from contracts that are procured by the WA Dept. of Enterprise Services (DES). In this situation, the DES performs all the bidding requirements and the participating agency can rely on the bid process and make purchases from the contract. The DES retains all the bid documentation. If the master contract(s) is material to the grant, the procurement process may need to be tested at DES. For controls, the auditor should document how the auditee uses the DES contracts. They should ensure they are paying the same rates as in the DES contract. **Note: DES does not check for suspension or debarment.**

SUSPENSION AND DEBARMENT (S&D)

Applies To: The entity must complete the requirement for:

All *new* subrecipient contracts (no threshold)

All *new* contracts (purchases) of \$25,000 or more.

Requirement: The entity must complete at least one of the following to verify the other party is not prohibited (excluded) from receiving federal funds during the procurement process or at the time the contract is made:

1. Check their status on the online search engine SAM.gov (and print support)
2. Put a clause in the contract, whereby the signer attests they are not suspended or debarred.
3. Obtain a signed certificate, whereby the signer attests they are not suspended or debarred.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

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Gain an understanding of the grantee's internal controls and identify the key controls to ensure:

(1) The agency followed State law and procedures and that the policies and procedures were the same as for non-Federal funds.

(2) Suspension & Debarment: vendors with contracts exceeding \$25,000 and all subrecipients are not suspended or debarred from participating in federal programs. *NOTE TO AUDITOR: When identifying internal controls for suspension and debarment, focus on the auditee's awareness of the requirement and the process it follows to ensure compliance. If a certificate or clause is in the contract or bid document, the control should focus on a person putting it in the documents or reviewing the documents to ensure it is included. Avoid a control that relies on the fact that "the clause is included in the contract."*

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as "LOW" when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

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Procurement

States shall use the same State policies and procedures used for procurements from non-Federal funds (2 CFR section 200.317). The policies are established in RCW 39 and also the Department of Enterprise Services and located on their website at <https://des.wa.gov/about/projects-initiatives/procurement-reform/current-policies>

Grantees and subgrantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

AGGREGATE VS. PER-UNIT COST TO DETERMINE THRESHOLD

Note that the cost thresholds are not limited to each individual item purchased. The cost threshold will also apply to many like-kind items. For instance, an entity may purchase 500 tablets over 70 transactions during the year. Each tablet or transaction may be less than the lowest competitive threshold, but the aggregate purchase of tablets should be the dollar value used to determine which threshold applies. For example, if the 500 tablets cost \$200,000, the grantee should complete the procurement procedures required by this aggregate amount.

Contracts Must Include All Required Provisions

In addition to other provisions required by the Federal agency or non-Federal entity, all contracts made by the non-Federal entity under the Federal award must contain provisions covering the following, as applicable.

(A) Contracts for more than the simplified acquisition threshold currently set at \$150,000, which is the inflation adjusted amount determined by the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) as authorized by 41 U.S.C. 1908, must address administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and provide for such sanctions and penalties as appropriate.

(B) All contracts in excess of \$10,000 must address termination for cause and for convenience by the non-Federal entity including the manner by which it will be effected and the basis for settlement.

(C) Equal Employment Opportunity. Except as otherwise provided under 41 CFR Part 60, all contracts that meet the definition of “federally assisted construction contract” in 41 CFR Part 60-1.3 must include the equal opportunity clause provided under 41 CFR 60-1.4(b), in accordance with Executive Order 11246, “Equal Employment Opportunity” (30 FR 12319, 12935, 3 CFR Part, 1964-1965 Comp., p. 339), as amended by Executive Order 11375, “Amending Executive Order 11246 Relating to Equal Employment Opportunity,” and implementing regulations at 41 CFR part 60, “Office of Federal Contract Compliance Programs, Equal Employment Opportunity, Department of Labor.”

(D) Davis-Bacon Act, as amended (40 U.S.C. 3141-3148). When required by Federal program legislation, all prime construction contracts in excess of \$2,000 awarded by non-Federal entities must include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 3141-3144, and 3146-3148) as supplemented by Department of Labor regulations (29 CFR Part 5, “Labor Standards Provisions Applicable to Contracts Covering Federally Financed and Assisted Construction”). In accordance with the statute, contractors must be required to pay wages to laborers and mechanics at a rate not less than the prevailing wages specified in a wage determination made by the Secretary of Labor. In addition, contractors must be required to pay wages not less than once a week. The non-Federal entity must place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation. The decision to award a

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contract or subcontract must be conditioned upon the acceptance of the wage determination. The non-Federal entity must report all suspected or reported violations to the Federal awarding agency. The contracts must also include a provision for compliance with the Copeland “Anti-Kickback” Act (40 U.S.C. 3145), as supplemented by Department of Labor regulations (29 CFR Part 3, “Contractors and Subcontractors on Public Building or Public Work Financed in Whole or in Part by Loans or Grants from the United States”). The Act provides that each contractor or subrecipient must be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he or she is otherwise entitled. The non-Federal entity must report all suspected or reported violations to the Federal awarding agency.

(E) Contract Work Hours and Safety Standards Act (40 U.S.C. 3701-3708). Where applicable, all contracts awarded by the non-Federal entity in excess of \$100,000 that involve the employment of mechanics or laborers must include a provision for compliance with 40 U.S.C. 3702 and 3704, as supplemented by Department of Labor regulations (29 CFR Part 5). Under 40 U.S.C. 3702 of the Act, each contractor must be required to compute the wages of every mechanic and laborer on the basis of a standard work week of 40 hours. Work in excess of the standard work week is permissible provided that the worker is compensated at a rate of not less than one and a half times the basic rate of pay for all hours worked in excess of 40 hours in the work week. The requirements of 40 U.S.C. 3704 are applicable to construction work and provide that no laborer or mechanic must be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

(F) Rights to Inventions Made Under a Contract or Agreement. If the Federal award meets the definition of “funding agreement” under 37 CFR §401.2 (a) and the recipient or subrecipient wishes to enter into a contract with a small business firm or nonprofit organization regarding the substitution of parties, assignment or performance of experimental, developmental, or research work under that “funding agreement,” the recipient or subrecipient must comply with the requirements of 37 CFR Part 401, “Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements,” and any implementing regulations issued by the awarding agency.

(G) Clean Air Act (42 U.S.C. 7401-7671q.) and the Federal Water Pollution Control Act (33 U.S.C. 1251-1387), as amended—Contracts and subgrants of amounts in excess of \$150,000 must contain a provision that requires the non-Federal award to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act (42 U.S.C. 7401-7671q) and the Federal Water Pollution Control Act as amended (33 U.S.C. 1251-1387). Violations must be reported to the Federal awarding agency and the Regional Office of the Environmental Protection Agency (EPA).

(H) Debarment and Suspension (Executive Orders 12549 and 12689)—A contract award (see 2 CFR 180.220) must not be made to parties listed on the governmentwide exclusions in the System for Award Management (SAM), in accordance with the OMB guidelines at 2 CFR 180 that implement Executive Orders 12549 (3 CFR part 1986 Comp., p. 189) and 12689 (3 CFR part 1989 Comp., p. 235), “Debarment and Suspension.” SAM Exclusions contains the names of parties debarred, suspended, or otherwise excluded by agencies, as well as parties declared ineligible under statutory or regulatory authority other than Executive Order 12549.

(I) Byrd Anti-Lobbying Amendment (31 U.S.C. 1352)—Contractors that apply or bid for an award exceeding \$100,000 must file the required certification. Each tier certifies to the tier above that it will not and has not used Federal appropriated funds to pay any person or organization for influencing or attempting to influence an officer or employee of any agency, a member of Congress, officer or employee of Congress, or an employee of a member of Congress in connection with obtaining any Federal contract, grant or any other award covered by 31 U.S.C. 1352. Each tier must also disclose any lobbying with non-Federal funds that

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takes place in connection with obtaining any Federal award. Such disclosures are forwarded from tier to tier up to the non-Federal award.

(J) See §200.322 Procurement of recovered materials.

Suspension and Debarment

Entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. “Covered transactions” include contracts for goods and services equal to or in excess of \$25,000 and all non-procurement transactions (e.g., awards to subrecipients), irrespective of award amount unless exempt as provided in 2 CFR section 180.215..

Record of Work Done.:

Inherent Risk of Noncompliance

Step 1

We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Procurement / Suspension and Debarment.

From: I. Procurement/Suspension and Debarment, 2 CFR 200 (Part 3 of the Compliance Supplement):

Compliance Requirements

Procurement - States:

States will use the same state policies and procedures used for procurements from non-Federal funds. They also must ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations. (2 CFR Section 200.317)

Suspension and Debarment - States:

Non-Federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred. “Covered transactions” include those procurement contracts for goods and services awarded under a nonprocurement transaction (e.g., grant or cooperative agreement) that are expected to equal or exceed \$25,000 or meet certain other criteria as specified in 2 CFR section 180.220. All nonprocurement transactions entered into by a recipient (i.e., subawards to subrecipients), irrespective of award amount, are considered covered transactions, unless they are exempt as provided in 2 CFR section 180.215.

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When a non-Federal entity enters into a covered transaction with an entity at a lower tier, the non-Federal entity must verify that the entity, as defined in 2 CFR section 180.995 and agency adopting regulations, is not suspended or debarred or otherwise excluded from participating in the transaction. This verification may be accomplished by (1) checking the System for Award Management (SAM) Exclusions maintained by the General Services Administration (GSA) and available at <https://www.sam.gov/SAM/> (Note: The OMB guidance at 2 CFR part 180 and agency implementing regulations still refer to the SAM Exclusions as the Excluded Parties List System (EPLS)), (2) collecting a certification from the entity, or (3) adding a clause or condition to the covered transaction with that entity (2 CFR section 180.300).

From: Procurement/Suspension and Debarment, 2 CFR 200 (program specific guidance part 4):

1. In general, State DOTs and LPAs must award construction contracts on the basis of the lowest responsive bid submitted by a bidder meeting the contracting agency's criteria for responsibility. Competitive bidding is required unless the contracting agency is able to demonstrate to FHWA that some other method is more cost effective or that an emergency exists (23 USC 112 (b)(1); 23 CFR sections 635.104 and 635.114), or if exempt by other law, such as for the Recreational Trails Program (23 U.S.C. 133(i)), or through the use of qualified youth service or conservation corps (MAP-21 Section 1524). Contracting agencies also may procure construction services through competitive proposals by using design-build contracts (23 USC 112(b)(3); 23 CFR part 636) or construction manager/general contractor contracts (23 USC 112(b)(4)).

2. For construction contracts, bidding documents must be advertised for at least 3 weeks, unless a shorter period is justified in the project files. Recipients may not negotiate with the potential contractors during the time between bid opening and contract award (such negotiations would be noted in the contract files). Awards must be made to the lowest responsible bidder. If the award was made to a bidder other than the low bidder, then the project files must contain justification (23 CFR sections 635.112(b), 635.113, and 635.114).

State Requirements RCW 39.26:

RCW 39.26.160 Bid awards—Considerations—Requirements and criteria to be set forth—Negotiations—Use of enterprise vendor registration and bid notification system.

(1)(a) After bids that are submitted in response to a competitive solicitation process are reviewed by the awarding agency, the awarding agency may:

- (i) Reject all bids and rebid or cancel the competitive solicitation;*
- (ii) Request best and final offers from responsive and responsible bidders; or*
- (iii) Award the purchase or contract to the lowest responsive and responsible bidder.*

(b) The agency may award one or more contracts from a competitive solicitation.

(2) In determining whether the bidder is a responsible bidder, the agency must consider the following elements:

- (a) The ability, capacity, and skill of the bidder to perform the contract or provide the service required;*
- (b) The character, integrity, reputation, judgment, experience, and efficiency of the bidder;*
- (c) Whether the bidder can perform the contract within the time specified;*
- (d) The quality of performance of previous contracts or services;*
- (e) The previous and existing compliance by the bidder with laws relating to the contract or services;*
- (f) Whether, within the three-year period immediately preceding the date of the bid solicitation, the bidder has been determined by a final and binding citation*

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and notice of assessment issued by the department of labor and industries or through a civil judgment entered by a court of limited or general jurisdiction to have willfully violated, as defined in RCW 49.48.082, any provision of chapter 49.46, 49.48, or 49.52 RCW; and

(g) Such other information as may be secured having a bearing on the decision to award the contract.

(3) In determining the lowest responsive and responsible bidder, an agency may consider best value criteria, including but not limited to:

(a) Whether the bid satisfies the needs of the state as specified in the solicitation documents;

(b) Whether the bid encourages diverse contractor participation;

(c) Whether the bid provides competitive pricing, economies, and efficiencies;

(d) Whether the bid considers human health and environmental impacts;

(e) Whether the bid appropriately weighs cost and noncost considerations; and

(f) Life-cycle cost.

(4) The solicitation document must clearly set forth the requirements and criteria that the agency will apply in evaluating bid submissions. Before award of a contract, a bidder shall submit to the contracting agency a signed statement in accordance with chapter 5.50 RCW verifying under penalty of perjury that the bidder is in compliance with the responsible bidder criteria requirement of subsection (2)(f) of this section. A contracting agency may award a contract in reasonable reliance upon such a sworn statement.

(5) The awarding agency may at its discretion reject the bid of any contractor who has failed to perform satisfactorily on a previous contract with the state.

(6) After reviewing all bid submissions, an agency may enter into negotiations with the lowest responsive and responsible bidder in order to determine if the bid may be improved. An agency may not use this negotiation opportunity to permit a bidder to change a nonresponsive bid into a responsive bid.

(7) The procuring agency must enter into the state's enterprise vendor registration and bid notification system the name of each bidder and an indication as to the successful bidder.

See also the requirements for construction and maintenance of highways under RCW [47.28](#).

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

On June 27, 2022 we received a copy of the Department's current key internal controls over Procurement/ Suspension and Debarment (see [Internal Control request letter \(with agency response\) - Procurement, Suspension & Debarment](#)).

On July 7, 2022 we met with Jenna Fettig, Contract Ad and Award Manager, Heidi Jensen, State Documentation Construction Engineer, and Jesse Daniels, External Audit Liaison, to gain an understanding of the internal controls over subrecipient suspension and debarment.

Procurement

Jenna Fettig, Contract Ad & Award Manager, informed us that her office has responsibility for the procurement of construction contracts up to the point of execution. The following steps are performed by the Contract Ad and Award Office:

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- Preparing the contract to be solicited for bid
- Advertising the contract to be bid upon
- Maintaining a system whereby contractors are prequalified prior to being allowed to bid
- Performing the bid opening process
- Following the contract through to the execution phase

Key Control #1: The Department maintains policies for procurement, including acceptable practices, conflicts of interest and standards of behavior for the department in their Ad & Award Manual, which is approved by the Federal Highways Administration. (Control Activities/ Information & Communication). The Ad & Award manual (see [Advertisement & Award Manual](#)) contains requirements from the Federal Highway Administration (FHWA), which includes 23 CFR 635 Subpart A – *Contract Procedures*, and any changes to the manual or to corresponding Washington Administrative Code provisions get approved by the FHWA prior to publication or enactment.

Key Control #2: The Department utilizes a Construction Manual to document requirements for construction, including bid submission and evaluation procedures, awarding contracts, defining scope of work for projects, payment of contractors, and required documentation, which is approved by the Federal Highways Administration. (Control Activities/ Information & Communication) (see [Construction Manual](#)).

Only prequalified contractors are allowed to bid on federal highway construction projects. Prequalification is required by RCW 47.28.070 and states, in part, that:

In order to obtain a contract proposal form, a person, firm or corporation shall have all of the following requirements:

1. *Adequate financial resources or the ability to secure such resources;*
2. *The necessary experience, organization, and technical qualifications to perform the proposed contract;*
3. *The ability to comply with required performance schedules taking into consideration all of its existing business commitments;*
4. *A satisfactory record of performance, integrity, judgment, and skills; and*
5. *Be otherwise qualified and eligible to receive an award under applicable laws and regulations.*

Prequalification is also outlined in WAC 468-16 *Prequalification for Contractors*, and states:

No contract for the construction, improvement or repair of any state highway, or of any other public highway to be awarded and administered by the department of transportation, may be awarded to any contractor who has not first been prequalified to perform the work. Bidding proposals will be issued only to prequalified contractors.

Contractors are approved for specific types of work and dollar amounts within a maximum contract amount based upon a calculation which is based upon experience and project size. **Key Control #3: The Prequalification Analyst reviews to ensure prequalified contractors are allowed to bid on federal construction projects before sending contractor prequalification notices to bidders, which are signed by the Contract Ad & Award Manager. (Control Activities)** Prequalification is determined by Dianna Rader, Prequalification Analyst, is applicable for six quarters, and may be renewed twice by completion of a supplemental questionnaire (see [Standard Questionnaire 420-010](#)). Ferry vessel projects use a separate questionnaire (see [Ferries Questionnaire 670-079](#)). For contracts of \$100,000 or less (including sales tax) a separate questionnaire (see [Standard Questionnaire 272-063](#)) is used as to to maximize opportunities for Women, Minority, Disadvantaged or Small Business Enterprises or in the case that the work is unusual and will require the Department to find specialty

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contractors. State funded projects of \$7,500 or less need not be advertised. When such projects are not advertised, a minimum of three written quotations must be solicited.

Contractors must submit an audited financial statement, non-collusion agreement form, and a notarized maximum bidding capacity statement. After a contractor has been confirmed as prequalified, the Prequalification Analyst initiates a contract review process, generates the notification letter, and sends it to the Contract Ad & Award Manager for review and signature. This letter informs the contractor of their prequalification status, the amount for which they are prequalified, what type of work they are prequalified to do, and the expiration date of their prequalification.

All contractor information is maintained in the CICS mainframe system. Electronic copies of contracts are stored in an electronic archival system called ECM portal. The Contracts Payment Division and the Ad and Award office have access to the systems. System edits prevent a proposal package from being sent out to a contractor who is not prequalified or whose prequalification status has expired. A bidder will request a proposal package before Ad/Award checks the system to determine if the proposal documents can be sent to the contractor. A manual review is done in the case that the proposal documents cannot be sent out. If a contractor requests bid documents and is not prequalified, they will be contacted by the Ads and Awards office in order to obtain the necessary documents for prequalification. Once the Department determines a contractor to be eligible to bid on a contract, they establish the parameters of the bids that the contractor will be eligible to bid on.

Once prequalified, a contractor is eligible to receive contract proposal forms. The proposal forms are the only eligible method for bidding on a contract. Calls for bids are published in the Seattle Daily Journal of Commerce, the Department's Construction Website, through a GOV Delivery distribution and for WSF Vessel/Terminal Projects on WSF's Projects website: <http://www.wsdot.wa.gov/Ferries/Business/contracts/upcomingprojects>.

The Department uses two bidding processes: Regular Ad Process and Small Works Process. The Small Works Process is only to be used for contracts under \$350,000 and use a roster of prequalified businesses. There is also another process for Small Works Projects under \$100,000. Small Works Projects do not need to be advertised under the same requirements of larger contracts. For any project under \$100,000 that falls under Small Works, contractors can request and go through a project-specific process that allows them to bypass the "regular" prequalification process. Any Small Works Projects over the \$100,000 threshold place the contractor on an approved small works roster.

The Regular Ad Process begins with regional staff putting together the plans, specifications, and estimate and standard forms (PS&E). The PS&E is prepared in accordance with the Plans Preparation Manual M 22-31 ([RCW 47.28.040](#)). Per Appendix 1 of the Ad & Award Manual, all projects must have formal approval action in order to be advertised. Projects are separated into three levels depending on the risk the Department is assuming with the advertisement of the project. For all three levels the Region Administrator sends a letter to Headquarters indicating the project meets the conditions of the level of approval. For "Level 1" approval (projects that are complete in all aspects), the Region may approve directly and send it out for advertisement after altering Headquarters. For "Level 2" (projects that are generally complete, but still have some noncritical issues to be resolved prior to proceeding to bid opening) and "Level 3" (projects that are lacking one or more critical elements to be a complete biddable project, but there is a clear and overwhelming need to begin the advertisement process) the Region needs to receive concurrence from Headquarters. Final approval for levels 2 & 3 comes from the Region after concurrence is received. **Key Control #4: After Regional offices approve that a project meets advertising risk requirements, the office sends a letter to Headquarters Ad & Award certifying the project meets the conditions of the assigned level of approval, before sending it for publishing. For projects with a risk of Level 2 or Level 3, Headquarters must provide concurrence with the finding before sending it for publishing. (Control Activities)** Once an approval for advertising has been obtained from a region, the required FHWA 1273 requirements are added to the contract, as well as any additional

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requirements, including the Disadvantaged Business Enterprise (DBE) requirements. The agency requires that a percentage of work must be performed by DBEs.

The Department publishes an ad describing the work specifications, funding mechanism, bid items, and bid open date. Bids must be advertised for a minimum of three weeks. An email is sent to all contractors that have subscribed for these ads, though not all are eligible to bid on the project. Once a contractor can demonstrate that they have the experience required to perform the work, the bidders can order plans and proposals from the agency. Changes made to the project plans are made by addendum and posted on the website. The agency mails a new proposal and plans to the prospective bidders if the cost of the project changes. Questions from bidders go directly to the project engineer, and the engineer must post answers to the questions on the website.

Bids must be received by the bid closing date (Wednesdays) by 11:00:59 in the Contract Ad & Award Office. Paper bids are stamped with the date and time received and put into the office's safe until the time that bids are reviewed. Bids may be submitted electronically through Bid Express. Typically, all bids are received electronically for big projects. Paper bids are then opened to ensure that all required documentation has been received. Contract Ad & Award staff then take all bids to the bid opening room to be read in front of the public. The lowest three bids are then announced in order (1st lowest, 2nd, and 3rd). The results are then posted on the Department's website.

The bid considerations to be followed can be found in [RCW 39.26.160](#)

Once the lowest three bids are established, DOT staff performs a thorough review of the lowest three bids to ensure requirements are met to include the following:

- Verification of the Company Signature on proposal is the authorized prequalified person.
- Verification of the Bonding Company
- DBE requirement for responsiveness
- Bid Check for completeness and mathematical errors
- Secretary of State registration
- Department of Labor & Industries (LNI) registration
- System for Award Management (SAM) disbarment listing (previously called EPLS)
- Washington State Debarment List (LNI)
- Buy America requirement
- Apprentice Utilization requirement (LNI)

Key Control #5: Bridge office staff, region management, and headquarters construction administration review bid status and bid tabulation reports to ensure the lowest responsible bidder was awarded the contract. (Control Activities) The Contract Ad & Award teams (HQ or Regional) examines the unit price for bid items. The unit price is extremely important because the scope of work often changes on projects. If two bids are relatively close in price, but one has a significantly higher unit price, it could be in the Department's best interest to go with the contractor with the higher bid, but lower unit price. Once the contract is executed, the unit price will not change, but the scope of work could increase. Low bid contracts that have a unit price significantly higher than other bidders are referred to as materially unbalanced and can result in bid rejection because the Department could pay less for the total project cost with the second low bid. The contract is then awarded within 45 days and executed within the next 20 days. Ad & Award awards the lowest responsible bid unless it is found to

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be non-responsive or materially unbalanced.

The Department then monitors and measures the performance of the contractor's adherence to the contract by completion of the Contractor Performance Report per WAC 468-16-210, which states:

- (1) The evaluation of contractor performance shall be made on a form substantially in the format as illustrated herein.
- (2) A Prime Contractor Performance Report Manual provides detailed instructions for preparation of the prime contractor performance report.

The project office rates each contractor's performance using the Prime Contractor Performance Report manual. The awards office investigates any reports of sub-standard work which could lead to a contractor's prequalification status being suspended. Any procurement actions are maintained in a file kept at the awards office. Documentation is retained for seven years.

Suspension and Debarment

Jenna Fettig, Contract Ad & Award Manager, also discussed how the Department ensures that contractors are not suspended or debarred from participating in federally funded projects. Primary contractors are required to submit a sworn affidavit, standard questionnaire and audited financial statements as part of their prequalification to bid. **Key Control #6: Prior to awarding a contract, Ad & Award Staff check contractor suspension and debarment status via SAM.gov and retain a screen print of the check with the contract documentation. (Control Activity/ Information & Communication)**

Key Control #7: The Department's construction contracts contains standard federal form FHWA 1273, "Required Contract Provisions Federal-Aid Construction Contracts", which includes suspension and debarment provisions for contracts they enter with entities at the next lower tier per 2 CFR 180 and 1200. (Control Activities/ Information & Communication) (see [Microsoft Word - F A 1273 Provisions Revised 8_12.docx \(wa.gov\)](#))

The bid proposal package, also called "Contract Provisions and Plans," contains certificates that the bidder must sign, acknowledging the requirements for suspension and debarment. The Contract Provisions and Plans are incorporated into the signed contract document with the winning bidder. **Key Control #8: The Deputy State Construction Engineer or the State Ferries Assistant Secretary (or designee) reviews each contract, and signs to enter into contract with the vendor. (Control Activities)**

Summary of Key Controls

Key Control #1: The Department maintains policies for procurement, including acceptable practices, conflicts of interest and standards of behavior for the department in their Purchasing Manual and in their Advertising and Award Manual. (Control Activities/ Information & Communication)

Key Control #2: The Department utilizes a Construction Manual to document requirements for construction, including bid submission and evaluation procedures, awarding contracts, defining scope of work for projects, payment of contractors, and required documentation. The manual is approved by the FHWA. (Control Activities/ Information & Communication)

Key Control #3: The Prequalification Analyst reviews to ensure prequalified contractors are allowed to bid on federal construction projects before sending contractor prequalification notices. (Control Activities)

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Key Control #4: After Regional offices approve that a project meets advertising risk requirements, the office sends a letter to Headquarters Ad & Award certifying the project meets the conditions of the assigned level of approval, before sending it for publishing. For projects with a risk of Level 2 or Level 3, Headquarters must provide concurrence with the finding before sending it for publishing. (Control Activities)

Key Control #5: Bridge office staff, region management, and headquarters construction administration review bid status and bid tabulation reports to ensure the lowest responsible bidder was awarded the contract. (Control Activities)

Key Control #6: Prior to awarding a contract, Ad & Award Staff check contractor suspension and debarment status via SAM.gov and retain a screen print of the check with the contract documentation. (Control Activity/ Information & Communication)

Key Control #7: The Department's construction contracts contains standard federal form FHWA 1273, "Required Contract Provisions Federal-Aid Construction Contracts", which includes suspension and debarment provisions for contracts they enter with entities at the next lower tier per 2 CFR 180 and 1200. (Control Activities/ Information & Communication)

Key Control #8: The Deputy State Construction Engineer or the State Ferries Assistant Secretary (or designee) reviews each contract, and signs to enter into contract with the vendor. (Control Activities)

Evaluation of Results: Did you identify any control deficiencies? No control deficiencies were identified.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.6.PRG - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: I. Local Passthrough Suspension and Debarment - Controls

Prepared By: AWW, 8/16/2022

Reviewed By: ACS, 8/19/2022

Purpose/Conclusion.

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Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance that covered transactions are not made with a debarred or suspended party.

To identify key internal controls the agency has established to prevent or detect noncompliance with suspension and debarment requirements.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Stephanie Tax, Local Programs Manager

Kyle McKeon, Engineering Services Manager

Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Suspension and Debarment, we assessed preliminary control risk as low.

Testing Strategy:

Procurement/Suspension and Debarment - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Written Procurement Policies and Procedures

When procuring property and services under a Federal award, a state must follow the same policies and procedures it uses for procurements from its non-Federal funds. The state will comply with § 200.322 Procurement of recovered materials and ensure that every purchase order or other contract includes any clauses required by section § 200.326 Contract provisions.

Aggregate vs. Per-unit Cost to Determine Threshold

Note that the cost thresholds are not limited to each individual item purchased. The cost threshold will also apply to many like-kind items. For instance, an entity may purchase 500 tablets over 70 transactions during the year. Each tablet or transaction may be less than the lowest competitive threshold, but the aggregate purchase of tablets should be the dollar value used to determine which threshold applies. For example, if the 500 tablets cost \$200,000, the grantee should complete the procurement procedures required by this aggregate amount.

Contracts Must Include All Required Provisions

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In addition to other provisions required by the Federal agency or non-Federal entity, all contracts made by the non-Federal entity under the Federal award must contain provisions as applicable (see Policies/Standards tab for list of required provisions).

Interlocal Agreements: Transactions between governments are exempt

When one government uses federal grant funds to pay for professional services provided by another government, it is not expected to obtain quotes or seek competition. If the grantee purchases equipment or other goods directly from another local government, these transactions are exempt from competitive procurement (does not apply to piggy-backing purchases). This is because federal procurement standards (2 CFR section 200.318(e)) encourages governmental entities to enter into interlocal agreements to maximize economy and efficiency. It assumes the economic benefit and efficiency has or will be achieved. RCW 39.34.030 sets forth the standards for interlocal agreements – the form of the agreement or contract may vary so long as it contains the necessary information. This exemption does not include purchases made from a third party vendor, such as a purchasing co-op, or piggy-backing off another government's bid for equipment, materials or services.

Purchasing from a Master Contract - DES has performed the procurement process

State agencies make purchases from contracts that are procured by the WA Dept. of Enterprise Services (DES). In this situation, the DES performs all the bidding requirements and the participating agency can rely on the bid process and make purchases from the contract. The DES retains all the bid documentation. If the master contract(s) is material to the grant, the procurement process may need to be tested at DES. For controls, the auditor should document how the auditee uses the DES contracts. They should ensure they are paying the same rates as in the DES contract. **Note: DES does not check for suspension or debarment.**

SUSPENSION AND DEBARMENT (S&D)

Applies To: The entity must complete the requirement for:

All *new* subrecipient contracts (no threshold)

All *new* contracts (purchases) of \$25,000 or more.

Requirement: The entity must complete at least one of the following to verify the other party is not prohibited (excluded) from receiving federal funds during the procurement process or at the time the contract is made:

1. Check their status on the online search engine SAM.gov (and print support)
2. Put a clause in the contract, whereby the signer attests they are not suspended or debarred.
3. Obtain a signed certificate, whereby the signer attests they are not suspended or debarred.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's*

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written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the grantee's internal controls and identify the key controls to ensure:

(1) The agency followed State law and procedures and that the policies and procedures were the same as for non-Federal funds.

(2) Suspension & Debarment: vendors with contracts exceeding \$25,000 and all subrecipients are not suspended or debarred from participating in federal programs. *NOTE TO AUDITOR: When identifying internal controls for suspension and debarment, focus on the auditee's awareness of the requirement and the process it follows to ensure compliance. If a certificate or clause is in the contract or bid document, the control should focus on a person putting it in the documents or reviewing the documents to ensure it is included. Avoid a control that relies on the fact that "the clause is included in the contract."*

Evaluation of Results: Did you identify any control deficiencies? If yes, you must:

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as "LOW" when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

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Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Procurement

States shall use the same State policies and procedures used for procurements from non-Federal funds (2 CFR section 200.317). The policies are established in RCW 39 and also the Department of Enterprise Services and located on their website at <https://des.wa.gov/about/projects-initiatives/procurement-reform/current-policies>

Grantees and subgrantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

AGGREGATE VS. PER-UNIT COST TO DETERMINE THRESHOLD

Note that the cost thresholds are not limited to each individual item purchased. The cost threshold will also apply to many like-kind items. For instance, an entity may purchase 500 tablets over 70 transactions during the year. Each tablet or transaction may be less than the lowest competitive threshold, but the aggregate purchase of tablets should be the dollar value used to determine which threshold applies. For example, if the 500 tablets cost \$200,000, the grantee should complete the procurement procedures required by this aggregate amount.

Contracts Must Include All Required Provisions

In addition to other provisions required by the Federal agency or non-Federal entity, all contracts made by the non-Federal entity under the Federal award must contain provisions covering the following, as applicable.

(A) Contracts for more than the simplified acquisition threshold currently set at \$150,000, which is the inflation adjusted amount determined by the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) as authorized by 41 U.S.C. 1908, must address administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and provide for such sanctions and penalties as appropriate.

(B) All contracts in excess of \$10,000 must address termination for cause and for convenience by the non-Federal entity including the manner by which it will be effected and the basis for settlement.

(C) Equal Employment Opportunity. Except as otherwise provided under 41 CFR Part 60, all contracts that meet the definition of “federally assisted construction contract” in 41 CFR Part 60-1.3 must include the equal opportunity clause provided under 41 CFR 60-1.4(b), in accordance with Executive Order 11246, “Equal Employment Opportunity” (30 FR 12319, 12935, 3 CFR Part, 1964-1965 Comp., p. 339), as amended by Executive Order 11375, “Amending Executive Order 11246 Relating to Equal Employment Opportunity,” and implementing regulations at 41 CFR part 60, “Office of Federal Contract Compliance Programs, Equal Employment Opportunity, Department of Labor.”

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(D) Davis-Bacon Act, as amended (40 U.S.C. 3141-3148). When required by Federal program legislation, all prime construction contracts in excess of \$2,000 awarded by non-Federal entities must include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 3141-3144, and 3146-3148) as supplemented by Department of Labor regulations (29 CFR Part 5, “Labor Standards Provisions Applicable to Contracts Covering Federally Financed and Assisted Construction”). In accordance with the statute, contractors must be required to pay wages to laborers and mechanics at a rate not less than the prevailing wages specified in a wage determination made by the Secretary of Labor. In addition, contractors must be required to pay wages not less than once a week. The non-Federal entity must place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation. The decision to award a contract or subcontract must be conditioned upon the acceptance of the wage determination. The non-Federal entity must report all suspected or reported violations to the Federal awarding agency. The contracts must also include a provision for compliance with the Copeland “Anti-Kickback” Act (40 U.S.C. 3145), as supplemented by Department of Labor regulations (29 CFR Part 3, “Contractors and Subcontractors on Public Building or Public Work Financed in Whole or in Part by Loans or Grants from the United States”). The Act provides that each contractor or subrecipient must be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he or she is otherwise entitled. The non-Federal entity must report all suspected or reported violations to the Federal awarding agency.

(E) Contract Work Hours and Safety Standards Act (40 U.S.C. 3701-3708). Where applicable, all contracts awarded by the non-Federal entity in excess of \$100,000 that involve the employment of mechanics or laborers must include a provision for compliance with 40 U.S.C. 3702 and 3704, as supplemented by Department of Labor regulations (29 CFR Part 5). Under 40 U.S.C. 3702 of the Act, each contractor must be required to compute the wages of every mechanic and laborer on the basis of a standard work week of 40 hours. Work in excess of the standard work week is permissible provided that the worker is compensated at a rate of not less than one and a half times the basic rate of pay for all hours worked in excess of 40 hours in the work week. The requirements of 40 U.S.C. 3704 are applicable to construction work and provide that no laborer or mechanic must be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

(F) Rights to Inventions Made Under a Contract or Agreement. If the Federal award meets the definition of “funding agreement” under 37 CFR §401.2 (a) and the recipient or subrecipient wishes to enter into a contract with a small business firm or nonprofit organization regarding the substitution of parties, assignment or performance of experimental, developmental, or research work under that “funding agreement,” the recipient or subrecipient must comply with the requirements of 37 CFR Part 401, “Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements,” and any implementing regulations issued by the awarding agency.

(G) Clean Air Act (42 U.S.C. 7401-7671q.) and the Federal Water Pollution Control Act (33 U.S.C. 1251-1387), as amended—Contracts and subgrants of amounts in excess of \$150,000 must contain a provision that requires the non-Federal award to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act (42 U.S.C. 7401-7671q) and the Federal Water Pollution Control Act as amended (33 U.S.C. 1251-1387). Violations must be reported to the Federal awarding agency and the Regional Office of the Environmental Protection Agency (EPA).

(H) Debarment and Suspension (Executive Orders 12549 and 12689)—A contract award (see 2 CFR 180.220) must not be made to parties listed on the governmentwide exclusions in the System for Award Management (SAM), in accordance with the OMB guidelines at 2 CFR 180 that implement Executive Orders 12549 (3 CFR part 1986 Comp., p. 189) and 12689 (3 CFR part 1989 Comp., p. 235), “Debarment and Suspension.” SAM Exclusions contains the names

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of parties debarred, suspended, or otherwise excluded by agencies, as well as parties declared ineligible under statutory or regulatory authority other than Executive Order 12549.

(I) Byrd Anti-Lobbying Amendment (31 U.S.C. 1352)—Contractors that apply or bid for an award exceeding \$100,000 must file the required certification. Each tier certifies to the tier above that it will not and has not used Federal appropriated funds to pay any person or organization for influencing or attempting to influence an officer or employee of any agency, a member of Congress, officer or employee of Congress, or an employee of a member of Congress in connection with obtaining any Federal contract, grant or any other award covered by 31 U.S.C. 1352. Each tier must also disclose any lobbying with non-Federal funds that takes place in connection with obtaining any Federal award. Such disclosures are forwarded from tier to tier up to the non-Federal award.

(J) See §200.322 Procurement of recovered materials.

Suspension and Debarment

Entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. “Covered transactions” include contracts for goods and services equal to or in excess of \$25,000 and all non-procurement transactions (e.g., awards to subrecipients), irrespective of award amount unless exempt as provided in 2 CFR section 180.215..

Record of Work Done.

Inherent Risk of Noncompliance

Step 1

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Procurement / Suspension and Debarment.

I. Procurement and Suspension and Debarment

3. The Common Grant Rule policy for Suspension and Debarment precludes the use of excluded persons or firms in government procurements. See 2 CFR part 180 and 2 CFR part 1200 and reference <https://sam.gov/SAM/> for a list of ineligible parties.

2 CFR §180.300 and §180.335 are applicable to Suspension and Debarment for this program cluster.

2 CFR §180.300 - What must I do before I enter into a covered transaction with another person at the next lower tier?

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When entering into a covered transaction with another person at the next lower tier, you must verify that the person with whom you intend to do business is not excluded or disqualified. You do this by:

- (a) Checking SAM Exclusions; or*
- (b) Collecting a certification from that person; or*
- (c) Adding a clause or condition to the covered transaction with that person.*

§180.330 - What requirements must I pass down to persons at lower tiers with whom I intend to do business?

Before entering into a covered transaction with a participant at the next lower tier, you must require that participant to -

- (a) Comply with this subpart as a condition of participation in the transaction. You may do so using any method(s), unless regulation of the Federal agency responsible for the transaction requires you to use specific methods.*
- (b) Pass the requirement to comply with this subpart to each person with whom the participant enters into a covered transaction at the next lower tier.*

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

On June 27, 2022 we received a copy of the Department's current key internal controls over Local Programs Suspension and Debarment (see WSDOT LP Suspension & Debarment Controls Letter).

On July 12, 2022 we met with Stephanie Tax, Local Programs Manager, Kyle McKeon, Engineering Services Manager, and Jesse Daniels, External Audit Liaison, to gain an understanding of the internal controls over subrecipient suspension and debarment. During the meeting we requested the applicable Local Agency Guidelines (LAG) manual versions that were applicable for the audit period. The LAG manual are the written policies and procedures related to subrecipient suspension and debarment. The LAG manual is revised at least annually by the Local Programs Engineering Services staff and submitted to the Federal Highways Administration (FHWA) of the U.S. Department of Transportation for approval. During the audit period there were two different active versions of the LAG manual: One published June 2021 (see June 2021 LAG Manual); and one published June 2022 (see Local Agency Guidelines M 36-63 Version .41 June 2022 (wa.gov)).

For the relevant section of the LAG manual, Chapter 22 - Local Agency Agreement, we noted no difference in the text of the chapters. The noted difference was an updated Local Agency Agreement form example, to be discussed further below. **Key Control #1: The Local Agency Guidelines manual contains standard language from the federal Provisions for Federal-Aid Construction Contracts, Form FHWA 1273 regarding subrecipient suspension and debarment requirements for both First and Lower Tier participants that is included in all subawards. The manual is submitted by the Local Programs Engineering Manager and approved by the Federal Highway Administration at least annually. (Control Activities/ Information & Communication)**

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The Department uses a boilerplate Local Agency Agreement (Agreement) form that local agencies must sign when agreeing to accept federal funds. When updates are required to an existing Agreement the Department uses a Local Agency Agreement Supplement (Supplement), which states, “All provisions in the basic agreement remain in effect except as modified by this supplement. The Local Agency certifies that it is not excluded from receiving Federal funds by a Federal suspension or debarment (2 CFR Part 180)”. Stephanie explained that the LAG manual contains a copy of the Agreement and Supplement, which is reviewed and approved as part of the annual FHWA LAG manual approval. The June 2021 Agreement (see [Dec 2020 Local Agency Agreement](#)) and Supplement (see [Dec 2020 Local Agency Agreement Supplement](#)) was last revised December 2020, while the June 2022 Agreement (see [Apr 2022 Local Agency Agreement](#)) and Supplement (see [Apr 2022 Local Agency Agreement Supplement](#)) were revised April 2022. We noted no difference in the text of the forms. Both forms contain language that states, “*The Local Agency having complied, or hereby agreeing to comply, with the terms and conditions set forth in (1) Title 23, U.S. Code Highways, (2) the regulations issued pursuant thereto, (3) 2 CFR Part 200, (4) 2 CFR Part 180 – certifying that the local agency is not excluded from receiving Federal funds by a Federal suspension or debarment...*”

- 2 CFR 200.206(d)(1) states, “*The Federal awarding agency must comply with the guidelines on governmentwide suspension and debarment in [2 CFR part 180](#), and must require non-Federal entities to comply with these provisions. These provisions restrict Federal awards, subawards and contracts with certain parties that are debarred, suspended or otherwise excluded from or ineligible for participation in Federal programs or activities.*”
- 2 CFR 200.214 states, “*Non-Federal entities are subject to the non-procurement debarment and suspension regulations implementing Executive Orders 12549 and 12689, [2 CFR part 180](#). The regulations in [2 CFR part 180](#) restrict awards, subawards, and contracts with certain parties that are debarred, suspended, or otherwise excluded from or ineligible for participation in Federal assistance programs or activities.*”
- 2 CFR 180.300 states that “*When you enter into a covered transaction with another person at the next lower tier, you must verify that the person with whom you intend to do business is not excluded or disqualified. You do this by:*
 - (a) Checking SAM Exclusions; or*
 - (b) Collecting a certification from that person; or*
 - (c) Adding a clause or condition to the covered transaction with that person.*”

Stephanie stated that when the suspension and debarment language was added to the May 2020 revised agreement, Local Programs staff stopped performing SAM exclusion checks and started to solely rely on the suspension and debarment clause in the Agreement to be signed by a representative of the local agency. The form also contains a clause that the subrecipient that it will, “*...incorporate or cause to be incorporated into any contract for construction work, or modification thereof, as defined in the rules and regulations of the Secretary of Labor in 41 CFR Chapter 60, which is paid for in whole or in part with funds obtained from the Federal Government or borrowed on the credit of the Federal Government pursuant to a grant, contract, loan, insurance, or guarantee or understanding pursuant to any federal program involving such grant, contract, loan, insurance, or guarantee, the required contract provisions for Federal-Aid Contracts (FHWA 1273), located in Chapter 44 of the Local Agency Guidelines.*” FHWA 1273 provisions state that subrecipients must follow 2 CFR 180 and 2 CFR 1200. 2 CFR 1200.332 directs subrecipients that, “*You as a participant must include a term or condition in lower-tier transactions requiring lower-tier participants to comply with subpart C of the OMB guidance in 2 CFR part 180, as supplemented by this subpart.*”

Local Programs staff use a checklist to confirm that award information is complete, all applicable federal regulations, and contains required attachments under

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Department policy before executing a subaward (agreement). The checklists are reviewed are signed by Stephanie Tax, Local Programs Manager. **Key Control #2: Before a subaward can be made effective, the Local Agency agreement is reviewed by the Local Programs Program staff to ensure award information is complete, including all applicable federal regulations and required attachments under Department policy have been documented prior to execution of the agreement, and is signed by the Local Programs Manager. This review is also used to confirm that suspension and debarment clauses required under 2 CFR 180.300 are included in the agreement terms & conditions. (Control Activities/ Information & Communication)**

Summary of Key Controls

Key Control #1: The Local Agency Guidelines manual contains standard language from the federal Provisions for Federal-Aid Construction Contracts, Form FHWA 1273 regarding subrecipient suspension and debarment requirements for both First and Lower Tier participants that is included in all subawards. The manual is submitted by the Local Programs Engineering Manager and approved by the Federal Highway Administration at least annually. (Control Activities/ Information & Communication)

Key Control #2: Before a subaward can be made effective, the Local Agency agreement is reviewed by the Local Programs Program staff to ensure award information is complete, including all applicable federal regulations and required attachments under Department policy have been documented prior to execution of the agreement, and is signed by the Local Programs Manager. This review is also used to confirm that suspension and debarment clauses required under 2 CFR 180.300 are included in the agreement terms & conditions. (Control Activities/ Information & Communication)

Evaluation of Results: We did not identify any control deficiencies.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.6.PRG - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: M. Subrecipient Monitoring - Controls (Risk Assessments, Subaward Information, and Fiscal Monitoring)

Prepared By: AWW, 8/23/2022

Reviewed By: ACS, 8/24/2022

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Purpose/Conclusion.

Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance that Federal award information and compliance requirements are identified to subrecipients, subrecipient activities are monitored, subrecipient audit findings are resolved, the impact of any subrecipient noncompliance on the pass-through entity is evaluated, and subrecipients obtained required audits and took appropriate corrective action on audit findings.

To identify key internal controls the agency has established to prevent or detect noncompliance with subrecipient monitoring requirements.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Stephanie Tax, Local Programs Program Manager

Kyle McKeon, Local Programs Engineering Manager

Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Subrecipient Monitoring (Risk Assessments, Subaward Information, and Fiscal Monitoring), we assessed preliminary control risk as low.

While the Department's internal controls are not sufficient to ensure compliance with requirements for subaward information, as it does not list the indirect cost rate as required per 2 CFR 200.332(a)(1)(xiv), we found the likelihood of noncompliance is **more than remote** and the magnitude of potential noncompliance is **less than material**. While we have determined a weakness exists in its internal controls, as the Department provides the indirect rate in a separate document in funding packages and can provide proof of the indirect rate used, we do not consider the potential noncompliance to result to be material in aggregate. An exit item will be reported at EI_S1Washington_SA22_WSDOT_Highway Construction_Subaward Information.

Testing Strategy.

Subrecipient Monitoring - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

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The general subrecipient monitoring requirements are described below. In addition to this information, review Part 4 of the Compliance Supplement, the grant agreement, and any available program guidelines to determine any unique requirements over Subrecipient Monitoring for the federal award you are auditing.

(a) Subrecipient Contracts – Identification Elements: The pass-through entity (PTE) must clearly identify the contract as a federal subaward when the subaward is made (or subsequent subaward modification). The contracts must include:

1. Specific federal identification elements per 2 CFR section 200.332(a)(1) – find a list of the 13 requirements in the Policy/Standards tab
2. All program requirements imposed on the PTE that are passed through to the subrecipient (federal statutes, regulations, and the terms and conditions of the PTE's award).
3. Any additional program requirements imposed by the PTE on the subrecipient.

Note: The auditor may be able to test suspension and debarment requirements while testing contracts for the other required elements. See testing strategy for Procurement/Suspension and Debarment.

(b) Risk Evaluations: PTEs must perform a risk assessment for every subrecipient to determine and support their level of monitoring. It is a best practice - but not required - to complete risk assessments before the subaward is made (unless specifically required by the grantor). Example considerations are in the Policy/Standards tab.

(c) Monitoring Activities: Monitoring activities must be reasonable based on the inherent risk of the program and subrecipient non-compliance. Auditors will need to use their judgement and consider any monitoring steps identified by the entity in the subrecipient risk evaluation or required by the award contract. At a minimum, subaward monitoring must include:

1. Reviewing financial, performance and special reports required by the PTE.
2. Ensuring the subrecipient receives a single audit (if required) and the subrecipient takes timely and appropriate action on all deficiencies from audits, on-site reviews, etc.
3. Issuing a management decision when their subrecipient receives audit findings for their program.

Subrecipient's Reimbursement Requests: When the PTE receives claims for reimbursement, they should either:

1. request copies of supporting documentation for costs included on the requests; or
2. ask the subrecipient retain supporting documentation for review for on-site visits (if part of the monitoring plan).

Note: The pass-through agency is not expected to perform an extensive audit of the fiscal records, but it should have a process in place so that it can reasonably detect unallowable or unsupported costs.

Case-by-case Information: There is additional information for the auditor when the following situations occur. Find this information in the Policy/Standards tab

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as needed:

- A. For-Profit Subrecipients
- B. PTE Agreed-Upon Procedure Engagements
- C. Fixed-amount Subawards

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) Subrecipient Contracts: The entity includes all necessary information in the subrecipient contract per 2 CFR section 200.332(a)(1).

NOTE: The control may be someone writes the contract to include all of the elements, someone reviews the contracts to specifically confirm all elements are included, or someone ensures they use an established contract template that includes the elements and periodically makes sure that template is up to date with the federal requirements (since elements may change over time).

(b) Risk Assessments: The auditee performs a risk assessment of each subrecipient to determine the appropriate level of monitoring.

(c) Monitoring: Subrecipients are monitored to ensure that federal awards are used for authorized purposes and in accordance with Federal statutes, regulations, and the terms and conditions of the Federal award. This includes monitoring the subrecipient to ensure they are performing eligibility determinations appropriately and accurately (as applicable). The auditee must have a process in place to provide reasonable assurance that they can prevent or detect non-compliance or unallowable costs.

(d) Subrecipients' Audits:

- Subrecipients receive a single audit if necessary.
- Management decisions are issued on audit findings within 6 months after receipt of the subrecipient's audit report

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- Subrecipients took timely and appropriate corrective action on all audit findings.
- Sanctions are taken (or other appropriate action) in cases of continued inability or unwillingness of a subrecipient to have the required audits.

NOTE: The control may be that someone checks with SAO, on the SAO website or with the subrecipient to determine if an audit was completed and the results. The auditee should make or retain documentation of this process.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as “LOW” when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee’s internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria.*

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

The requirements for subrecipient monitoring for the subaward are contained in 31 USC 7502(f)(2) (Single Audit Act Amendments of 1996 (Pub. L. No. 104-156)), 2 CFR sections 200.331, .332, and .501(h); Federal awarding agency regulations; and the terms and conditions of the award.

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Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. State agencies cannot be subrecipients of another state agency. (Note: there are a few very rare exceptions, such as some FEMA awards, where a federal grantor may specify state agencies be treated as subrecipients). Please keep in mind, however, that if the managing state agency gives federal funds to a second state agency, we may need to test subrecipient monitoring at the second agency.

DEFINITION OF “FIRST TIER” SUBRECIPIENT

First tier subrecipients are those that receive federal awards from direct (prime) recipients. For example, state agencies are often direct (prime) recipients of grant funds. If a state agency passes the funding through to a local government, the local government is the first tier subrecipient. Similarly, some local governments receive federal awards directly from a federal agency. In this case, the local government is the direct (prime) recipient. Then, if the local government passes funding through to another local government or non-profit, the receiving local government/non-profit is the first tier subrecipient.

SUBRECIPIENT CONTRACTS – IDENTIFICATION ELEMENTS

Subaward contracts must include the following elements per federal requirements per 2 CFR section 200.331(a)(1):

<i>Subaward Contract Checklist</i>	
Element	Element
(i) Subrecipient name (which must match the name associated with its unique entity identifier);	(viii) Total Amount of Federal Funds Obligated to the subrecipient by the pass-through entity including the current obligation;
(ii) Subrecipient's unique entity identifier;	(ix) Total Amount of the Federal Award committed to the subrecipient by the pass-through entity;
(iii) Federal Award Identification Number (FAIN);	(x) Federal award project description, as required to be responsive to the Federal Funding Accountability and Transparency Act (FFATA);
(iv) Federal Award Date (see §200.39 Federal award date) of award to the recipient by the Federal agency;	(xi) Name of Federal awarding agency, pass-through entity, and contact information for awarding official of the Pass-through entity;
(v) Subaward Period of Performance Start and End Date;	(xii) Assistance Listings number and Title; the pass-through entity must identify the dollar amount made available under each Federal award and the Assistance Listings Number at time of disbursement;

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(vi) Subaward Budget Period Start and End Date;	(xiii) Identification of whether the award is R&D; and
(vii) Amount of Federal Funds Obligated by this action by the pass-through entity to the subrecipient;	(xiv) Indirect cost rate for the Federal award (including if the de minimis rate is charged per §200.414 Indirect (F&A) costs).

SUBRECIPIENT RISK EVALUATIONS

PTEs must perform a risk assessment for every subrecipient to determine and support their level of monitoring (2 CFR section 200.331(b)). This evaluation may include consideration of:

1. The subrecipient's prior experience with the same or similar subawards;
2. The results of previous audits including whether or not the subrecipient receives a single audit as mandated, and the extent to which the same or similar subaward has been audited as a major program at the subrecipient;
3. Whether the subrecipient has new personnel or new or substantially changed systems
4. The extent and results of Federal awarding agency monitoring (e.g., if the subrecipient also receives Federal awards directly from a Federal awarding agency).

IS THE LEVEL OF MONITORING REASONABLE?

The auditor may need to consider whether the amount of oversight is reasonable. Factors such as the size of awards, percentage of the total program's funds awarded to subrecipients, and the complexity of the compliance requirements may influence the extent of monitoring procedures. See additional monitoring considerations below. If there are significant concerns regarding monitoring, contact the Single Audit Specialist.

A. FOR-PROFIT SUBRECIPIENTS

Some Federal awards may be passed through to for-profit entities. For-profit subrecipients are accountable to the PTE for the use of the Federal funds provided. Because the single audit is not applicable to for-profit subrecipients, the PTE is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients for the subaward. The agreement with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the agreement, and post-award audits (2 CFR section 200.501(h)).

B. PTE AGREED-UPON PROCEDURES ENGAGEMENTS

A pass-through entity may arrange for agreed-upon procedures engagements for certain aspects of subrecipient activities, such as eligibility determinations. Since the pass-through entity determines the procedures to be used and compliance areas to be tested, these agreed-upon procedures engagements enable the pass-through entity to target the coverage to areas of greatest risk. The pass-through entity's costs of agreed-upon procedures engagements is allocable to the federal award if the agreed-upon procedures are performed for subrecipients below the single audit threshold for audit (currently at \$750,000 for fiscal years ending on or after December 31, 2015) **AND** the AUP is limited in scope to one or more of the following types of compliance requirements: activities allowed or

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unallowed; allowable costs/cost principles; eligibility; and reporting (Uniform Guidance 2 CFR §200.425 Audit services).

C. FIXED AMOUNT SUBAWARDS

Per 2 CFR 200.332, with prior written approval from the Federal awarding agency, a pass-through entity may provide subawards based on fixed amounts up to \$150,000, provided that the subawards meet the requirements for fixed amount awards in 2 CFR 200.201. Except in the case of termination before completion, there is no governmental review of the actual costs incurred by the awardee in performance of these fixed amount subawards.

Record of Work Done:

Inherent Risk of Noncompliance

Step 1

We believe the following inherent risks increase the risk of material noncompliance with the compliance requirement. We will determine whether the agency has implemented internal controls to address these risks and we will also consider these risks when designing our tests of compliance.

- Subrecipient monitoring involves a high degree of subjectivity by the State agency in determining whether its monitoring efforts are sufficient to ensure compliance with Uniform Guidance and federal program monitoring requirements.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Subrecipient Monitoring.

Part 4 of the 2022 Uniform Guidance Compliance Supplement for the Highway Planning and Construction Cluster under M. Subrecipient Monitoring, states:

"State DOTs are responsible for determining that subrecipients of Federal-aid highway funds have adequate project delivery systems for projects approved under 23 USC. They also are required to determine whether subrecipients have sufficient accounting controls to properly manage such Federal-aid funds (23 USC 106(g)(4)(A))."

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control

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environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

We consulted the previous audit findings related to subrecipient monitoring and reviewed the Department's corrective action plans developed in response to the findings.

Summary of Corrective Actions:

2021-009 The Washington State Department of Transportation did not have adequate internal controls over and did not comply with requirements to perform risk assessments for subrecipients of the Highway Planning and Construction Cluster.

The Department has taken the following corrective actions to address the audit recommendations:

- As of June 2019, WSDOT established a risk assessment program to inform required monitoring activities.
- As of June 2019, WSDOT developed a risk assessment form to document assessments performed.
- As of June 2022, WSDOT updated the risk assessment form to allow for documentation of multiple obligations during a project's phase.

The Department will:

- Continue to maintain ongoing communication with regional staff to ensure risk assessments are performed and properly documented in accordance with the risk assessment program guidelines.
- Work with regional management to modify staff's position descriptions to include performing required monitoring activities, such as completing risk assessments timely. This is in process and will take place as part of the annual performance evaluation cycles with the regional Local Program's engineers over the next year.
- Communicate changes to the risk assessment approach to appropriate Local Program's staff and stakeholders.

The Department will complete these additional corrective measures by June 2023.

Program Controls Overview

On July 12, 2022 we spoke with Stephanie Tax, Local Programs Manager, Kyle McKeon, Local Programs Engineering Manager, and Jesse Daniels, External Audit Liaison, to gain an understanding of internal controls over subrecipient monitoring.

Stephanie explained to that all federal highway pass-through funding is distributed by the Department to local jurisdictions (cities and counties) for federally-eligible highway construction and improvement projects. The Local Programs Division of WSDOT utilizes System Program Oversight Reporting & Tracking (SPORT) system to document all Local Program subrecipients and their subawards. We also confirmed SPORT is used for tracking subrecipient expenditures and reimbursement requests submitted to the Department on federally-funded projects. SPORT is a unique, specialized system designed by the Department for Local Programs use, and directly uploads data into the Department's proprietary accounting information system (TRAINS) for all project billings as well as FHWA's financial management system (FMIS [or "femis"]) for all project authorizations.

Local Programs publishes the Local Agency Guidelines (LAG) Manual, which provides local agencies with statewide policies and standards to follow when

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using FHWA funds for transportation projects. Any updates to the LAG manual are submitted by Local Programs Engineering to FHWA for approval before publishing the public manual. During the audit period there were two different active versions of the LAG manual: One published June 2021 (see [June 2021 LAG Manual](#)); and one published June 2022 (see [Local Agency Guidelines M 36-63 Version .41 June 2022 \(wa.gov\)](#)).

Subaward Information

Projects can only be administered by subrecipients who are Certified Agencies (CA), which are appointed by the Department. If a subrecipient applying for federal assistance is not already a CA, it may still receive federal pass-through funding for a project under one of two conditions (per the LAG Manual):

1. A non-CA subrecipient enters into agreement with a CA agency to administer all aspects of the proposed project. This requires prior written approval from the Region Local Programs Engineer.
2. The Region Local Programs Engineer at the Department acts as the CA for the non-CA agency and approves the agency to perform specific aspects of the project, where necessary. An approved plan for the administration of the project is then executed between the agency and the Region Local Programs Engineer. This category allows projects of a smaller size to be performed (in part) by the non-CA.

There is an application process to become a Certified Agency (CA), which is outlined in the LAG Manual Chapter 13.3 *CA Requirements*. All of the following elements are required to become a "CA":

- Projects must be administered in accordance with the Local Agency Guidelines.
- Projects must utilize a Professional Civil Engineer registered in the state of Washington who is either on staff as a public employee, or is a contracted employee designated as the agency's Engineer.
- The agency shall have sufficient expertise and capability to perform and supervise the design, environmental, Plans, Specifications & Estimates (PS&E), and construction-administration phases of the project.
- The agency must have designated an official approving authority for all WSDOT delegated project approvals. This authority (agency executive, or policy-governing body) must officially approve each project step for which it is the approving authority, as identified in the agreement.

We did not note any differences in language between the different versions of the LAG manual for this subsection.

Key Control #1: For all new subrecipients seeking to be a Certified Agency (CA), Local Programs performs a Certification Acceptance Review (CAR), documented using a standard form after evaluating the local agency's experience, resources, staff knowledge, and overall capacity for projects. This form documents Local Programs' certification of the local agency to effectively manage a federally- funded project. (Control Activities) If the agency is accepted as Certifiable, an acceptance letter (Qualification Agreement) is drafted with the local agency by Local Programs Director. After this is achieved, a subaward can be executed for the proposed project(s). If the agency is not accepted, an agreement is drafted with another Certified Agency to serve as monitoring the local agency's operations. This process is outlined further in the LAG Manual, Chapter 13: Certification Acceptance Program. The Engineering Services Manager, Kyle McKeon informed us that as of FY21 there were 104 Certified Agencies including the 39 Washington counties receiving federal assistance from WSDOT for local construction projects.

A subaward agreement is then reached between the CA and WSDOT, which is referred to as a Local Agency Agreement. These Agreements are approved by the Department's Region Local Programs and the Local Programs Division Manager only after reviewing the applicant's Federal Aid Project Prospectus, and all

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necessary accompanying supporting documentation (such as maps, safety checklists, blueprints, engineer's reports, and estimates). The project prospectus also includes the local agency's DUNS number. **Key Control #2: A local programs authorization package checklist is maintained for each funding package submittal to ensure and verify that all required elements necessary for processing an individual package are included. The authorization package checklist and associated documentation are reviewed by both WSDOT Region, and HQ Local Programs. Checkboxes are used on the checklist to indicate local agency submission and region review of the funding package elements. HQ review approval is documented by processing of the funding package. (Control Activities)**

Local Programs, in conjunction with the local agency's contracting staff, are responsible for preparing the Local Agency Agreement. The agreements are reviewed by the Local Programs Division Manager to ensure all appropriate information has been included, and the Agreement is then signed by the Local Programs Division Manager to indicate the effective date of approval. The Division's current (as of April 2022, see [Apr 2022 Local Agency Agreement](#)) standard agreement template, which is available via the Department's website, includes the following fields of information:

- Subrecipient name
- Subrecipient DUNS identifier
- Federal award date
- Subaward Period of performance begin and end date
- Subaward Budget Period Start and End Date
- Amount of Federal funds obligated by this action to the subrecipient by the pass-through entity;
- Total Amount of Federal funds obligated to the subrecipient by the pass-through entity (including amounts furnished through other subawards)
- Total amount of the Federal award committed to the subrecipient (i.e. the portion of the total Federal award obligated to the subrecipient by the pass-through entity)
- Federal project description
- Name of the federal awarding agency, pass-through entity, and official contact information
- CFDA number, name, and Federal Award Identification Number (FAIN) funding the subaward
- Indirect cost rate applied to the Federal award project*

**Per our testing in SFY21 we found the Department listed if the subrecipient used an indirect cost rate, however, the Department did not list the actual percentage. However, the Department provides the indirect cost rate in a separate document as part of the funding documentation. We confirmed this was true for SFY22 as well.*

There are additional fields of information required under the Uniform Guidance for all federal subawards, outlined in 2 CFR 200.332(a)(1), which must include:

- Eligibility of funding for research and development costs *(Note: We confirmed with the Single Audit Specialist prior to planning for the audit that the Highway Planning & Construction Cluster awards are not eligible for Research & Development activities. Therefore, we are not evaluating whether the Department, in issuing subawards to qualified subrecipients, documents the eligibility of Research & Development costs, in accordance with 2 CFR 200.331, as this requirement is not applicable to the federal program under audit.)*

For awards under the previous Local Agency Agreement (December 2020 – June 2022, see [Dec 2020 Local Agency Agreement](#)), the form did not include the CFDA name.

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NOTE: As the Department is not expected to be in material compliance with required subaward information as they do not list the indirect cost rate as required per 2 CFR 200.332(a)(1)(xiv), we have chosen to issue an exit item. While we have determined a weakness exists in its internal controls, as the Department provides the indirect rate in a separate document in funding packages and can provide proof of the indirect rate used, we do not consider the noncompliance to be material in aggregate.

Prior to receiving any federal grant funding, the local agency project(s) must have been reviewed and authorized by the Federal Highway Administration (FHWA) of the USDOT. *Note: We addressed this requirement in our testing of compliance with Special Tests and Provisions #5: Project Approvals, documented separately at N. Special Tests and Provisions (Project Approvals) - Local Programs - Controls. We will not re-review compliance with federal authorization of local agency projects, here.*

Risk Assessments

During the prior audit, we issued a finding for the Department not having adequate internal controls over and not complying with federal requirements to perform risk assessments for subrecipients of the Highway Planning and Construction Cluster. Management did not ensure the Department met federal requirements to perform risk assessments of subrecipients.

Per Kyle, who oversees Risk Assessments of local program agencies performed by the Regional Offices responsible for the oversight and monitoring of federal projects. The Local Programs Division is required under 2 CFR 200.332(b) to assess the risk of each subrecipient with federal program requirements, which is performed prior to issuing a subaward (local agreement). As a result of the FY2019 single audit, the Division implemented a standard operating procedure requiring Region Local Programs Engineers (LPE) to conduct risk assessments of any local agencies that apply for federal funding for their solicited projects. The risk assessment procedure is documented at and was put into place June 2019.

The Department has six Region LPEs who perform the risk assessments. **Key Control #3: Region Local Program Engineers perform Subrecipient Risk Assessments at each state of a project, are documented using a standardized form prepared by the Department, and signed by a Region Local Program Engineer or Deputy. (Control Activities/ Monitoring)** Per the LAG manual chapter 53.3 Project Reviews, “Projects will be selected from the available projects awarded to the local agency based upon the assigned risk level documented in the risk assessments performed at the end of each project by the Region LPE.” Region LPEs have established relationships with local agency project personnel and are in a unique position to assess risk. Region LPEs assess local agency risk of noncompliance using the following factors:

- staff experience,
- past performance and practice of the local agency,
- the number of federal aid projects an agency has, the size of the local agency, and
- the complexity of the local agency’s projects.

Additionally, HQ Local Programs also adopted a roles and responsibilities document which details the expectations that each Regional Local Programs Engineer is to perform. A copy of the risk assessment is included. Region LPEs use this evaluation of risk to determine the level of monitoring the agency receives, which Region LPEs track in their document review tracking sheets. Further, Local Program enters into individual agreements with non-CA agencies that detail other requirements agencies must comply with which further reduces risk and ensures successful delivery. Per the FHWA and Department stewardship agreement,

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FHWA reviews the program on an annual basis, to which there have been no major findings. Region LPE's are required to perform risk assessments of the local agencies and that during PMR visits, Kyle's team has begun to review the risk assessment evaluations for selected agencies to ensure they were performed for the selected project.

Accounting Controls Over Federal Aid Funds

Per the 2021 Compliance Supplement, the Department is required to meet the requirements of 23 USC 106(g)(4)(A), which states:

(g) Oversight Program -

(4) Responsibility of the States -

(A) In general - the States shall be responsible for determining that subrecipients of Federal funds under this title have -

(i) adequate project delivery systems for projects approved under this section; and

(ii) sufficient accounting controls to properly manage such Federal funds.

During the prior audit we issued a finding for the Department not having adequate internal controls over and not complying with federal requirements to ensure sufficient account controls to monitor federal funds existed for subrecipients of the Highway Planning and Construction Cluster. We did not identify any such internal controls in the SFY2020 single audit.

We inquired with the Department as to what processes are in place to implement and comply with this requirement. We also reviewed the Department's LAG manual, and provisions of the FHWA Stewardship & Oversight Agreement, and noted that in 23.2, Billing Procedures for Local Agency Ad and Award and Agency Force Work, it states that full backup documentation is required for submission on the first project billing. Stephanie explained that subrecipients are also required to inform Local Programs when they make changes to their financial system. We met with Stephanie Tax on September 30, 2021 to discuss Local Programs controls over ensuring subrecipients have sufficient accounting controls for managing federal funds. Stephanie explained that the office met with FHWA and they agreed to a review of the first billing (reimbursement) of a subrecipient's project and associated back up documents, and not reviewing all construction daily reports. She explained this is how WSDOT ensures subrecipients have done review, set rates, and the reimbursement aligns with their documentation. She further detailed that Local Programs can ask for detailed back up documentation for a project at any time from a subrecipient, if the office decides it needs to look further into any issues.

The backup documents are emailed to Local Programs by the subrecipient, and the office reviews all documentation provided. During the review, they look to account for all spending in the first bill item and to ensure all costs are eligible under the subaward. If ineligible costs arise, Local Programs communicates back to the subrecipient and explains why the costs are not eligible for reimbursement. For example, if a project is authorized on June 1st and project expenses prior to June are billed, they will explain that the subrecipient cannot claim reimbursement for those expenses.

Stephanie also explained that Local Programs has no official policy on subrecipients updating their accounting systems, the subrecipient generally lets them know of updates, and if Local Programs notices a difference in documentation between reviews they will inquire with the subrecipient regarding the change. The office typically reviews 20-30 first bills on average each year. **Key Control #4 - To ensure subrecipients have sufficient accounting controls over federal funds, Local Programs staff reviews the first billing of all projects to ensure the subrecipients have done review, set rates, and that the reimbursement aligns with documentation. If any issues arise, the office follows up with the subrecipient to communicate why costs are ineligible. (Control Activities/Monitoring)**

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Other Monitoring Efforts:

The Regional Local Programs office also performs a final walk through and review of the project prior to closure. The results are documented within the “Final Inspection of Federal Aid Project” LAG manual Appendix 53.52 (or DOT form 140-500). Also, the subrecipient submits a “Final Project Summary Form” that details the final project costs and is compared to the most current work order. These two forms provide assurance that DOT receives what it paid for. A project cannot be closed until the signed reports are received by the HQ Local Programs Office. The final reports are provided to Local Programs – Program Management (The Local Program – Program Manager’s Team) who performs the final administrative review.

Summary of Key Controls

Key Control #1: For all new subrecipients seeking to be a Certified Agency (CA), Local Programs performs a Certification Acceptance Review (CAR), documented using a standard form after evaluating the local agency's experience, resources, staff knowledge, and overall capacity for projects. This form documents Local Programs' certification of the local agency to effectively manage a federally- funded project. (Control Activities)

Key Control #2: A local programs authorization package checklist is maintained for each funding package submittal to ensure and verify that all required elements necessary for processing an individual package are included. The authorization package checklist and associated documentation are reviewed by both WSDOT Region, and HQ Local Programs. Checkboxes are used on the checklist to indicate local agency submission and region review of the funding package elements. HQ review approval is documented by processing of the funding package. (Control Activities)

Key Control #3: Region Local Program Engineers perform Subrecipient Risk Assessments at each state of a project, are documented using a standardized form prepared by the Department, and signed by a Region Local Program Engineer or Deputy. (Control Activities/ Monitoring)

Key Control #4 - To ensure subrecipients have sufficient accounting controls over federal funds, Local Programs staff reviews the first billing of all projects to ensure the subrecipients have done review, set rates, and that the reimbursement aligns with documentation. If any issues arise, the office follows up with the subrecipient to communicate why costs are ineligible. (Control Activities/ Monitoring)

Evaluation of Results: *We identified the following control deficiencies:*

- The Department is not expected to be in material compliance with required subaward information as they do not list the indirect cost rate as required per 2 CFR 200.332(a)(1)(xiv)

We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. For the missing subaward information the likelihood of noncompliance is **more than remote** and the magnitude of potential noncompliance is **less than material**. While we have determined a weakness exists in its internal controls, as the Department provides the indirect rate in a separate document in funding packages and can provide proof of the indirect rate used, we do not consider the noncompliance to be material in aggregate. An exit item will be reported at EI_S1Washington_SA22_WSDOT_Highway Construction_Subaward Information.

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As we not find the missing indirect cost rates to affect overall materiality, we will assess preliminary control risk at LOW and proceed with testing the internal controls in Step 5.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.6.PR.G - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: M. Subrecipient Monitoring - Controls (Project Management Reviews)

Prepared By: AWW, 8/17/2022

Reviewed By: ACS, 8/19/2022

Purpose/Conclusion.

Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance that Federal award information and compliance requirements are identified to subrecipients, subrecipient activities are monitored, subrecipient audit findings are resolved, the impact of any subrecipient noncompliance on the pass-through entity is evaluated, and subrecipients obtained required audits and took appropriate corrective action on audit findings. To identify key internal controls the agency has established to prevent or detect noncompliance with subrecipient monitoring requirements. To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Stephanie Tax, Local Programs Program Manager
Kyle McKeon, Local Programs Engineering Manager
Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Subrecipient Monitoring, we found the agency does not have adequate internal controls to prevent material noncompliance. Therefore we assess **preliminary control risk as high and will report a finding for a material weakness.** 2022-009 The Washington State Department of Transportation did not have adequate internal controls over and did not comply with requirements to conduct program monitoring of subrecipients

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of the Highway Planning and Construction Cluster. No internal control testing is necessary in this instance.

Testing Strategy:

Subrecipient Monitoring - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

The general subrecipient monitoring requirements are described below. In addition to this information, review Part 4 of the Compliance Supplement, the grant agreement, and any available program guidelines to determine any unique requirements over Subrecipient Monitoring for the federal award you are auditing.

(a) Subrecipient Contracts – Identification Elements: The pass-through entity (PTE) must clearly identify the contract as a federal subaward when the subaward is made (or subsequent subaward modification). The contracts must include:

1. Specific federal identification elements per 2 CFR section 200.332(a)(1) – find a list of the 13 requirements in the Policy/Standards tab
2. All program requirements imposed on the PTE that are passed through to the subrecipient (federal statutes, regulations, and the terms and conditions of the PTE's award).
3. Any additional program requirements imposed by the PTE on the subrecipient.

Note: The auditor may be able to test suspension and debarment requirements while testing contracts for the other required elements. See testing strategy for Procurement/Suspension and Debarment.

(b) Risk Evaluations: PTEs must perform a risk assessment for every subrecipient to determine and support their level of monitoring. It is a best practice - but not required - to complete risk assessments before the subaward is made (unless specifically required by the grantor). Example considerations are in the Policy/Standards tab.

(c) Monitoring Activities: Monitoring activities must be reasonable based on the inherent risk of the program and subrecipient non-compliance. Auditors will need to use their judgement and consider any monitoring steps identified by the entity in the subrecipient risk evaluation or required by the award contract. At a minimum, subaward monitoring **must** include:

1. Reviewing financial, performance and special reports required by the PTE.

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2. Ensuring the subrecipient receives a single audit (if required) and the subrecipient takes timely and appropriate action on all deficiencies from audits, on-site reviews, etc.
3. Issuing a management decision when their subrecipient receives audit findings for their program.

Subrecipient's Reimbursement Requests: When the PTE receives claims for reimbursement, they should either:

1. request copies of supporting documentation for costs included on the requests; or
2. ask the subrecipient retain supporting documentation for review for on-site visits (if part of the monitoring plan).

Note: The pass-through agency is not expected to perform an extensive audit of the fiscal records, but it should have a process in place so that it can reasonably detect unallowable or unsupported costs.

Case-by-case Information: There is additional information for the auditor when the following situations occur. Find this information in the Policy/Standards tab as needed:

- A. For-Profit Subrecipients
- B. PTE Agreed-Upon Procedure Engagements
- C. Fixed-amount Subawards

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

- (a) Subrecipient Contracts:** The entity includes all necessary information in the subrecipient contract per 2 CFR section 200.332(a)(1).

NOTE: The control may be someone writes the contract to include all of the elements, someone reviews the contracts to specifically confirm all elements are included, or someone ensures they use an established contract template that includes the elements and periodically makes sure that

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template is up to date with the federal requirements (since elements may change over time).

(b) Risk Assessments: The auditee performs a risk assessment of each subrecipient to determine the appropriate level of monitoring.

(c) Monitoring: Subrecipients are monitored to ensure that federal awards are used for authorized purposes and in accordance with Federal statutes, regulations, and the terms and conditions of the Federal award. This includes monitoring the subrecipient to ensure they are performing eligibility determinations appropriately and accurately (as applicable). The auditee must have a process in place to provide reasonable assurance that they can prevent or detect non-compliance or unallowable costs.

(d) Subrecipients' Audits:

- Subrecipients receive a single audit if necessary.
- Management decisions are issued on audit findings within 6 months after receipt of the subrecipient's audit report
- Subrecipients took timely and appropriate corrective action on all audit findings.
- Sanctions are taken (or other appropriate action) in cases of continued inability or unwillingness of a subrecipient to have the required audits.

NOTE: The control may be that someone checks with SAO, on the SAO website or with the subrecipient to determine if an audit was completed and the results. The auditee should make or retain documentation of this process.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as **"LOW"** when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

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Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

The requirements for subrecipient monitoring for the subaward are contained in 31 USC 7502(f)(2) (Single Audit Act Amendments of 1996 (Pub. L. No. 104-156)), 2 CFR sections 200.331, .332, and .501(h); Federal awarding agency regulations; and the terms and conditions of the award.

Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. State agencies cannot be subrecipients of another state agency. (Note: there are a few very rare exceptions, such as some FEMA awards, where a federal grantor may specify state agencies be treated as subrecipients). Please keep in mind, however, that if the managing state agency gives federal funds to a second state agency, we may need to test subrecipient monitoring at the second agency.

DEFINITION OF “FIRST TIER” SUBRECIPIENT

First tier subrecipients are those that receive federal awards from direct (prime) recipients. For example, state agencies are often direct (prime) recipients of grant funds. If a state agency passes the funding through to a local government, the local government is the first tier subrecipient. Similarly, some local governments receive federal awards directly from a federal agency. In this case, the local government is the direct (prime) recipient. Then, if the local government passes funding through to another local government or non-profit, the receiving local government/non-profit is the first tier subrecipient.

SUBRECIPIENT CONTRACTS – IDENTIFICATION ELEMENTS

Subaward contracts must include the following elements per federal requirements per 2 CFR section 200.331(a)(1):

<i>Subaward Contract Checklist</i>	
Element	Element
(i) Subrecipient name (which must match the name associated with its unique entity identifier);	(viii) Total Amount of Federal Funds Obligated to the subrecipient by the pass-through entity including the current obligation;

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(ii) Subrecipient's unique entity identifier;	(ix) Total Amount of the Federal Award committed to the subrecipient by the pass-through entity;
(iii) Federal Award Identification Number (FAIN);	(x) Federal award project description, as required to be responsive to the Federal Funding Accountability and Transparency Act (FFATA);
(iv) Federal Award Date (see §200.39 Federal award date) of award to the recipient by the Federal agency;	(xi) Name of Federal awarding agency, pass-through entity, and contact information for awarding official of the Pass-through entity;
(v) Subaward Period of Performance Start and End Date;	(xii) Assistance Listings number and Title; the pass-through entity must identify the dollar amount made available under each Federal award and the Assistance Listings Number at time of disbursement;
(vi) Subaward Budget Period Start and End Date;	(xiii) Identification of whether the award is R&D; and
(vii) Amount of Federal Funds Obligated by this action by the pass-through entity to the subrecipient;	(xiv) Indirect cost rate for the Federal award (including if the de minimis rate is charged per §200.414 Indirect (F&A) costs).

SUBRECIPIENT RISK EVALUATIONS

PTEs must perform a risk assessment for every subrecipient to determine and support their level of monitoring (2 CFR section 200.331(b)). This evaluation may include consideration of:

1. The subrecipient's prior experience with the same or similar subawards;
2. The results of previous audits including whether or not the subrecipient receives a single audit as mandated, and the extent to which the same or similar subaward has been audited as a major program at the subrecipient;
3. Whether the subrecipient has new personnel or new or substantially changed systems
4. The extent and results of Federal awarding agency monitoring (e.g., if the subrecipient also receives Federal awards directly from a Federal awarding agency).

IS THE LEVEL OF MONITORING REASONABLE?

The auditor may need to consider whether the amount of oversight is reasonable. Factors such as the size of awards, percentage of the total program's funds awarded to subrecipients, and the complexity of the compliance requirements may influence the extent of monitoring procedures. See additional monitoring

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considerations below. If there are significant concerns regarding monitoring, contact the Single Audit Specialist.

A. FOR-PROFIT SUBRECIPIENTS

Some Federal awards may be passed through to for-profit entities. For-profit subrecipients are accountable to the PTE for the use of the Federal funds provided. Because the single audit is not applicable to for-profit subrecipients, the PTE is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients for the subaward. The agreement with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the agreement, and post-award audits (2 CFR section 200.501(h)).

B. PTE AGREED-UPON PROCEDURES ENGAGEMENTS

A pass-through entity may arrange for agreed-upon procedures engagements for certain aspects of subrecipient activities, such as eligibility determinations. Since the pass-through entity determines the procedures to be used and compliance areas to be tested, these agreed-upon procedures engagements enable the pass-through entity to target the coverage to areas of greatest risk. The pass-through entity's costs of agreed-upon procedures engagements is allocable to the federal award if the agreed-upon procedures are performed for subrecipients below the single audit threshold for audit (currently at \$750,000 for fiscal years ending on or after December 31, 2015) **AND** the AUP is limited in scope to one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; and reporting (Uniform Guidance 2 CFR §200.425 Audit services).

C. FIXED AMOUNT SUBAWARDS

Per 2 CFR 200.332, with prior written approval from the Federal awarding agency, a pass-through entity may provide subawards based on fixed amounts up to \$150,000, provided that the subawards meet the requirements for fixed amount awards in 2 CFR 200.201. Except in the case of termination before completion, there is no governmental review of the actual costs incurred by the awardee in performance of these fixed amount subawards.

Record of Work Done:

Inherent Risk of Noncompliance

Step 1

We believe the following inherent risks increase the risk of material noncompliance with the compliance requirement. We will determine whether the agency has implemented internal controls to address these risks and we will also consider these risks when designing our tests of compliance.

- Subrecipient monitoring involves a high degree of subjectivity by the State agency in determining whether its monitoring efforts are sufficient to ensure compliance with Uniform Guidance and federal program monitoring requirements.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

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Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Subrecipient Monitoring.

Part 4 of the 2022 Uniform Guidance Compliance Supplement for the Highway Planning and Construction Cluster under M. Subrecipient Monitoring, states:

"State DOTs are responsible for determining that subrecipients of Federal-aid highway funds have adequate project delivery systems for projects approved under 23 USC. They also are required to determine whether subrecipients have sufficient accounting controls to properly manage such Federal-aid funds (23 USC 106(g)(4)(A))."

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

We consulted the previous audit findings related to project management reviews and reviewed the Department's corrective action plans developed in response to the findings.

Summary of Corrective Actions:

2021-008 The Washington State Department of Transportation did not have adequate internal controls over and did not comply with requirements to conduct program monitoring of subrecipients of the Highway Planning and Construction Cluster.

The Department has a formal request pending with FHWA to allow a change in Local Programs PMR process that will supersede the language in the S&O Agreement. Once approved, Local Programs will:

- Design and implement a risk-based approach to completing PMRs.
- Update the LAG manual to reflect the risk-based approach to complete PMRs.
- Communicate changes to policies and procedures to Local Program staff and stakeholders.

These corrective actions are expected to fully take effect by December 2022.

Program Controls Overview

On July 12, 2022 we spoke with Stephanie Tax, Local Programs Manager, Kyle McKeon, Local Programs Engineering Manager, and Jesse Daniels, External Audit Liaison, to gain an understanding of internal controls over subrecipient monitoring.

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Stephanie explained to us that all federal highway pass-through funding is distributed by the Department to local jurisdictions (cities and counties) for federally-eligible highway construction and improvement projects. The Local Programs Division of WSDOT utilizes System Program Oversight Reporting & Tracking (SPORT) system to document all Local Program subrecipients and their subawards. We also confirmed SPORT is used for tracking subrecipient expenditures and reimbursement requests submitted to the Department on federally-funded projects. SPORT is a unique, specialized system designed by the Department for Local Programs use, and directly uploads data into the Department's proprietary accounting information system (TRAINS) for all project billings as well as FHWA's financial management system (FMIS [or "femis"]) for all project authorizations.

Local Programs publishes the Local Agency Guidelines (LAG) Manual, which provides local agencies with statewide policies and standards to follow when using FHWA funds for transportation projects. Any updates to the LAG manual are submitted by Local Programs Engineering to FHWA for approval before publishing the public manual. During the audit period there were two different active versions of the LAG manual: One published June 2021 (see [June 2021 LAG Manual](#)); and one published June 2022 (see [Local Agency Guidelines M 36-63 Version .41 June 2022 \(wa.gov\)](#)).

Project Management Reviews/Accounting Controls

Per the 2021 Compliance Supplement, the Department is required to meet the requirements of 23 USC 106(g)(4)(A), which states:

(g) Oversight Program -

(4) Responsibility of the States -

(A) In general - the States shall be responsible for determining that subrecipients of Federal funds under this title have -

(i) adequate project delivery systems for projects approved under this section; and

(ii) sufficient accounting controls to properly manage such Federal funds.

Project Management Reviews

During the prior audit, we issued a finding for the Department not having adequate internal controls over and not complying with federal requirements to perform project management reviews (PMR) for subrecipients of the Highway Planning and Construction Cluster at least every 3 years per the stewardship and oversight agreement with FHWA.

Per Kyle McKeon, who oversees PMRs of local program agencies performed by the Regional Offices responsible for the oversight and monitoring of federal projects: The Department agrees to perform fiscal and program monitoring of local agencies through the PMR process, which is outlined in the LAG Manual, Chapter 53.3: Project Closure. Both the June 2021 and June 2022 manuals state:

"In order to ensure that local agencies are administering FHWA funded projects in reasonable compliance with FHWA requirements and regulations and the Local Agency Guidelines manual, WSDOT will perform procedural reviews on federal funded local agency ad-and-award projects. Projects will be selected from the available projects awarded to the local agency based upon the assigned risk level documented in the risk assessments performed at the end of each project by the Region LPE. These reviews will be:

- *Project Management Reviews (PMR) performed by HQ Local Programs*
 - *CA Agencies must have a PMR performed every three years. (Meaning the HQ Local Program will select a qualifying project from the list of awarded federal projects. The project selection will occur near the beginning of third federal fiscal year cycle and with the actual review occurring near completion of construction.)*
 - *PMRs will be performed in one of two ways, in person file reviews or electronic file reviews.*

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- *Documentation Reviews are performed by the Region Local Programs Engineer with the frequencies of the reviews being based upon the risk assessment performed on each phase of the projects.*
 - *CA Agencies having a low risk status will receive a documentation review a minimum of once per year on each phase of the of the project. (Meaning that the agency will receive a review during the design and the construction phases of projects.)*
 - *CA Agencies having a high-risk status will receive a documentation review once per year for all projects – Projects selected should be near the middle of the design or construction phase, allowing for the agency to make correction or adjustment to their administration of the design or contract to achieve reasonable compliance.*
 - *Documentation Reviews will be performed using the same methods as the formal PMR. These documentation Reviews may either be in person or by electronic methods. Documentation Reviews results are stored in the Region's project files. The agency shall be given a copy of the results and recommendations from these reviews.*
- Project Closure Chapter 53 WSDOT Local Agency Guidelines M 36-63.40 Page 53-3 (June 2021) The agency may lose CA status, have its delegation of authority reduced to a project or phase of a project, or be placed on probationary CA. This may be the result of:*
- *A PMR or Documentation Review.*
 - *An audit by the State Auditor.*
 - *Final project inspection.*
 - *The qualifications and experience of the agency staff are altered."*

Local Programs HQ conducts detailed reviews of subrecipients' performance under the program based on an open and active project with the agency. The project that the agency will be reviewed and evaluated on is selected based on the size, cost, duration (length), and complexity of the project, in consideration of the nature and history of the subrecipient (past performance, staffing experience, involvement with past projects of a similar nature, etc.). This review is completed by the Local Programs Engineering Services Manager, and his staff; the review cycle is based on a federal fiscal year (October to September).

On average, Local Programs Engineering Services Team had performed approximately 25-35 PMR reviews per federal fiscal year, depending on the number of local agencies with active and open projects, as a local agency can only be a subrecipient of federal funds if they have an open and active project. However, due to the Covid-19 pandemic agency staff have not been performing PMRs at the normal rate due to state travel restrictions. Electronic/Desk review PMRs were instituted beginning July 2020. The timing of the review will also depend on the percentage of completion of the project that staff want to use to evaluate agency performance and financial documentation; reviews are generally timed to occur when the project substantially complete, but not completed and closed. Reviews of both the CAs and Non-CAs provide assurance that the subrecipient is in compliance with FHWA and WSDOT provisions during the life of the federally funded project and that they have adequate processes in place to administer the projects awarded to them.

Per the Stewardship and Oversight Agreement with the FHWA, WSDOT is to perform a PMR for each local agency at least once every three years, which we identified in the 2020 single audit was not the case. PMRs were being scheduled outside of the three-year window because of a lack of available projects for review, or scheduling conflicts arising due to staffing levels. The timing of the PMR will also depend on the percentage of the desired project's completion and whether Engineering Services staff will be able to evaluate all aspects of compliance at the time of the review, or if documentation will not yet be available based on the current state of the project. The Engineering Services Manager commented that in order for a PMR to be an effective measurement of the local agency's project compliance, the project should be at least halfway complete in order for the Engineering Services staff to have sufficient information to review based upon completed or in-progress work. Kyle confirmed that the agency has not caught up past due PMRs, and thus the Department is not in material compliance

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with requirements to ensure it completed PMRs of subrecipients every three years, as required by the Stewardship and Oversight Agreement.

As the Department is not expected to be in material compliance with monitoring per their agreement with FHWA, we determined a material weakness exists in its internal controls, since no changes to the Department's internal controls related to PMRs have occurred since the prior audit finding was issued. Therefore we will not perform any further analysis of the internal controls for PMRs over this part of the compliance requirement. (Identified Weakness - Control Activities/Monitoring)

Kyle explained that the Local Programs Director, Jay Drye, sent a request to FHWA to request that the Department may use a risk-based approach when selecting subrecipient's to receive PMRs, work zone reviews, documentation reviews, and fiscal monitoring reviews, as opposed to the every three years requirement. The risk-based approach focuses on high dollar and higher risk projects. As the Department has not received FHWA's concurrence to waive the three-year PMR requirement, we will proceed with applying the requirements currently in the Agreement to measure the Department's compliance.

Key Control #5: The Local Programs Engineering Services Manager tracks the scheduling and completion of the Project Management Reviews on a tracking spreadsheet broken down by Region, utilizes a risk-based approach in the selection of agencies (per FHWA LAG revision approval 05/23/2022) and projects that will receive a PMR. Each agency will be given a risk analysis score based upon individual risk assessments, past PMR results, over funding awarded, and documented process issues. (Control Activities/ Monitoring) PMRs are scheduled by the Region Local Programs Engineers. Certified agencies are carried forward on the spreadsheet each federal fiscal year in which they have an active project. A copy of the PMR review template can be see at [DOT Form 272-024 Local Agency Project Management Review Checklist Change Order \(wa.gov\)](#).

Key Control #6: A Project Management Review checklist is used to ensure that the review process is consistent from agency to agency and that no required reviews are missed. The checklist is signed and dated by the Region staff involved in the reviews and signed by a representative of the local agency indicating the Department informed them of the results of the review. The Engineering Services Manager delegate signs the checklist indicating the review is complete and provides a copy of the PMR including any outstanding action items to be addressed. (Control Activities)

Key Control #7: If there were any issues identified as a result of the Project Management Review for the subrecipient to resolve, the Engineering Services Manager delegate reviews the findings and coordinates through the Region Local Programs Engineer allowing the agency a 30-day grace period to supply missing documentation. Upon completion of the 30-day grace period the Engineering Services Manager will issue a "Final Letter" to communicate to the subrecipient the issues observed during the review, and if there are any necessary corrective actions to be taken. A copy of the Final Letter is maintained in the local agency CA file at the Headquarters Local Programs Division. (Control Activities/ Information & Communication) These issues are communicated to local agency management by the evaluation team on the final day of the on-site visit. Once issues have been communicated, the local agency has 30 days prepare a Corrective Action Plan and to supply the required documentation for remediation. Follow up visits (if required) are to be conducted within 60 days of the initial visit in order for Department staff to verify corrective measures were implemented. Note: This is only required if the noncompliance identified is not related to missing/incomplete documentation, but rather, an internal control failure or noncompliance with FHWA requirements. On an annual basis, Local Programs Division submits a summary report of all Project Management Reviews completed during the federal fiscal year. This report is submitted to FHWA annually in (or around) January of each year.

Other Monitoring Efforts:

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The Regional Local Programs office also performs a final walk through and review of the project prior to closure. The results are documented within the “Final Inspection of Federal Aid Project” LAG manual Appendix 53.52 (or DOT form 140-500). Also, the subrecipient submits a “Final Project Summary Form” that details the final project costs and is compared to the most current work order. These two forms provide assurance that DOT receives what it paid for. A project cannot be closed until the signed reports are received by the HQ Local Programs Office. The final reports are provided to Local Programs – Program Management (The Local Program – Program Manager’s Team) who performs the final administrative review.

Summary of Key Controls

Key Control #5: The Local Programs Engineering Services Manager tracks the scheduling and completion of the Project Management Reviews on a tracking spreadsheet broken down by Region, utilizes a risk-based approach in the selection of agencies (per FHWA LAG revision approval 05/23/2022) and projects that will receive a PMR. Each agency will be given a risk analysis score based upon individual risk assessments, past PMR results, over funding awarded, and documented process issues. (Control Activities/ Monitoring)

Key Control #6: A Project Management Review checklist is used to ensure that the review process is consistent from agency to agency and that no required reviews are missed. The checklist is signed and dated by the Region staff involved in the reviews and signed by a representative of the local agency indicating the Department informed them of the results of the review. The Engineering Services Manager delegate signs the checklist indicating the review is complete and provides a copy of the PMR including any outstanding action items to be addressed. (Control Activities)

Key Control #7: If there were any issues identified as a result of the Project Management Review for the subrecipient to resolve, the Engineering Services Manager delegate reviews the findings and coordinates through the Region Local Programs Engineer allowing the agency a 30-day grace period to supply missing documentation. Upon completion of the 30-day grace period the Engineering Services Manager will issue a "Final Letter" to communicate to the subrecipient the issues observed during the review, and if there are any necessary corrective actions to be taken. A copy of the Final Letter is maintained in the local agency CA file at the Headquarters Local Programs Division. (Control Activities/ Information & Communication)

Evaluation of Results: *We identified the following control deficiencies:*

- The Department does not have sufficient internal controls to ensure subrecipients of FHWA funds receive project management reviews every three years per the Department’s Stewardship and Oversight Agreement with the Federal Highways Administration

We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **more than remote** and the magnitude of potential noncompliance is **material**. A material weakness will be reported at 2022-009 The Washington State Department of Transportation did not have adequate internal controls over and did not comply with requirements to conduct program monitoring of subrecipients of the Highway Planning and Construction Cluster.

Preliminary Control Risk Assessment

Step 4

We assess the preliminary control risk as: HIGH - Internal control design is not likely to be effective to prevent or detect non-compliance with grant

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requirements. We will report a **material weakness** in accordance with 2 CFR §200.516(1).

C.6.PRG - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: M. Subrecipient Monitoring - Controls (Subrecipient audits under the Uniform Guidance)

Prepared By: AWW, 8/23/2022

Reviewed By: ACS, 8/24/2022

Purpose/Conclusion.

Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance that Federal award information and compliance requirements are identified to subrecipients, subrecipient activities are monitored, subrecipient audit findings are resolved, the impact of any subrecipient noncompliance on the pass-through entity is evaluated, and subrecipients obtained required audits and took appropriate corrective action on audit findings. To identify key internal controls the agency has established to prevent or detect noncompliance with subrecipient monitoring requirements. To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Stephanie Tax, Local Programs Program Manager
Kyle McKeon, Local Programs Engineering Manager
Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Subrecipient Monitoring (Subrecipient audits under the Uniform Guidance), we assessed preliminary control risk as low.

Testing Strategy.

Subrecipient Monitoring - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the **Inherent and Internal Control Risk Guidance** that could apply to the compliance

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requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

The general subrecipient monitoring requirements are described below. In addition to this information, review Part 4 of the Compliance Supplement, the grant agreement, and any available program guidelines to determine any unique requirements over Subrecipient Monitoring for the federal award you are auditing.

(a) Subrecipient Contracts – Identification Elements: The pass-through entity (PTE) must clearly identify the contract as a federal subaward when the subaward is made (or subsequent subaward modification). The contracts must include:

1. Specific federal identification elements per 2 CFR section 200.332(a)(1) – find a list of the 13 requirements in the Policy/Standards tab
2. All program requirements imposed on the PTE that are passed through to the subrecipient (federal statutes, regulations, and the terms and conditions of the PTE's award).
3. Any additional program requirements imposed by the PTE on the subrecipient.

Note: The auditor may be able to test suspension and debarment requirements while testing contracts for the other required elements. See testing strategy for Procurement/Suspension and Debarment.

(b) Risk Evaluations: PTEs must perform a risk assessment for every subrecipient to determine and support their level of monitoring. It is a best practice - but not required - to complete risk assessments before the subaward is made (unless specifically required by the grantor). Example considerations are in the Policy/Standards tab.

(c) Monitoring Activities: Monitoring activities must be reasonable based on the inherent risk of the program and subrecipient non-compliance. Auditors will need to use their judgement and consider any monitoring steps identified by the entity in the subrecipient risk evaluation or required by the award contract. At a minimum, subaward monitoring **must** include:

1. Reviewing financial, performance and special reports required by the PTE.
2. Ensuring the subrecipient receives a single audit (if required) and the subrecipient takes timely and appropriate action on all deficiencies from audits, on-site reviews, etc.
3. Issuing a management decision when their subrecipient receives audit findings for their program.

Subrecipient's Reimbursement Requests: When the PTE receives claims for reimbursement, they should either:

1. request copies of supporting documentation for costs included on the requests; or
2. ask the subrecipient retain supporting documentation for review for on-site visits (if part of the monitoring plan).

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Note: The pass-through agency is not expected to perform an extensive audit of the fiscal records, but it should have a process in place so that it can reasonably detect unallowable or unsupported costs.

Case-by-case Information: There is additional information for the auditor when the following situations occur. Find this information in the Policy/Standards tab as needed:

- A. For-Profit Subrecipients
- B. PTE Agreed-Upon Procedure Engagements
- C. Fixed-amount Subawards

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) Subrecipient Contracts: The entity includes all necessary information in the subrecipient contract per 2 CFR section 200.332(a)(1).

NOTE: The control may be someone writes the contract to include all of the elements, someone reviews the contracts to specifically confirm all elements are included, or someone ensures they use an established contract template that includes the elements and periodically makes sure that template is up to date with the federal requirements (since elements may change over time).

(b) Risk Assessments: The auditee performs a risk assessment of each subrecipient to determine the appropriate level of monitoring.

(c) Monitoring: Subrecipients are monitored to ensure that federal awards are used for authorized purposes and in accordance with Federal statutes, regulations, and the terms and conditions of the Federal award. This includes monitoring the subrecipient to ensure they are performing eligibility determinations appropriately and accurately (as applicable). The auditee must have a process in place to provide reasonable assurance that they can prevent or detect non-compliance or unallowable costs.

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(d) Subrecipients' Audits:

- Subrecipients receive a single audit if necessary.
- Management decisions are issued on audit findings within 6 months after receipt of the subrecipient's audit report
- Subrecipients took timely and appropriate corrective action on all audit findings.
- Sanctions are taken (or other appropriate action) in cases of continued inability or unwillingness of a subrecipient to have the required audits.

NOTE: The control may be that someone checks with SAO, on the SAO website or with the subrecipient to determine if an audit was completed and the results. The auditee should make or retain documentation of this process.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as "LOW" when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

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Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

The requirements for subrecipient monitoring for the subaward are contained in 31 USC 7502(f)(2) (Single Audit Act Amendments of 1996 (Pub. L. No. 104-156)), 2 CFR sections 200.331, .332, and .501(h); Federal awarding agency regulations; and the terms and conditions of the award.

Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. State agencies cannot be subrecipients of another state agency. (Note: there are a few very rare exceptions, such as some FEMA awards, where a federal grantor may specify state agencies be treated as subrecipients). Please keep in mind, however, that if the managing state agency gives federal funds to a second state agency, we may need to test subrecipient monitoring at the second agency.

DEFINITION OF “FIRST TIER” SUBRECIPIENT

First tier subrecipients are those that receive federal awards from direct (prime) recipients. For example, state agencies are often direct (prime) recipients of grant funds. If a state agency passes the funding through to a local government, the local government is the first tier subrecipient. Similarly, some local governments receive federal awards directly from a federal agency. In this case, the local government is the direct (prime) recipient. Then, if the local government passes funding through to another local government or non-profit, the receiving local government/non-profit is the first tier subrecipient.

SUBRECIPIENT CONTRACTS – IDENTIFICATION ELEMENTS

Subaward contracts must include the following elements per federal requirements per 2 CFR section 200.331(a)(1):

<i>Subaward Contract Checklist</i>	
Element	Element
(i) Subrecipient name (which must match the name associated with its unique entity identifier);	(viii) Total Amount of Federal Funds Obligated to the subrecipient by the pass-through entity including the current obligation;
(ii) Subrecipient's unique entity identifier;	(ix) Total Amount of the Federal Award committed to the subrecipient by the pass-through entity;
(iii) Federal Award Identification Number (FAIN);	(x) Federal award project description, as required to be responsive to the Federal Funding Accountability and Transparency Act (FFATA);

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(iv) Federal Award Date (see §200.39 Federal award date) of award to the recipient by the Federal agency;	(xi) Name of Federal awarding agency, pass-through entity, and contact information for awarding official of the Pass-through entity;
(v) Subaward Period of Performance Start and End Date;	(xii) Assistance Listings number and Title; the pass-through entity must identify the dollar amount made available under each Federal award and the Assistance Listings Number at time of disbursement;
(vi) Subaward Budget Period Start and End Date;	(xiii) Identification of whether the award is R&D; and
(vii) Amount of Federal Funds Obligated by this action by the pass-through entity to the subrecipient;	(xiv) Indirect cost rate for the Federal award (including if the de minimis rate is charged per §200.414 Indirect (F&A) costs).

SUBRECIPIENT RISK EVALUATIONS

PTEs must perform a risk assessment for every subrecipient to determine and support their level of monitoring (2 CFR section 200.331(b)). This evaluation may include consideration of:

1. The subrecipient's prior experience with the same or similar subawards;
2. The results of previous audits including whether or not the subrecipient receives a single audit as mandated, and the extent to which the same or similar subaward has been audited as a major program at the subrecipient;
3. Whether the subrecipient has new personnel or new or substantially changed systems
4. The extent and results of Federal awarding agency monitoring (e.g., if the subrecipient also receives Federal awards directly from a Federal awarding agency).

IS THE LEVEL OF MONITORING REASONABLE?

The auditor may need to consider whether the amount of oversight is reasonable. Factors such as the size of awards, percentage of the total program's funds awarded to subrecipients, and the complexity of the compliance requirements may influence the extent of monitoring procedures. See additional monitoring considerations below. If there are significant concerns regarding monitoring, contact the Single Audit Specialist.

A. FOR-PROFIT SUBRECIPIENTS

Some Federal awards may be passed through to for-profit entities. For-profit subrecipients are accountable to the PTE for the use of the Federal funds provided. Because the single audit is not applicable to for-profit subrecipients, the PTE is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients for the subaward. The agreement with the for-profit subrecipient should describe applicable compliance requirements and the for-profit

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subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the agreement, and post-award audits (2 CFR section 200.501(h)).

B. PTE AGREED-UPON PROCEDURES ENGAGEMENTS

A pass-through entity may arrange for agreed-upon procedures engagements for certain aspects of subrecipient activities, such as eligibility determinations. Since the pass-through entity determines the procedures to be used and compliance areas to be tested, these agreed-upon procedures engagements enable the pass-through entity to target the coverage to areas of greatest risk. The pass-through entity's costs of agreed-upon procedures engagements is allocable to the federal award if the agreed-upon procedures are performed for subrecipients below the single audit threshold for audit (currently at \$750,000 for fiscal years ending on or after December 31, 2015) **AND** the AUP is limited in scope to one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; and reporting (Uniform Guidance 2 CFR §200.425 Audit services).

C. FIXED AMOUNT SUBAWARDS

Per 2 CFR 200.332, with prior written approval from the Federal awarding agency, a pass-through entity may provide subawards based on fixed amounts up to \$150,000, provided that the subawards meet the requirements for fixed amount awards in 2 CFR 200.201. Except in the case of termination before completion, there is no governmental review of the actual costs incurred by the awardee in performance of these fixed amount subawards.

Record of Work Done.

Inherent Risk of Noncompliance

Step 1

We believe the following inherent risks increase the risk of material noncompliance with the compliance requirement. We will determine whether the agency has implemented internal controls to address these risks and we will also consider these risks when designing our tests of compliance.

- Subrecipient monitoring involves a high degree of subjectivity by the State agency in determining whether its monitoring efforts are sufficient to ensure compliance with Uniform Guidance and federal program monitoring requirements.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Subrecipient Monitoring.

Part 4 of the 2022 Uniform Guidance Compliance Supplement for the Highway Planning and Construction Cluster under M. Subrecipient Monitoring, states:

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"State DOTs are responsible for determining that subrecipients of Federal-aid highway funds have adequate project delivery systems for projects approved under 23 USC. They also are required to determine whether subrecipients have sufficient accounting controls to properly manage such Federal-aid funds (23 USC 106(g)(4)(A))."

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

We consulted the previous audit findings related to subrecipient monitoring (Single Audits) and reviewed the Department's corrective action plans developed in response to the findings.

Summary of Corrective Actions:

2021-010 The Department of Transportation did not have adequate internal controls over and did not comply with requirements to issue management decisions for audit findings to subrecipients of the Highway Planning and Construction Cluster.

The Department will:

- Review subrecipient single audit findings for fiscal year 2020 that were received during fiscal year 2022 and ensure the Local Programs Division issues all required Decision Letters.
- Continue to review all single audits issued for subrecipient agencies and send Decision Letters based on SAO recommendations.

Program Controls Overview

On July 12, 2022 we spoke with Stephanie Tax, Local Programs Manager, Kyle McKeon, Local Programs Engineering Manager, and Jesse Daniels, External Audit Liaison, to gain an understanding of internal controls over subrecipient monitoring.

Stephanie explained to that all federal highway pass-through funding is distributed by the Department to local jurisdictions (cities and counties) for federally-eligible highway construction and improvement projects. The Local Programs Division of WSDOT utilizes System Program Oversight Reporting & Tracking (SPORT) system to document all Local Program subrecipients and their subawards. We also confirmed SPORT is used for tracking subrecipient expenditures and reimbursement requests submitted to the Department on federally-funded projects. SPORT is a unique, specialized system designed by the Department for Local Programs use, and directly uploads data into the Department's proprietary accounting information system (TRAINS) for all project billings as well as FHWA's financial management system (FMIS [or "femis"]) for all project authorizations.

Local Programs publishes the Local Agency Guidelines (LAG) Manual, which provides local agencies with statewide policies and standards to follow when using FHWA funds for transportation projects. Any updates to the LAG manual are submitted by Local Programs Engineering to FHWA for approval before publishing the public manual. During the audit period there were two different active versions of the LAG manual: One published June 2021 (see); and one published June 2022 (see [Local Agency Guidelines M 36-63 Version .41 June 2022 \(wa.gov\)](#)).

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Subrecipient Audits

During the prior audit we issued a finding for the Department not having adequate internal controls over and not complying with federal requirements to ensure subrecipients of the Highway Planning and Construction Cluster received required single audits per 2 CFR 200.332.

Key Control #8 - Included in the boilerplate language of the WSDOT standard local agency agreement template is the requirement for the subrecipient to receive a federal compliance audit if they expend at least \$750,000 or more in federal assistance (pass-through, or directly received from the federal government) during their fiscal year. The Local Programs Manager reviews each agreement to ensure this language is included in the subaward template. (Control Activities) The LAG Manual, Chapter 53.4 Financial and Compliance Audit, also informs local programs subrecipients of the following audit requirements:

***.41 Single Audit** - The local agency is responsible for ensuring that a federal single audit is performed in accordance with 2 CFR Part 200.501 - Audit Requirements. WSDOT is also responsible for ensuring that FHWA funds are properly expended. The State Auditor will therefore audit each local agency.*

***.44 Audit Report** - The state auditor notifies Local Programs upon completion of a formal audit report. If findings on a particular audit arise, Local Programs contacts the agency to confirm the findings and coordinate resolution. Audit findings must be resolved within six months of the date that the audit report is issued. Upon resolution, Local Programs issues a Management Review letter to the agency and provides copies to the FHWA. Audits will normally include the following categories:*

- *Interagency Agreements*
- *Land Development or Land Acquisition Projects*
- *Tier Contracting Procedures*
- *Fund Management – Transactions*
- *Accounting Methods – Cash or Accrual*
- *DBE-EEO Practices*
- *Use of Grant Acquired Equipment”*

We did not note any differences in language between the different versions of the LAG manual for this subsection.

The LAG Manual, Chapter 53.4 Financial and Compliance Audit, also informs local programs subrecipients of the following audit requirements:

.41 Single Audit - The local agency is responsible for ensuring that a federal single audit is performed in accordance with 2 CFR Part 200.501 - Audit Requirements. WSDOT is also responsible for ensuring that FHWA funds are properly expended. The State Auditor will therefore audit each local agency.

.44 Audit Report - The state auditor notifies Local Programs upon completion of a formal audit report. If findings on a particular audit arise, Local Programs contacts the agency to confirm the findings and coordinate resolution. Audit findings must be resolved within six months of the date that the

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audit report is issued. Upon resolution, Local Programs issues a Management Review letter to the agency and provides copies to the FHWA.

Stephanie explained that Local Programs uses SPORT to track all Local Programs subrecipients and their federal highway subawards, and all corresponding subrecipient expenditures and requests for reimbursement. SPORT directly uploads into the TRAINS for billings as well as FMIS for project authorizations. SPORT is also used to track subrecipient audits. Each Agency's reported expenditures are keyed into SPORT indicating whether or not they should be receiving an audit. Currently, Local Programs has language on the Single Audit requirements detailed in the LAG manual, the Local Agency Agreement (section VIII), and is discussed at various training throughout the state and relies on the subrecipient to notify the Department of when audits are required to be performed. Both the Analyst and Project Controller are on the SAO audit report distribution list, so they receive notification of audit reports issued by our Office. Upon notification, either the Local Programs Project Funding Analyst, or the Project Controller obtains and reviews the audit report from the SAO web site. They log into SPORT to the "audit info" page for the applicable agency and enter the report number, audit period, issue date and audit results, as well as whether or not the audit affected the Highway Planning and Construction Cluster grants. The date this review is performed, and a basic summary of any audit issues or findings, are also noted in SPORT. The Local Programs Funding Analyst uses a standardized written procedure the Department developed to record audits reported by subrecipients and how to confirm audit report issuance via SAO's Audit Reports tool (see). **Key Control #9: To verify that local agencies receive required single audits, the Program Management's Transportation Engineer 3 and/or Fiscal Analyst receives confirmation of the audit report(s) for the subrecipient, and enters the audit results into SPORT including: Report Date, Status of Audit Findings, Management Decisions, and Corrective Action resolution. (Control Activities/ Monitoring)**

If there are any results on the report, Local Programs Project Funding Analyst reaches out to SAO and inquire about the audit. SAO audits almost all of the Department's Highway Planning and Construction Cluster subrecipients, but there are sometimes subrecipients that are not audited by SAO (typically these are Tribes and occasionally a non-profit). In these instances, the Local Programs Project Funding Analyst checks the Federal Audit Clearing House web site to determine whether or not an audit has been completed. **Key Control #10: If a subrecipient has received a single audit finding for the Highway Planning and Construction Cluster subaward, the report is forwarded from the Program Management's Transportation Engineer 3 and/or Fiscal Analyst to the Local Programs Program Manager, who reviews the audit report and reviews agency's applicable project(s) in SPORT, as applicable. The Program Manager follows up with a management decision letter, if applicable, to confirm the local agency's corrective action plan detailed in the audit report and remind the local agency, that the Region Local Programs Engineer may review in the future. (Information and Communication/ Monitoring)**

Beginning in August 2020 Local Programs began sending emails to each subrecipient with active agreements asking them to confirm if they did or did not spend \$750,000 in federal funds in a specific calendar year. The Analyst runs a report to see which subrecipients received less than \$750,000 in federal funds from the Department. If the subrecipient does not provide a timely response, Stephanie Tax confirmed Local Programs follows up with the subrecipient to ensure they get a response. **Key Control #11: Local Programs staff sends an emailed request for information on federal award expenditures and a written attestation from the subrecipient that it did not expend \$750,000 or more in annual federal financial assistance that would require a Single Audit. (Control Activities/Monitoring)**

Summary of Key Controls

Key Control #8 - Included in the boilerplate language of the WSDOT standard local agency agreement template is the requirement for the subrecipient to receive a federal compliance audit if they expend at least \$750,000 or more in federal assistance (pass-through, or directly received from the federal government) during their fiscal year. The Local Programs Manager reviews each agreement to ensure this language is included in the subaward template. (Control Activities)

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Key Control #9: To verify that local agencies receive required single audits, the Program Management's Transportation Engineer 3 and/or Fiscal Analyst receives confirmation of the audit report(s) for the subrecipient, and enters the audit results into SPORT including: Report Date, Status of Audit Findings, Management Decisions, and Corrective Action resolution. (Control Activities/ Monitoring)

Key Control #10: If a subrecipient has received a single audit finding for the Highway Planning and Construction Cluster subaward, the report is forwarded from the Program Management's Transportation Engineer 3 and/or Fiscal Analyst to the Local Programs Program Manager, who reviews the audit report and reviews agency's applicable project(s) in SPORT, as applicable. The Program Manager follows up with a management decision letter, if applicable, to confirm the local agency's corrective action plan detailed in the audit report and remind the local agency, that the Region Local Programs Engineer may review in the future. (Information and Communication/ Monitoring)

Key Control #11: Local Programs staff sends an emailed request for information on federal award expenditures and a written attestation from the subrecipient that it did not expend \$750,000 or more in annual federal financial assistance that would require a Single Audit. (Control Activities/Monitoring)

Evaluation of Results: We did not identify any control deficiencies.

Preliminary Control Risk Assessment

Step 4

We assess the preliminary control risk as: LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.6.PR.G - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: N. Special Tests and Provisions (Quality Assurance Program) - Controls

Prepared By: JDP, 1/30/2023

Reviewed By: ACS, 2/1/2023

Purpose/Conclusion.

Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance of compliance with **the following** Special Tests and Provision:

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- **Quality Assurance Program**

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal requirements related to **Quality Assurance Program**.

To provide a preliminary control risk assessment based upon our understanding of the internal controls **for Quality Assurance Program**.

Source:

Jesse Daniels - Audit Liaison

Garrett Webster - Assistant State Materials Engineer - Materials Quality

Kevin Burns - Quality Systems Manager

Randy Mawdsley - Quality Systems Manager (retired)

Pat Norton - Assistant Materials Quality Assurance Engineer

Conclusion:

- **Quality Assurance Program**

Based on our understanding of internal controls over Special Tests and Provision, we assessed preliminary control risk as low.

Testing Strategy:

Special Tests and Provisions - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the **Inherent and Internal Control Risk Guidance** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review Part 4 of the Compliance Supplement (or Part 5 for Program Clusters) that applies to your audit period to determine if there are any special tests and provisions for the program. Also, review the grant agreement/contract, any available program guidelines or handbooks, and inquire with the entity (including the grant program manager, audit liaison, or entity management) to identify any material special provisions.

Once all applicable special requirements for the program have been identified, determine which are material and should be audited. These types of activities are material:

- (1) Mentioned in the Compliance Supplement, Part 4 or 5
- (2) Can result in material non-compliance (quantitatively or qualitatively)
- (4) Affect a large part of the program (significant dollar amounts)
- (5) Non-compliance could cause the awarding agency to seek repayment for part of the award or reduce future awards (as stipulated in the contract)

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Exclude special requirements that do not meet these criteria from your review.

Note: If a program is not in part 4 of the compliance supplement, consult with the SWSA supervisor or AIC after making a preliminary identification of Special Tests and Provisions to test.

There may be special elements that apply to other compliance requirements, such as additional reporting, procurement, or subrecipient monitoring requirements. For efficiency, these special provisions can be addressed in those other compliance sections. The audit documentation should clearly identify where the special provisions are being addressed.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the grantee's internal controls and identify the key controls to ensure:

- (a) compliance with the Special Provisions contained in Part 4 (or Part 5) of the Compliance Supplement and/or the grant agreement.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as “LOW” when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or

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2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria.:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Record of Work Done.:

Inherent Risk of Noncompliance

Step 1

We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Special Tests and Provisions.

Compliance Requirements - A State DOT or LPA must have a quality assurance (QA) program, approved by FHWA, for construction projects on the NHS to ensure that materials and workmanship conform to approved plans and specifications. Verification sampling must be performed by qualified testing personnel employed by the State DOT, or by its designated agent, excluding the contractor (23 CFR sections 637.201, 637.205, 637.207, and 637.209).

Understanding of Internal Controls

Step 3

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In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

The Quality Assurance program begins with FHWA and WSDOT signing the Federal Aid Highway Program Stewardship & Oversight Agreement. This document outlines the FHWA requirements for compliance with the grant, and dictates what should be contained in the WSDOT Construction Manual. Chapter 9.5 of the Construction Manual outlines the quality assurance program and related requirements, and is used extensively as a reference by field personnel. **(Key Internal Control #1a - Control Activities/Information and Communication)** The Quality Assurance program ensures that materials incorporated into any highway construction project are in conformity with the approved plans and specifications of the project. The program also conforms to the criteria in FHWA's regulation for Quality Assurance Procedures for Construction. The Quality Assurance program includes the following elements:

1. WAQTC Testing Technician Qualified Program - The purpose of this program is to provide uniform statewide testing by ensuring technicians meet the WAQTC (Western Alliance for Quality Transportation Construction) certification and method qualification processes. This program is based on **AASHTO** (American Association of State Highway and Transportation Officials) **R 25 - Standard Practice for Technician Training and Certification Programs**. This provides a guideline for establishing evaluation and certification procedures for personnel engaged in sampling and testing of soils, aggregates, asphalt mixtures, and cement concrete in accordance with AASHTO testing methods, and is intended for use by organizations providing certification of sampling and testing technicians at the basic testing level for acceptance of materials and independent assurance.
2. Method Qualified Tester Program - The purpose of this program is to provide uniform statewide testing by ensuring technicians meet the WAQTC certification and method qualification processes.
3. Equipment Calibration/Standardization/Check and Maintenance Program - This program ensures that all laboratory equipment will be calibrated/standardized/checked as required by the test procedures. Region and field laboratories will calibrate/standardize/check all required equipment once a year unless otherwise specified by the WSDOT Verification Procedures.
4. Qualified Laboratory Program - This program ensures that all laboratories performing acceptance testing on state or federally funded construction projects have been qualified to do so.
5. Independent Assurance Program - This program's goal is to ensure that each active qualified tester will have an independent assurance (IA) evaluation for each module or method they are qualified in once a year. WSDOT is required to provide an annual report to the FHWA summarizing the results of the IA program. These reports provide a tool for the Region and WSDOT to analyze trends, identify training needs, and make improvements. It is recognized that not every tester will be evaluated by an IAI as testers come and go throughout the year, preventing the IAI from performing audits.

Along with outlining the above programs associated with the Quality Assurance program as a whole, the Construction Manual also details the responsibilities for the following Quality Assurance areas:

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1. *State Materials Laboratory*
1. State Materials Engineer
 2. Assistant State Materials Engineer
 3. Quality Systems Manager
 4. State Materials Laboratory Managers
2. *Regional Materials Laboratory*
1. Region Materials Engineer
 2. Region Laboratory Supervisor
 3. Region Independent Assurance Inspector
3. *Project Engineering Office*
1. Project Engineer
 2. PE Office Contact
4. *Individual Tester Requirements*
1. Certified and/or Method Qualified Tester
 2. Uncertified and/or Unqualified Method Tester

There are various different methods of acceptance depending on the type of product. Types of Acceptance methods used include:

- Sampling and Testing
- WSDOT Fabrications Inspection
- Manufacturer's Certificate of Compliance
- Miscellaneous Certificates of Compliance
- Shop Drawings
- Catalog Cuts
- Concrete Pipe Acceptance Report
- Visual Acceptance or Reduced Acceptance Criteria.

Verify that the QA program has been approved by FHWA

The Transportation Technical Engineer of the Construction Division indicated how they obtain documented approval from FHWA of the Construction Manual, which includes the QA program. Below is an example of the email approval from FHWA:

FHWA confirms that WSDOT administers federal-aid projects per the WSDOT Specifications and WSDOT's Construction Manual in which we approve the

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content including changes that are made to both documents. Our process for approval is less formal in the sense that as changes arise in the WSDOT specifications and WSDOT Construction Manual, WSDOT provides us the changes for our review and approval. We typically provide comments and approvals via email as changes arise. We also have a construction monitoring plan which identifies some of the functions WSDOT does on our behalf.

The Stewardship and Oversight Agreement between FHWA and WSDOT (particular Section X: FHWA Oversight Program under 23 U.S.C. 106(g) and Attachment C in relation to construction manuals) also discuss how FHWA and WSDOT work together in performing stewardship and oversight of federal-aid projects. Here is the link to the [Stewardship and Oversight Agreement](#).

We also asked how WSDOT ensures they involve FHWA when changes need to be made. The Transportation Technical Engineer explained that, prior to any changes being made, WSDOT sends an email to FHWA to inform them of the upcoming changes to the Construction Manual and to request their approval to make each change. The email requesting approval is sent two weeks prior to the update to allow sufficient time for FHWA's review. Once FHWA approval is obtained for any changes in the Construction Manual (M 41-01), which includes Chapter 9-5 - Quality Assurance, the revisions to the Construction Manual are posted on WSDOT's web site. Correspondence is maintained in the Construction Office to show evidence of this process. **(Key Control #1b - Control Activities/Information and Communication)**

Proper tests are being taken in accordance with the QA program requirements

WSDOT ensures that the proper tests are being taken in accordance with the QA program. The Materials Team explained that the State Materials Laboratory creates an initial materials list that is uploaded to a program called the Record of Materials (ROM) for most Design Bid Build projects under contract. However, Facilities Contracts, Emergency Contracts and other contracts identified by the Materials Quality Assurance section do not always utilize the ROM program. The ROM is not a purchasing or payment document. Instead, the ROM sets forth the materials that are expected to be used and the quantities for all materials that are based on the contract documents (Contract Plans and Special Provisions) known at the time of contract award. The ROM also documents the proper Acceptance Criteria including testing per the approved Request for Approval of Material (RAM) or properly submitted Qualified Products List (QPL) page. To ensure that the Project Engineer is aware of sampling and testing frequencies required for the material, the State Materials Lab (or PEO) will approve a RAM, or by receiving an approved QPL for a material that will specify that the item may be requiring testing. The RAM/QPL will be reviewed by the Project Engineer in conjunction with Chapter 9 for frequency of testing **(Key Control #2 - Control Activities)**.

How the record of materials is created: The State Materials Laboratory uploads the initial materials and acceptance criteria into the ROM program shortly after the contract is awarded. The ROM is not a purchasing nor a payment document. ROMs are not required for Emergency contracts, Facility contracts and other contracts identified by the Materials Quality Assurance Section. In addition, some initial ROM uploads are blank, allowing for the PEO to populate and update the ROM with materials used for their contract. The ROM is used by the Project Office to communicate and monitor which materials are used on the job site and is updated by the Project Engineer Office throughout the life of the contract per Construction Manual Section 9-1.2C Record of Materials. Therefore, per the Materials Team, use of the materials off of the ROM issued by the Mats Lab provides initial information to the Project Engineer Office on materials acceptance and testing. The actual testing performed by the Project Engineer Office can be different from the initial ROM as changes occur when materials are or are not used, and changes in the quantities of materials used on the construction project.

The Project Engineer Office (PEO) uses the ROM computer program to maintain the materials documentation information for the State Contracts administered by that PEO. The ROM manages and tracks all of the material used on WSDOT Construction contracts, not including Emergency contracts, Facilities contracts or other contracts identified by the MQAS. This program is the entry point for management of the initial upload of materials and acceptance criteria after the

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contract is awarded; the documentation and materials used on highway construction contracts can be tracked with this program. ROM reports can be generated from the Record of Materials, with details on which materials have been, used, the acceptance methods, and if the materials passed. Therefore, the ROM report is used to assist the project office in tracking the materials approved, samples tested, Manufacturer's Certificate of Compliance, Shop Drawings and Catalog Cuts received, Field Inspector Acceptance/Verification, and other pertinent data necessary for the Project Engineer's and the Region's certification of materials. To document that material tests occurred on permanently incorporated materials, the ROM is maintained throughout the course of the project by the project engineer and will be updated to reflect materials placed within 30 calendar days of the material payment (**Key Control #3 - Control Activities**)

To ensure that all materials brought to the project conform with material specifications the Department utilizes random sampling of the material to ensure it meets specifications. By utilizing random sampling the contractor is unable to provide non-conforming materials because they know the sampling frequency and deliver material conforming items when tests are about to occur. The random sample methodology the Department utilizes is documented in a table. The sampling frequency is determined by selecting a number between 1-100 and there is a corresponding x-value related to each number. (For example if 37 was chosen the corresponding x-value is 0.063. If the sampling frequency for concrete placed, was one sample every 100 C.Y. and our random number we received was 37). The sampling would be performed at 63.01 C.Y. or the sixth truck, as each truck can only bring 10 C.Y.

PEOs have a variety of ways of selecting their random number such as utilizing a stop watch for the random number, license plates, or even random number apps as long as the sampling frequency is logical. PEOs may document there sampling in variety of ways also, this could be a tracking spreadsheet on excel or a whiteboard. The Department is able to verify that the sampling frequency was met by verifying dates of delivery tickets, there quantities and sampling dates on materials samples if there is no spreadsheet tracker.

Audits - Construction Quality Audits

Construction Quality Audits will be performed by the Construction Division - State Materials Laboratory to document conformance of project records to DBE compliance, construction administration and materials certification standards. The Construction Quality Audit consists of documentation review and may include a field review. The documentation review will normally be conducted at the Project Office unless arrangements are made for it to be conducted elsewhere. The goal is to perform a construction quality audit on at least one project per Project Office every three years. Construction Quality Audits may be conducted more frequently at the discretion of the Construction Division. Projects will be selected with consideration given to project size and complexity.

Construction Quality Audits are typically performed during the active life of the project; generally, 20 percent to 80 percent complete, but also may occur after substantial completion has occurred. Construction Quality Audits are performed to validate that construction inspection, contract administration, materials testing and documentation are completed in accordance with established requirements and standards (**Monitoring**). Records reviewed will include those maintained and developed by the Project Engineer for DBE compliance, inspection requirements, approval, testing, acceptance and field verification of materials placed and paid for on the Contract.

The following areas are reviewed during the construction quality audit:

- Record of Materials
- Materials Approval
- Materials Acceptance
- Field Verification

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- Materials Testing Frequencies

Audit areas with less than 10% deficiency are exit items, while audit areas that exceed 10% are findings.

The Construction Manual's Audits Programs (Construction Manual Section SS 1-09.12 and Region Project Documentation Reviews 10-5 notes policies or procedures for secondary review to ensure that materials incorporated into the project are tested for conformance with approved specifications). In addition, the Materials Quality Assurance Audit Program also notifies the FHWA Division Office and the WSDOT Internal Audit Office so they can accompany on MQA audits, if desired. Not all projects will be audited.

Verification sampling activities are performed by qualified testing personnel employed by the agency or by its designated agent

WSDOT Construction Manual Section 9-5 Quality Assurance Program covers the various requirements for the WSDOT Quality Assurance Program (QAP). WSDOT ensures that acceptance and verification sampling activities are performed by qualified testing personnel employed by the agency or by its designated agent. Testers must pass a module certification written exam or a method qualification written exam and a performance exam and they are then are then certified for a period of five years ending the last day of the month in which the initial exam was successfully completed, after which they must become recertified (*After the 2020 audit we were informed that the Department has changed this to be from the certification completion date. They will no longer be taking the initial exam date as the first date of certification*).

The certification records for all testers, whether they are WSDOT method qualified testers or module certified testers, are kept in a qualified tester database and in hard copies at both HQ and the testers region. To ensure that certified module testers are in the database a Quality Systems Management Section representative will sign and send the completed form back to the IAI and tester. *Note: prior to January 2022 Method Testers document their review of tester examinations on the examination itself and do not send tester exam results to the QSM for the signed form.* The IAI is responsible for maintenance of the Region's qualified tester information in the Tester Qualification Database and in hard copy files within the Region. The tester database also includes method qualified testers, historical data, not only active module testers. **(Key Internal Control #4 - Control Activities)**. In accordance with Chapter 9-5.4F (will be 9-5.4B with next Construction Manual update) of the Construction Manual, Region Independent Assurance Inspectors (IAI) perform Independent Assurance (IA) audits of active testers performing sampling, acceptance, or verification testing. The Independent Assurance Inspector performs audits of testers and verifies a tester is performing the test correctly and they are certified in both written and performance tests. The overall audit results are compiled and reviewed by the Quality Systems Manager and then submitted to FHWA annually. **(Key Control #5 - Control Activities/Monitoring)** WSDOT goal is to conduct a 100% review of testers on an annual basis; however, in accordance to 9-5.7 if a region is unable to audit a tester the regional IAI will document the reason the annual tester audit was not completed. Testing and sampling of testers is conducted in accordance with FHWA requirements.

Summary of Key Internal Controls

Key Control #1a - The quality assurance program begins with FHWA and WSDOT signing the Federal Aid Highway Program Stewardship & Oversight Agreement. This document outlines the FHWA requirements for compliance to the grant, and dictates what should be contained in the WSDOT Construction Manual. Chapter 9.5 of the Construction Manual outlines the quality assurance program and is used extensively as a reference by field personnel. **(Control Activities/Information and Communication)**

Key Control #1b - Once FHWA approval is obtained for any changes in the Construction Manual (M 41-01), which includes Chapter 9-5 - Quality Assurance,

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the revisions to the Construction Manual are posted on WSDOT's web site. Correspondence is maintained in the Construction Office to show evidence of this process. **(Control Activities/Information and Communication)**

Key Control #2 - To ensure that the Project Engineer is aware of sampling and testing frequencies required for the material, the State Materials Lab or PEO will approve a RAM, or by receiving an approved QPL for a material that will specify that the item may be requiring testing. The RAM/QPL/ASA will be reviewed in conjunction with Chapter 9 for frequency of testing **(Control Activities)**

Key Control #3 - To document that material tests occurred, the ROM is maintained throughout the course of the project by the project engineer and will be updated to reflect materials placed within 30 calendar days of the material payment **(Control Activities)**

Key Control #4 - To ensure that qualified module and method testers are in the database a Quality Systems Management Section representative will sign and send the completed form back to the IAI and tester. *Note: prior to January 2022 Method Testers document their review of tester examinations on the examination itself and do not send tester exam results to the QSM for the signed form.* The IAI is responsible for maintenance of the Region's qualified tester information in the Tester Qualification Database and in hard copy files within the Region. The tester database also includes method testers, historical data, not only active module testers. **(Control Activities).** -

During the identification of key control #4 we noted that it wasn't in place during the whole SFY. However due to other compensating controls we will test.

Key Control #5 - The audit verifies a tester is performing the test correctly and they are certified in both written and performance tests. The overall audit results are compiled and submitted to FHWA annually **(Control Activities/Monitoring).**

Evaluation of Results: Did you identify any control deficiencies? No

Key Internal Control #4 is found to be a control weakness; the design of this internal control during the audit period would not have been effective to prevent material noncompliance. However due to compensating controls in existence during the audit period, we will still test internal controls for effectiveness in Step 5.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.6.PR.G - 20.205/219/224-Highway Planning & Construction Cluster - DOT

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Procedure Step: N. Special Tests and Provisions (Project Approvals) - State Administered Projects - Controls

Prepared By: AWW, 7/15/2022

Reviewed By: ACS, 7/28/2022

Purpose/Conclusion:

Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance of compliance with the following Special Tests and Provision:

- Project Approvals - State Administered Projects

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal requirements related to Project Approvals - State Administered Projects.

- To provide a preliminary control risk assessment based upon our understanding of the internal controls for Project Approvals - State Administered Projects

Source:

Katya Braun, Transportation Engineer 4, Capital Program Development and Mangement

Jamie Upah, Federal Aid & Work Order Authorization Manager - Capital Program Development & Management

Alyssa Ball, Capital Programs Budget & Reporting

Jesse Daniels, External Audit Liaison

Conclusion:

- Project Approvals - State Administered Projects

Based on our understanding of internal controls over Special Tests and Provision, we assessed preliminary control risk as low.

Testing Strategy:

Special Tests and Provisions - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

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Step 2: Gather Information

Review Part 4 of the Compliance Supplement (or Part 5 for Program Clusters) that applies to your audit period to determine if there are any special tests and provisions for the program. Also, review the grant agreement/contract, any available program guidelines or handbooks, and inquire with the entity (including the grant program manager, audit liaison, or entity management) to identify any material special provisions.

Once all applicable special requirements for the program have been identified, determine which are material and should be audited. These types of activities are material:

- (1) Mentioned in the Compliance Supplement, Part 4 or 5
- (2) Can result in material non-compliance (quantitatively or qualitatively)
- (4) Affect a large part of the program (significant dollar amounts)
- (5) Non-compliance could cause the awarding agency to seek repayment for part of the award or reduce future awards (as stipulated in the contract)

Exclude special requirements that do not meet these criteria from your review.

Note: If a program is not in part 4 of the compliance supplement, consult with the SWSA supervisor or AIC after making a preliminary identification of Special Tests and Provisions to test.

There may be special elements that apply to other compliance requirements, such as additional reporting, procurement, or subrecipient monitoring requirements. For efficiency, these special provisions can be addressed in those other compliance sections. The audit documentation should clearly identify where the special provisions are being addressed.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the grantee's internal controls and identify the key controls to ensure:

- (a) compliance with the Special Provisions contained in Part 4 (or Part 5) of the Compliance Supplement and/or the grant agreement.

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Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as **“LOW”** when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Record of Work Done:

Inherent Risk of Noncompliance

Step 1

We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

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Gather Information

Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Special Tests and Provisions.

3. Project Approvals

Compliance Requirements FHWA project approval/authorization to proceed is required before costs are incurred for all phases of projects, except for certain property acquisition costs permitted under 23 USC 108, certain emergency repair work under 23 USC 125, and preliminary engineering under Section 1440 of the FAST Act (23 USC 101). Based on the Stewardship and Oversight Agreement between the State DOT and the FHWA Division office, projects may be authorized under the authority in 23 USC 106(c) which allows the State DOT to assume responsibilities for designs, plans, specifications, estimates, contract awards, and inspection of progress. When FHWA authorizes a construction project or phase in a project agreement, the State DOT may incur costs (i.e. advertise for bids or use force account work) (23 CFR sections 630.205(c), 635.112(a)m 635.204, and 635.309).

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

On June 27, 2022 we received a copy of the Department's current key internal controls over Special Tests and Provisions - Project Approvals - State Administered Projects (see [FY22 Internal Controls - Project Approval Final](#)).

On July 12, 2022 we met with program staff to gain an understanding of the internal controls over State Administered Project Approvals.

- Katya Braun, Transportation Engineer 4, Capital Program Development and Mangement
- Jamie Upah, Federal Aid & Work Order Authorization Manager - Capital Program Development & Management
- Alyssa Ball, Capital Programs Budget & Reporting
- Jesse Daniels, External Audit Liaison

Key Control #1: The Capital Program Development and Management Office maintains the Program Management Manual (M30-05.02) that describes the centralized, coordinated development and management of WSDOT's capital programs to achieve the department's strategic goals, objectives, and benefits. Chapters 5 and 8 contains information on Funds Management and Federal Aid, which includes policies for federal-aid projects. (Information & Communication) (see [Project Management Manual](#))

Preliminary Engineering needs to take place prior to approval of the Construction phase of a project. Before construction work can begin, the Department

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identifies preliminary project information that includes project scope and estimate. Once the preliminary project information has been identified, a unique Project Item Number is established in the Capital Program Management System (CPMS). Then regional Program Management offices create work order authorizations (WOAs) within ECM Portal software which are submitted to CPDM. These WOAs are reviewed at CPDM headquarters and approved or denied on a project-to-project basis.

When a project is proposed for Federal funding, it is reviewed for compliance with Federal requirements, and then a Federal Aid Project Agreement (FAPA) is initiated by WSDOT in the Federal Aid Tracking System (FATS) and signed by both WSDOT and FHWA. **Key Control #2: A Federal Aid Project Agreement (FAPA) must be completed and signed by both the Department and FHWA. The FAPA contains project specific financial coding specific to the project and phase, and must be the same within FHWA and the Department's systems and is reviewed. (Control Activities)**

Key Control #3: A Project Financial Specialist (PFS) creates the FAPA for the project in FATS and certifies it. The Federal Aid & Work Order Authorization Manager or designee reviews all FAPA information, to ensure funding request complies with all applicable federal laws (USC, CFR & FHWA Orders & Guidelines), then authorizes, and transmits the FAPA to FHWA Fiscal Management Information System (FMIS) for approval. (Control Activities) After funding is approved by FHWA, the PFS verifies that approval prior to sending the WOA Accounting's Project Support & Receivables Unit (PS&R) for their processing. The date of FHWA approval is documented on the FAPA after FHWA approval signatures are transmitted back from FMIS to FATS.

PS&R releases the WOA information to TRAINS and TRAINS then sends the information to AFRS, which allows payments for the project to be processed. This is indicated by the status indicator in TRAINS changes to O (open) and dated, which allows the system to accept charges to the project

The following steps are performed by the Contract Ad and Award Office:

- Preparing the contract to be solicited for bid
- Advertising the contract to be bid upon
- Maintaining a system whereby contractors are prequalified prior to being allowed to bid
- Performing the opening bid process
- Following the contract process through to execution

After execution of the contract, payments are authorized through TRAINS, so control of the funding continues to reside with WSDOT. Expenditures are turned in to WSDOT for payment, any modifications are approved through the same process as initial approval. Each change in funding requirements whether related to Preliminary Engineering or Construction phases will go through the same approval process, since the Department is required to obtain separate federal approval for any increases or decreases in the amounts proposed for spending prior to expenditures made.

Key Internal Controls Identified:

Key Control #1: The Capital Program Development and Management Office maintains the Program Management Manual (M30-05.02) that describes the centralized, coordinated development and management of WSDOT's capital programs to achieve the department's strategic goals, objectives, and benefits. Chapters 5 and 8 contains information on Funds Management and Federal Aid, which includes policies for federal-aid projects. (Information & Communication)

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Key Control #2: A Federal Aid Project Agreement (FAPA) must be completed and signed by both the Department and FHWA. The FAPA contains project specific financial coding specific to the project and phase, and must be the same within FHWA and the Department's systems and is reviewed. (Control Activities)

Key Control #3: A Project Financial Specialist (PFS) creates the FAPA for the project in FATS and certifies it. The Federal Aid & Work Order Authorization Manager or designee reviews all FAPA information, to ensure funding request complies with all applicable federal laws (USC, CFR & FHWA Orders & Guidelines), then authorizes, and transmits the FAPA to FHWA Fiscal Management Information System (FMIS) for approval. (Control Activities)

Evaluation of Results: We did not identify any internal control deficiencies. We will proceed with testing the identified internal controls for effectiveness in Step 5.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.6.PR.G - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: N. Special Tests and Provisions (Project Approvals) - Local Programs - Controls

Prepared By: AWW, 7/13/2022

Reviewed By: ACS, 7/28/2022

Purpose/Conclusion.*

Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance of compliance with the following Special Tests and Provision:

- Special Test #5 - Project Approvals - Local Programs

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal requirements related to Special Test #5 - Project Approvals - Local Programs

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To provide a preliminary control risk assessment based upon our understanding of the internal controls for Special Test #5 - Project Approvals - Local Programs

Source:

Stephanie Tax, Local Programs Program Manager
Jesse Daniels, External Audit Liaison

Conclusion:

- Special Test #5 - Project Approvals - Local Programs

Based on our understanding of internal controls over Special Tests and Provision, we assessed preliminary control risk as low.

Testing Strategy:

Special Tests and Provisions - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the *Inherent and Internal Control Risk Guidance* that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review Part 4 of the Compliance Supplement (or Part 5 for Program Clusters) that applies to your audit period to determine if there are any special tests and provisions for the program. Also, review the grant agreement/contract, any available program guidelines or handbooks, and inquire with the entity (including the grant program manager, audit liaison, or entity management) to identify any material special provisions.

Once all applicable special requirements for the program have been identified, determine which are material and should be audited. These types of activities are material:

- (1) Mentioned in the Compliance Supplement, Part 4 or 5
- (2) Can result in material non-compliance (quantitatively or qualitatively)
- (4) Affect a large part of the program (significant dollar amounts)
- (5) Non-compliance could cause the awarding agency to seek repayment for part of the award or reduce future awards (as stipulated in the contract)

Exclude special requirements that do not meet these criteria from your review.

Note: If a program is not in part 4 of the compliance supplement, consult with the SWSA supervisor or AIC after making a preliminary identification of Special Tests and Provisions to test.

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There may be special elements that apply to other compliance requirements, such as additional reporting, procurement, or subrecipient monitoring requirements. For efficiency, these special provisions can be addressed in those other compliance sections. The audit documentation should clearly identify where the special provisions are being addressed.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the grantee's internal controls and identify the key controls to ensure:

- (a) compliance with the Special Provisions contained in Part 4 (or Part 5) of the Compliance Supplement and/or the grant agreement.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as "LOW" when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling

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methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Record of Work Done:

Inherent Risk of Noncompliance

Step 1

We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Special Tests and Provisions.

3. Project Approvals

Compliance Requirements FHWA project approval/authorization to proceed is required before costs are incurred for all phases of projects, except for certain property acquisition costs permitted under 23 USC 108, certain emergency repair work under 23 USC 125, and preliminary engineering under Section 1440 of the FAST Act (23 USC 101). Based on the Stewardship and Oversight Agreement between the State DOT and the FHWA Division office, projects may be authorized under the authority in 23 USC 106(c) which allows the State DOT to assume responsibilities for designs, plans, specifications, estimates, contract awards, and inspection of progress. When FHWA authorizes a construction project or phase in a project agreement, the State DOT may incur costs (i.e. advertise for bids or use force account work) (23 CFR sections 630.205(c), 635.112(a)m 635.204, and 635.309).

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

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On June 27, 2022 we received a copy of the Department's current key internal controls over Local Programs Suspension and Debarment (see [FY22 Internal Controls - Project Approval Final](#)).

On July 12, 2022 we met with Stephanie Tax, Local Programs Manager, Kyle McKeon, Engineering Services Manager, and Jesse Daniels, External Audit Liaison, to gain an understanding of the internal controls over Local Programs Project Approvals.

Local entities apply to have WSDOT help provide oversight and funding to infrastructure projects they have need for. Information is sent to Local Programs Division at WSDOT where the Local Programs – Program Manager reviews the request and determines if there are applicable funds available. Local Program staff enter the project parameters into the Statewide Project Oversight Reporting & Tracking (SPORT) which are submitted as text files to FHWA's FMIS for approval. **Key Control #1: Upon receipt of FHWA approval, project parameters are reviewed by the Local Programs Staff for accuracy and completeness and sent to AFS for entry into TRAINS to allow payments to be processed for the project. (Control Activities/ Information & Communication)** Project documentation is printed out for hard copy signature at local entity and preliminary engineering phase will begin.

Preliminary engineering is performed by WSDOT at the Local Program Office. Once completed, the WSDOT approved project is submitted for FHWA approval for construction. The project is then given to the local entity which is responsible for the project from that point on, including advertising as they deem necessary. Expenditures are turned in to WSDOT for payment through SPORT, so control of the funding resides with WSDOT, any modifications are approved through the same process as initial approval. This is also reviewed and tested in Subrecipient Monitoring, under Key Control #3 as follows. *M. Subrecipient Monitoring - Controls* at [M. Subrecipient Monitoring - Controls \(Risk Assessments, Subaward Information, and Fiscal Monitoring\)](#).

Local Programs, in conjunction with the Department's contracting staff, are responsible for preparing the Local Agency Agreement. They include the grant's conditions, CFDA number and award data, award amount and guidelines for the authorized use of funds, project scope, and all special conditions and requirements for the individual project. The agreement is then reviewed to ensure all appropriate language is included. The Local Agency Agreement is signed by both the Agency Official (subrecipient) and the Department's Local Programs Program Manager. Prior to receiving any grant funds, the project must also be reviewed and approved by representatives at the FHWA.

Summary of Key Controls

Key Control #1: Upon receipt of FHWA approval, project parameters are reviewed by the Local Programs Staff for accuracy and completeness and sent to AFS for entry into TRAINS to allow payments to be processed for the project. (Control Activities/ Information & Communication)

Evaluation of Results: We did not identify any internal control deficiencies. We will proceed with testing the identified internal controls for effectiveness in Step 5.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we

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can place reliance on the controls.

C.6.PRG - 20.205/219/224-Highway Planning & Construction Cluster - DOT

Procedure Step: N. Special Tests and Provisions (Value Engineering) - Controls

Prepared By: AWW, 8/30/2022

Reviewed By: ACS, 9/2/2022

Purpose/Conclusion.:

Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance of compliance with the following Special Tests and Provision:

- Special Test #5 - #4 - Value Engineering

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal requirements related to Special Test #4 - Value Engineering

To provide a preliminary control risk assessment based upon our understanding of the internal controls for Special Test #4 - Value Engineering

Source:

Mark Gabel, State Value Engineering Manager

Tomi Hume-Pontius, State Value Engineering Coordinator

Jesse Daniels, External Audit Liaison

Conclusion:

- Special Test #4 - Value Engineering

Based on our understanding of internal controls over Special Tests and Provision, we assessed preliminary control risk as low.

Testing Strategy.:

Special Tests and Provisions - Post Uniform Guidance Awards

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Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the *Inherent and Internal Control Risk Guidance* that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review Part 4 of the Compliance Supplement (or Part 5 for Program Clusters) that applies to your audit period to determine if there are any special tests and provisions for the program. Also, review the grant agreement/contract, any available program guidelines or handbooks, and inquire with the entity (including the grant program manager, audit liaison, or entity management) to identify any material special provisions.

Once all applicable special requirements for the program have been identified, determine which are material and should be audited. These types of activities are material:

- (1) Mentioned in the Compliance Supplement, Part 4 or 5
- (2) Can result in material non-compliance (quantitatively or qualitatively)
- (4) Affect a large part of the program (significant dollar amounts)
- (5) Non-compliance could cause the awarding agency to seek repayment for part of the award or reduce future awards (as stipulated in the contract)

Exclude special requirements that do not meet these criteria from your review.

Note: If a program is not in part 4 of the compliance supplement, consult with the SWSA supervisor or AIC after making a preliminary identification of Special Tests and Provisions to test.

There may be special elements that apply to other compliance requirements, such as additional reporting, procurement, or subrecipient monitoring requirements. For efficiency, these special provisions can be addressed in those other compliance sections. The audit documentation should clearly identify where the special provisions are being addressed.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the

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document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the grantee's internal controls and identify the key controls to ensure:

- (a) compliance with the Special Provisions contained in Part 4 (or Part 5) of the Compliance Supplement and/or the grant agreement.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as "LOW" when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Record of Work Done:

Inherent Risk of Noncompliance

Step 1

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We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Special Tests and Provisions.

Part 4, OMB Uniform Guidance Compliance Supplement, 20.205 - Highway Planning and Construction Cluster states in part:

Compliance Requirements State DOTs are required to establish a value engineering (VE) program and ensure that a VE analysis is performed on all applicable projects. The program should include procedures to approve or reject recommendations and for monitoring to ensure that resulting, approved recommendations are incorporated into the plans, specifications, and estimate. Applicable projects are (a) projects located on the NHS with an estimated total project cost of \$50 million or more that utilize state-aid highway program funding; (b) bridge projects located on the NHS with an estimated total cost of \$40 million or more that utilize state-aid highway program funding; and (c) any other projects that the FHWA determines to be appropriate. Projects utilizing the design-build method of construction do not require a VE analysis (23 USC 106(e)(5)). Critical elements of VE programs include identification of a state VE coordinator; establishment of a VE policy, and documented VE procedures, including requirements to identify applicable projects, verify required VE analyses are completed on State DOT and subrecipient projects; and monitor, assess, and report on the performance of the VE program (23 USC 106(e); 23 CFR part 627).

Audit Objectives Determine whether established VE programs include VE policies and procedures, documented analyses conducted for applicable projects, evaluations of VE recommendations, and incorporation of approved recommendations into the plans, specifications, and estimate for the project.

Title 23 Code of Federal Regulations (CFR), Part 627 - *Value Engineering [VE]*, states in part:

627.5 Applicable Projects.

(a) A VE analysis shall be conducted prior to the completion of final design on each applicable project that utilizes Federal-aid highway funding, and all approved recommendations shall be included in the project's plans, specifications and estimates prior to authorizing the project for construction (as specified in 23 CFR 630.205).

(b) Applicable projects requiring a VE analysis shall include the following:

(1) Each project located on the National Highway System (NHS) (as specified in 23 U.S.C. 103) with an estimated total project cost of \$50 million or

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more that utilizes Federal-aid highway funding;

(2) Each bridge project located on the NHS with an estimated total project cost of \$40 million or more that utilizes Federal-aid highway funding;

(3) Any major project (as defined in 23 U.S.C. 106(h)), located on or off of the NHS, that utilizes Federal-aid highway funding in any contract or phase comprising the major project;

(4) Any project where a VE analysis has not been conducted and a change is made to the project's scope or design between the final design and the construction letting which results in an increase in the project's total cost exceeding the thresholds identified in paragraphs (b)(1), (2) or (3) of this section; and

(5) Any other project FHWA determines to be appropriate that utilizes Federal-aid highway program funding.

(c) An additional VE analysis is not required if, after conducting a VE analysis required under this part, the project is subsequently split into smaller projects in the design phase or the project is programmed to be completed by the letting of multiple construction projects. However, the STA may not avoid the requirement to conduct a VE analysis on an applicable project by splitting the project into smaller projects, or programming multiple design or construction projects.

(d) The STA [*State Transportation Agency*]'s VE Program's policies and procedures should identify when VE analyses are to be considered or conducted for projects falling below the required thresholds identified in paragraph (b) of this section in the planning and development of transportation projects where there is a high potential for the project to benefit from a VE analysis. While not required, FHWA encourages STAs to consider the following projects that may benefit from a VE analysis:

(1) Complex projects on or off the NHS that have a total project cost of \$25 million or more;

(2) Complex Bridge Projects on or off the NHS with an estimated total project cost of \$20 million or more;

(3) Design-build projects on or off the NHS with an estimated cost of \$25 million or more; and

(4) Any other complex, difficult or high cost project as determined by the STA.

(e) A VE analysis is not required for projects delivered using the design-build method of construction. While not required, FHWA encourages STAs and local public authorities to conduct a VE analysis on design-build projects that meet the requirements identified in paragraph (b) of this section.

(f) A VE analysis is required on projects delivered using the Construction Manager/General Contractor (CM/GC) method of contracting, if the project meets the requirements identified in paragraph (b) of this section.

627.7 VE Programs.

(a) The STA shall establish and sustain a VE program under which VE analyses are identified, conducted and approved VE recommendations implemented on all applicable projects (as defined in § 627.5). The STA's VE program shall:

(1) Establish and document VE program policies and procedures that ensure the required VE analysis is conducted on all applicable projects, and encourage conducting VE analyses on other projects that have the potential to benefit from this analysis;

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- (2) Ensure the VE analysis is conducted and all approved recommendations are implemented and documented in a final VE report prior to the project being authorized to proceed to a construction letting;
- (3) Monitor and assess the VE Program, and disseminate an annual report to the FHWA consisting of a summary of all approved recommendations implemented on applicable projects requiring a VE analysis, the accepted VECPs, and VE program functions and activities;
- (4) Establish and document policies, procedures, and contract provisions that identify when VECP's may be used; identify the analysis, documentation, basis, and process for evaluating and accepting a VECP; and determine how the net savings of each VECP may be shared between the agency and contractor;
- (5) Establish and document policies, procedures, and controls to ensure a VE analysis is conducted and all approved recommendations are implemented for all applicable projects administered by local public agencies; and ensure the results of these analyses are included in the VE program monitoring and reporting; and
- (6) Provide for the review of any project where a delay occurs between when the final plans are completed and the project advances to a letting for construction to determine if a change has occurred to the project's scope or design where a VE analysis would be required to be conducted (as specified in § 625.5(b)).

(b) STAs shall ensure the required VE analysis has been performed on each applicable project including those administered by subrecipients, and shall ensure approved recommendations are implemented into the project's plans, specifications, and estimates prior to the project being authorized for construction (as specified in 23 CFR 630.205).

(c) STAs shall designate a VE Program Coordinator to promote and advance VE program activities and functions. The VE Coordinator's responsibilities should include establishing and maintaining the STA's VE policies and procedures; facilitating VE training; ensuring VE analyses are conducted on applicable projects; monitoring, assessing, and reporting on the VE analyses conducted and VE program; participating in periodic VE program and project reviews; submitting the required annual VE report to the FHWA; and supporting the other elements of the VE program.

627.9 Conducting a VE analysis.

(a) A VE analysis should be conducted as early as practicable in the planning or development of a project, preferably before the completion of the project's preliminary design. At a minimum, the VE analysis shall be conducted prior to completing the project's final design.

(b) The VE analysis should be closely coordinated with other project development activities to minimize the impact approved recommendations might have on previous agency, community, or environmental commitments; the project's scope or schedule; and the use of innovative technologies, materials, methods, plans or construction provisions.

(c) When the STA or local public agency chooses to conduct a VE analysis for a project utilizing the design-build project delivery method, the VE analysis should be performed prior to the release of the final Request for Proposals or other applicable solicitation documents.

(d) For projects delivered using the CM/GC contracting method, a VE analysis is not required prior to the preparation and release of the RFP for the CM/GC contract. The VE analysis is required to be completed and approved recommendations incorporated into the project plans prior to requesting a construction

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price proposal from the CM/GC contractor.

(e) STAs shall ensure the VE analysis meets the following requirements:

- (1) Uses a multidisciplinary team not directly involved in the planning or design of the project, with at least one individual who has training and experience with leading VE analyses;
- (2) Develops and implements the VE Job Plan;
- (3) Produces a formal written report outlining, at a minimum:
 - (i) Project information;
 - (ii) Identification of the VE analysis team;
 - (iii) Background and supporting documentation, such as information obtained from other analyses conducted on the project (e.g., environmental, safety, traffic operations, constructability);
 - (iv) Documentation of the stages of the VE Job Plan which would include documentation of the life-cycle costs that were analyzed;
 - (v) Summarization of the analysis conducted;
 - (vi) Documentation of the proposed recommendations and approvals received at the time the report is finalized; and
 - (vii) The formal written report shall be retained for at least 3 years after the completion of the project.

(f) For bridge projects, in addition to the requirements in subsection (e), the VE analyses shall:

- (1) Include bridge substructure and superstructure requirements that consider alternative construction materials; and
- (2) Be conducted based on:
 - (i) An engineering and economic assessment, taking into consideration acceptable designs for bridges; and
 - (ii) An analysis of life-cycle costs and duration of project construction.

(g) STAs and local public agencies may employ qualified consultants (as defined in 23 CFR 172.3) to conduct a VE analysis. The consultant shall possess training and experience with leading VE analyses. A consulting firm or individual shall not be used to conduct or support a VE analysis if they have a conflict of interest (as specified in 23 CFR 1.33).

(h) STAs, and local public agencies are encouraged to use a VECP clause (or other such clauses under a different name) in an applicable project's contract, allowing the construction contractor to propose changes to the project's plans, specifications, or other contract documents. Whenever such clauses are used, the STA and local authority will consider changes that could improve the project's performance, value and quality, shorten the delivery time, or lower construction costs, while considering impacts on the project's overall life-cycle cost and other applicable factors. The basis for a STA or local authority to consider a VECP is the analysis and documentation supporting the proposed benefits that would result from implementing the proposed change in the project's contract or project plans.

(i) Proposals to accelerate construction after the award of the contract will not be considered a VECP and will not be eligible for Federal-aid highway program funding participation. Where it is necessary to accelerate construction, STAs and local public agencies are encouraged to use the appropriate

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incentive or disincentive clauses so that all proposers will take this into account when preparing their bids or price proposals.

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

On June 27, 2022 we received a copy of the Department's current key internal controls over Value Engineering (see Internal Control request letter (with agency response) - ST 4 - Value Engineering).

On July 12, 2022 we met with Mark Gabel, State Value Engineering Manager, Tomi Hume-Pontius, State Value Engineering Coordinator, and Jesse Daniels, External Audit Liaison, to gain an understanding of the internal controls over Local Programs Project Approvals.

Key Control #1: The Department maintains and documents its Value Engineering (VE) program criteria in the WSDOT Design Manual - Chapter 310, Value Engineering. This [manual](#) is submitted to the Federal Highway Administration (FHWA) of the U.S. Department of Transportation and reviewed for concurrence to ensure the Department's program design complies with federal requirements. (Control Activities/ Information & Communication) The manual can be viewed on the Department's [website](#). We noted the manual contained updates as recent as September 2021 to the VE section, which was prepared by John Tevis and submitted to FHWA for approval. The Design Manual provides policies, procedures and the methods for which the Department develops and documents the design of improvements to the Washington State transportation network, and was developed for use on projects involving state facilities and/or highways. One of the key tools included in the manual includes a Value Engineering Job Plan, which outlines each step of the VE analysis through a flowchart (see [link](#)).

Mark explained that there are appointed VE Coordinators at each of the six WSDOT regional offices, as well as headquarters, and the State Ferries Division (located in Seattle). Each of these coordinators respond to requests from project managers throughout the region and serve as a resource to facilitate the completion of Value Engineering analyses. The list of designated VE coordinators can be found [here](#). The State VE Manager coordinates with the Capital Program Development and Management (CPDM) division and each of the Region VE Coordinators to prepare an Annual VE Plan, which is used for scheduling projects for VE analysis and serves as the basis for determining VE program needs for team members, consultants, project management appointments, and training opportunities. A list of prequalified engineering consultants is maintained by the Consultant Services Division of WSDOT in the event that a design-build project, or other project with varying complexities or unique traits warrant the use of outside experts.

The Annual VE Plan is maintained as a working document to coordinate efforts between headquarters and region management. The roles and responsibilities of each team member involved in the VE process are defined in the manual as follows:

- State VE Manager
 - Reviews regional plans regarding VE content and schedule

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- Coordinates VE studies
- State VE Coordinator
 - Incorporates the regional annual VE plans and the Headquarters plan to create the Statewide VE Plan
 - Prepares an annual VE Report
 - Maintains policies for the department
 - Maintains a statewide list of qualified VE team leaders
 - Arranges training for future VE team leaders and team members
- Region VE Coordinators
 - Identify region-level projects needing VE analyses (approx. 12-36 months in advance), using CPMS reports
 - Presents a list of identified project to headquarters and region management to prioritize into an annual VE plan
 - Identifies potential team leaders and team members for the study
 - Assists in the planning and coordination of the VE study, including obtaining necessary meeting space and equipment
 - Works with headquarters to schedule the VE study
- VE Team Leaders
 - Guides the team efforts in completing the VE study, including planning and scoping
 - Ensures proper application of the VE guide
 - Follows the VE Job Plan (policy)
 - Schedules a pre-workshop meeting with the project team
 - Prepares the pre-study and post-study documentation
 - Oversees any consultants or third-party participants' work in the VE study
- VE Team Members
 - Should be outside of the project management team, and not involved in the planning or development phases of the project
 - Should have expertise needed to address major functional areas of the project and critical high-cost issues of the proposed study
 - Should complete Value Methodology Fundamentals training prior to participating

Section 310.02(2) of the manual outlines the requirements for conducting VE studies. Mark explained that the State's current thresholds are lower than the federal requirements, and they will be moving to using the federal requirements fully in the future. The Department's requirements include all of the following:

- Projects with a total estimated cost exceeding \$25 million, regardless of the funding source,
- Bridge projects located on or off of the federal-aid system with an estimated total cost of more than \$20 million, regardless of the funding source,
- Major projects with Federal-Aid Highway Program funding attached, or
- Any other project for which the project manager, Secretary of Transportation, or FHWA deems to be appropriate for VE analysis.

VE analysis is recommended during one of four phases of a project: (1) The planning/pre-scoping phase; (2) Scoping; (3) Design; or (4) Design Approval. It is during these four phases that most important project decisions are made and the opportunity to alter and affect the design of the project can still occur with the potential for cost avoidance.

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We asked Mark how the project team initiates a VE study. Throughout the fiscal year, project managers send Mark's team summary reports of projects entering the design/preliminary engineering phase coded in Capital Program Management System (CPMS), which is a computer database used by the Department in managing the design aspects of its highway construction projects. **Key Control #2: Region Value Engineering Coordinators or Project Engineers identify upcoming projects that require a value engineering study, and notify headquarters by completing a Value Engineering Workshop Request Form. The Headquarters State Value Engineering Manager reviews this information along with project information from the CPMS outlining the region projects that are currently in development. (Control Activities/Monitoring).** There are also semi-annual Value Engineering and Risk Assessment (VERA) community of practice sessions during which time the State VE team presents updates to policies and procedures, as well as discusses timing of scheduled VE workshops.

The VE workshop is the meeting in which the study is conducted, and the Department has an approved Workshop Guide for conducting the workshops (see [VE Workshop Guide](#)). A 7-Phase Job Plan is also incorporated into the VE study, which details how each phase of the study is to be conducted. The 7 phases of the plan include:

1. Gather information
2. Functional analysis
3. Creative thinking on measures designed to improve performance, enhance quality, and/or reduce project costs
4. Evaluate and select ideas feasible for development
5. Develop ideas into recommendations
6. Present recommendations to stakeholders
7. Implement approved recommendations

The study begins with the Project Manager requesting a Value Engineering Study (via a Workshop Request Form; [VE Workshop Request Template](#)), sent to the responsible Region VE Coordinator at 10 to 12 weeks before the proposed study date. The Region VE Coordinator and State VE Coordinator determine team leader and team member assignments based on expertise and availability. A "study package" is prepared and dispersed to each of the team members to review at least one week prior to the study begin date. VE studies typically range from three to five days to complete. The VE Coordinator is highly trained and experienced in leading and conducting VE studies. WSDOT's Consultants and VE Team Leaders are all certified SAVE Certified Value Specialists.

At the completion of the VE study, a Final VE Analysis Report must be prepared, including all of the following:

- Executive Summary
- Short description of the VE process
- Project Overview and Background
- Project Constraints and Controlling Decisions
- Contact Information for VE Team Members
- Areas of VE Focus
- Description of the creative and evaluation processes used during the study
- Final Recommendations

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After the report has been prepared, the Project Manager and Project Team are responsible for implementing the approved recommendations, and documenting the reasons for which recommendations were not implemented on the project. This is done with the assistance of the Recommendation Approval Form (see [VE Recommendation Approval Form Template](#)). **Key Control #3: The Project Manager reviews and approves (or rejects) the VE Team's recommendations, and once this is done the Project Manager signs the VE Recommendation Approval Form. (Control Activities)** To ensure final recommendations are implemented, the Value Engineering Analysis office is responsible for following up with the assigned Project Manager to monitor implementation of the recommendations. This implementation occurs through incorporation of the recommendations into the written Plans, Specifications and Estimates for the project.

A copy of the Final Report must be retained in a Project File, and the Final Report is also shared with FHWA for all projects on the National Highway System (NHS) or involving federal-aid. We asked Mark if FHWA participates in the review of the report, or the VE studies themselves. Mark commented that for each study, the VE program includes FHWA in the planning and in some cases, FHWA representatives participate in the study. However, FHWA always requests an annual summary report of the VE studies conducted throughout the preceding Federal Fiscal Year (FFY).

Summary of Key Controls

Key Control #1: The Department maintains and documents its Value Engineering (VE) program criteria in the WSDOT Design Manual - Chapter 310, *Value Engineering*. This [manual](#) is submitted to the Federal Highway Administration (FHWA) of the U.S. Department of Transportation and reviewed for concurrence to ensure WSDOT's program design complies with federal requirements. (Control Activities, Information and Communication)

Key Control #2: Region Value Engineering Coordinators or Project Engineers identify upcoming projects that require a value engineering study, and notify headquarters by completing a Value Engineering Workshop Request Form. The Headquarters State Value Engineering Manager reviews this information along with project information from the CPMS outlining the region projects that are currently in development. (Control Activities)

Key Control #3: The Project Manager reviews and approves (or rejects) the VE Team's recommendations, and once this is done the Project Manager signs the VE Recommendation Approval Form. (Control Activities)

Evaluation of Results: We did not identify an internal control deficiencies based on our understanding above. We will proceed with testing the identified key internal controls in Step 5.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

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Procedure Step: Overview
Prepared By: BZH, 9/27/2022
Reviewed By: ACS, 10/10/2022

Purpose/Conclusion.

Purpose:

To obtain an overview of how the program operates in Washington State and identify Office policies under which our work will be performed.

Source:

Jesse Daniels, External Audit Liaison

Steven Meyeroff, FTA Compliance Administrator

Conclusion:

We have obtained an overview of how the program operates in Washington State and have also identified and documented Office policies under the Guidance/Criteria tab.

Testing Strategy.

SAO Policy on Federal Single Audit is documented under the Policy/Standards tab.

Step 1: Overview of Program

Prepare a brief overview of the program as it operates in Washington State. Include the following:

- Copy of the current Grant Award and Terms and Conditions - both regular federal funding as well as ARRA funding (if applicable)
- Copy of any and all approved Cost Allocation Plans and Indirect Cost Plans (if applicable)
- Determine whether any other state agency (ies) expended part of the grant award. This should be done through a combination of inquiry with the agency, checking the prior year SEFA, examining expenditure reports by vendor, etc. If any additional agency (ies) received 10% or more of the total grant, complete additional compliance matrixes for each agency (ies) to determine which compliance components are direct and material to the grant as a whole.
- Purpose of the program and how the program operates in Washington state
- Key personnel / audit liaison / departments or divisions
- Significant accounting or information systems and how the accounting or information systems tie to AFRS

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- Determine if any federal auditors/reviewers have reviewed the program in the last 2 years. If so, describe how their results will impact our audit
- Determine whether the agency has an internal audit function. If so, request and review internal audit reports that may have related to the program's single audit objectives and describe how their results will impact our audit.

Step 2: Agency Risk Assessment and Internal Control Review

Review the results of the Overall COSO Evaluation located at B.1.PRG-Overall COSO Evaluation and document any risks that may affect the program. For those risks associated with a particular compliance requirement(s) document this risk in the "Gain an Understanding of Internal Controls" step for that requirement.

Step 3: Grant Award Numbers and Amounts

Document the grant award numbers and the amount of each award for all grant awards drawn on during the fiscal year.

Step 4: Previous Audit Findings

Document all previous, unresolved findings, including audit number and title, and specify where in the audit we will be performing follow up audit work. Hyperlink to the finding package in the planning procedures (B.1: Planning) and specify the pages for the finding(s).

Guidance/Criteria:

SAO Audit Policy 5110 – Conducting Single Audits and Program-Specific Audits (effective 6/30/16)

BACKGROUND

Entities that spend more than a threshold amount in federal awards in a fiscal year are required to receive a single audit. The scope of a single audit includes an entity's financial statements, internal controls over federal programs and compliance with federal laws and regulations. OMB Circular A-133 and the Uniform Guidance permit an auditee to elect to have a program-specific audit if the auditee spends federal awards under only one program (excluding research and development) and the federal program regulations do not require a financial statement audit.

REQUIREMENTS

1. The Auditor's Office will conduct a single audit whenever an auditee expends more than the threshold amount in federal awards in a fiscal year.

Fiscal Year	Applicable Federal Guidance	Threshold Amount
Years beginning prior to 12/26/2014	OMB Circular A-133	\$500,000
Years beginning on or after 12/26/2014	Uniform Guidance	\$750,000

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If portions of the audit are performed by other independent accounting firms, the Office will be the principal auditor for purposes of issuing audit reports. Refer to Policy 3510 – Use of Independent CPA’s Work.

2. Auditors performing single audits will use all applicable steps in the TeamMate Single Audit planning and compliance audit programs.

3. Entities that spend more than the threshold amount in federal awards in a fiscal year have the option of obtaining a program-specific audit.

When an auditee expends federal awards under only one federal program (excluding Research & Development) and the federal program’s laws, regulations, or grant agreements do not require a financial statement audit of the auditee, the auditee may elect to have a program-specific audit.

A program-specific audit may not be elected for Research & Development unless all of the federal awards expended were received from the same federal agency, or the same federal agency and the same pass-through entity, and that federal agency, or pass-through entity in the case of a subrecipient, approves in advance a program-specific audit.

If an entity requests a program-specific audit, the auditor should work closely with the entity and the federal agency involved to ensure that the audit will meet the requirements

of section ____ .235 of Circular A-133 or §200.501(c) and §200.507 of the Uniform Guidance.

RELATED POLICIES

Entire Section 6000 – Financial Statement Audits

REFERENCES

Single Audit Act Amendments of 1996

Title 2 U.S. Code of Federal Regulations Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance)

OMB Circular A-133 – Audits of States, Local Governments, and Non-Profit Organizations

AU-C §935 – Compliance Audits

SAO Audit Policy 5120 – Audit Standards for Single Audits (effective 6/30/16)

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BACKGROUND

The Single Audit Act of 1984, the Single Audit Act Amendments of 1996, subsequent revisions to OMB Circular A-133 in 2003 by the U.S. Office of Management and Budget and the Uniform Guidance require audits of federal awards to be performed in accordance with specific auditing standards and regulations.

REQUIREMENTS

1. Single audits will be performed in accordance with the following standards and guidance, as applicable:

- Government Auditing Standards, published by the Comptroller General of the United States (Yellow Book)
- The American Institute of Certified Public Accountants Statements on Auditing Standards (also known as generally accepted auditing standards or GAAS)
- Title 2 U.S. Code of Federal Regulations Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance) (fiscal years beginning after December 25, 2014)
- Office of Management and Budget Circular A-133 (fiscal years beginning prior to December 26, 2014)

RELATED POLICIES

5110 - Conducting Single Audits and Program-Specific Audits

6110 - Standards to be Followed

REFERENCES

Single Audit Act of 1984 (P.L 98-502)

Single Audit Act Amendments of 1996 (P.L. 104-156)

Title 2 U.S. Code of Federal Regulations Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance)

OMB Circular A-133 – Audits of States, Local Governments, and Non-Profit Organizations

AU-C §935 – Compliance Audits

Yellow Book – Government Auditing Standards

SAO Audit Policy 5210 – Planning Single Audits (effective 6/30/16)

BACKGROUND

The Office of Management and Budget's (OMB) Circular A-133 and Uniform Guidance require a risk-based approach to identify major federal

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programs for audit. This risk-based approach involves specific steps that must be followed to meet audit requirements.

REQUIREMENTS

1. Auditors planning single audits will complete and document all applicable pre-planning steps in the TeamMate Single Audit program. Those steps include the following:

- Determining if the Schedule of Expenditures of Federal Awards is fairly presented.
- Determining if the entity qualifies as a low-risk auditee to be eligible for reduced audit coverage.
- Making a preliminary judgment about materiality.
- Identifying major programs to audit using a risk-based approach.
- Following up on prior audit findings, performing procedures to assess the reasonableness of the summary schedule of prior audit findings, and reporting as a current-year audit finding when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding.

2. Pre-planning procedures and preliminary audit plans should receive supervisory review in a timely manner.

Refer to Policy 3160 - Supervision and Review.

3. Auditors will communicate information to the auditee or audit committee regarding the nature, timing, and extent of planned testing and reporting.

Communication to the auditee must include planned testing and reporting on compliance with laws and regulations and internal control over financial reporting. Refer to Policies 2130 - Inviting Elected Officials to Entrance/Exit Conferences and 2210 - Conducting Entrance Conferences.

REFERENCES

Single Audit Act Amendments of 1996

Title 2 U.S. Code of Federal Regulations Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance)

OMB Circular A-133 – Audits of States, Local Governments, and Non-Profit Organizations

AU-C §935 – Compliance Audits

SAO Audit Policy 5310 – Auditing Internal Controls and Compliance for Federal Programs in Single Audits (effective 6/30/16)

BACKGROUND

When conducting a single audit under the Single Audit Act and the Office of Management and Budget's (OMB) Circular A-133 or Uniform Guidance, the auditor must determine whether the auditee's financial statements and schedule of expenditures of federal awards are fairly

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presented (refer to Policy section 6000); assess the inherent risk of noncompliance; obtain an understanding of internal controls over major programs and perform internal control testing; assess the risk of material noncompliance; and determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs.

For financial statement audits, Government Auditing Standards and generally accepted auditing standards have similar requirements concerning the auditor's consideration of internal controls. However, OMB Circular A-133 and the Uniform Guidance set forth specific requirements for documenting and testing internal controls over federal programs.

REQUIREMENTS

1. Auditors will identify federal compliance requirements applicable to each program selected for audit.

The principal compliance requirements applicable to most federal programs are listed in Part 3 of the OMB Compliance Supplement. Auditors should also consult Parts 2, 4, 5 and 7 of the supplement and review the provisions of contract and grant agreements to identify compliance requirements not listed in the compliance supplement.

If an applicable compliance requirement is determined to not have a direct and material effect on the program, the auditor does not have to audit the requirement. However, the basis for that decision must be documented in the audit working papers.

2. Auditors will assess the risk of material noncompliance for every direct and material compliance requirement.

The risk of material noncompliance is a combined assessment of inherent risk and control risk based on the auditor's professional judgment. The assessment may be low, moderate, or high. Assessing the risk of material noncompliance as high does not result in an audit finding. Rather, the auditor should consider the risk when designing the nature and extent of compliance testing.

In making this assessment, the auditor should inquire with management regarding findings and recommendations in reports or other written communications resulting from previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit. The auditor should gain an understanding of management's response to findings and recommendations that could have a material effect on the entity's compliance with the applicable compliance requirements (for example, taking corrective action).

The auditor should consider whether any risk of material noncompliance is also pervasive with respect to the entity's compliance with other compliance requirements. If so, the auditor should design an appropriate overall response to address this pervasive risk.

3. Auditors will assess inherent risk, obtain an understanding of relevant internal controls and make a preliminary control risk assessment.

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The auditor should determine whether there are any inherent risks of noncompliance and whether the auditee has implemented controls to mitigate the risks. The assessment of inherent risk includes risks of noncompliance due to fraud.

The nature and extent of the procedures performed in obtaining an understanding of internal controls over compliance should provide the auditor with sufficient knowledge to plan the audit to support a low assessed level of control risk for major programs. The auditor's understanding shall be summarized in the audit documentation. In obtaining an understanding of internal controls, auditors will consider the applicability of the following five components: the control environment, risk assessment, control activities, information and communication, and monitoring.

Once internal controls are documented and evaluated, auditors will make a preliminary control risk assessment. The risk assessment should be either "high" (maximum) or "low."

Control risk should be assessed as "low" when (1) there is only a remote likelihood that noncompliance that is material could occur and not be prevented, or detected and corrected, on a timely basis or (2) the auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance. Otherwise, assess control risk at the maximum.

If preliminary control risk is assessed as low, auditors must perform tests of controls as discussed below. If control risk is assessed at the maximum, control testing is not necessary. However, auditors must report the control deficiency in an audit finding as a significant deficiency or material weakness, and consider whether additional compliance tests are required because of ineffective controls.

4. Auditors will test internal controls to support a low assessed level of control risk and make a final control risk assessment.

Auditors will plan the testing of internal controls to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program. Auditors will test controls as planned and then assess final control risk.

5. Auditors will test the auditee's compliance with each applicable material compliance requirement.

Based on the risk of material noncompliance, auditors will plan substantive (compliance) testing to support the opinion on compliance with each material requirement. Auditors are referred to the suggested audit procedures in parts 3, 4 and 5 of the Compliance Supplement and audit programs in TeamMate to assist them in developing substantive compliance tests.

Compliance testing will include tests of transactions and other auditing procedures necessary to provide auditors sufficient and appropriate evidence to support an opinion on compliance. Testing will be designed to examine a representative number of charges or occurrences (e.g. reports) related to each compliance requirement.

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The following should be considered in determining the number of transactions to test:

- The amount of expenditures for the program.
- The extent to which program requirements have changed since the previous audit.
- The grantee's experience in administering the program.
- Prior auditor experience with the program.
- The extent to which the program is carried out through subrecipients.
- The extent to which the program contracts for goods and services.
- The level to which the program is already subject to program reviews or other forms of independent oversight.
- The adequacy of the controls for ensuring compliance.
- The auditor's expectations about compliance.
- The potential impact of adverse findings.

6. Based on the results of the compliance testing, auditors will evaluate the sufficiency and appropriateness of the audit evidence obtained and conclude on whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each major program.

Auditors will consider both known and likely questioned costs, and other noncompliance described in Policy 5410 in reaching their conclusion on compliance.

7. Auditors will perform audit procedures up to the date of the auditor's report related to all audited programs to obtain sufficient appropriate evidence that all subsequent events related to the entity's compliance during the period covered by the auditor's report have been identified and appropriately addressed.

RELATED POLICIES

3210 – Audit Evidence

3240 – Sampling

5410 – Federal Findings, Questioned Costs, and Management Letters

5510 – Reporting on Single Audits

6000 – Financial Statement Audits

6410 – Subsequent Events

REFERENCES

Single Audit Act of 1984 (P.L. 98-502)

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Single Audit Act Amendments of 1996 (P.L. 104-156)

Title 2 U.S. Code of Federal Regulations Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance) and Compliance Supplement

AU-C §315 – Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

AU-C §330 – Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained

AU-C §265 – Communicating Internal Control Related Matters Identified in an Audit

AU-C §530 – Audit Sampling

AU-C §935 – Compliance Audits

SAO Audit Policy 5410 – Federal Findings, Questioned Costs, and Management Letters (effective 6/30/16)

BACKGROUND

Instances of noncompliance usually vary in amount and degree. The level of reporting non-compliance will differ depending on the nature, severity, and pervasiveness of the problem.

REQUIREMENTS

1. Depending on materiality, noncompliance with federal laws and regulations may be reported as a finding, in a management letter, or as an exit conference item.

The Office of Management and Budget's (OMB) Circular A-133 and Uniform Guidance requires the auditor to report the following as findings:

- Material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program.
- Known or likely questioned costs that are greater than \$25,000 (\$10,000 under Circular A-133) for a type of compliance requirement for a major program.
- Known questioned costs that are greater than \$25,000 (\$10,000 under Circular A-133) for a type of compliance requirement that are identified in a non-major program during the audit.
- Known fraud affecting a federal program.

Determinations about whether an instance of noncompliance is material should be made at the individual compliance requirement level and program level. If an instance of noncompliance, including known and likely questioned costs and other noncompliance, is considered material for a particular compliance requirement, a finding should be reported. If accumulated findings and questioned costs are material to the program as a whole, auditors should consider qualifying the opinion on the auditee's compliance with requirements applicable to each major program.

Auditors should not communicate a material instance of noncompliance in a management letter or exit conference item in lieu of reporting it as a

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finding in the audit report.

2. Depending on the likelihood of noncompliance and the magnitude of the potential noncompliance, deficiencies in internal controls over federal programs may be reported as a finding, in a management letter, or as an exit conference item.

Auditors should not communicate a significant deficiency or material weakness over internal controls in a management letter or exit conference item. Circular A-133, AICPA Statements on Auditing Standards (AU-C 935) and the Uniform Guidance require auditors to report both of these types of deficiencies in internal control over major programs as a finding.

Significant deficiencies and material weaknesses are defined in the AICPA's Statements on Auditing Standards (AU-C §935) as follows:

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

3. The appropriate director or designee must approve the use of management letters to report issues identified during single audits.

Although the use of management letters is an option under this policy, the Office expects that such instances will be rare. Audit managers must obtain the approval of their director or designee to use a management letter to report an issue identified in a single audit.

4. Except as noted under Item 3 above, auditors will follow the protocol for reporting identified audit issues in Policy 2310.

They also will follow the detailed guidance on preparing findings and management letters in the Audit Report Standards Manual.

RELATED POLICIES

2310 – Reporting Identified Audit Issues

5510 - Single Audit Reports

Audit Report Standards (ARS) Manual - Part 3, Chapters 6 and 7, and Part 5, Chapters 1, 2, 3 and 7

REFERENCES

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Single Audit Act of 1984 (P.L. 98-502)

Single Audit Act Amendments of 1996 (P.L. 104-156)

Title 2 U.S. Code of Federal Regulations Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance)

OMB Circular A-133 – Audits of States, Local Governments, and Non-Profit Organizations

AU-C §935 – Compliance Audits

SAO Audit Policy 5510 – Reporting on Single Audits (effective 6/30/16)

BACKGROUND

At the conclusion of the single audit, the auditor is required to issue reports related to compliance with federal grant requirements and internal controls over compliance, fair presentation of the financial statement(s) in accordance with the applicable reporting framework, and on internal controls and compliance and other matters under Government Auditing Standards.

The Audit Report Standards Manual identifies the specific audit reports for financial statement and single audits and contains guidance on preparing those reports. The Online Report Creation and Automation application (ORCA) is a tool designed to increase efficiency and accuracy for preparing audit reports. If an audit situation requires a report that is not covered in these resources, auditors should consult with their supervisor and manager, and with Team Audit Support/Quality Assurance.

REQUIREMENTS

1. Engagement results for single audits will be reported according to the guidelines provided in the Audit Reports Standards Manual.

2. Opinions other than unmodified for a major program must be reviewed by TAS/QA. Those opinions will be forwarded to the appropriate director or designee by TAS/QA.

3. If an auditor later becomes aware of omitted procedures that may have been necessary to support our opinion, errors or omitted federal programs related to the schedule of expenditures of federal awards or of information that existed at the date of the report that, had we been aware of it, may have affected our audit or report, the audit manager will consult with TAS/QA and their assistant director for additional information.

Auditors should follow the procedures outlined in Policy 6520 in these cases and, if the report is reissued, include a paragraph describing the reasons for reissuance and any changes from the original report.

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RELATED POLICIES

5410 – Federal Findings, Questioned Costs and Management Letters

6520 - Consideration of Omitted Procedures After the Report Date and Subsequent Discovery of Facts Existing at the Report Date

REFERENCES

Single Audit Act of 1984 (P.L 98-502)

Single Audit Act Amendments of 1996 (P.L. 104-156)

Title 2 U.S. Code of Federal Regulations Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance)

OMB Circular A-133 – Audits of States, Local Governments, and Non-Profit Organizations

AU-C §935 – Compliance Audits

Record of Work Done.

Step 1: Overview of Program

We obtained the Current Grant Awards and Terms and Conditions from the agency. See below for a copy of the most current grant awards and terms and conditions.

- Washington State Department of Transportation (WSDOT) [[WA 2017-2021 COMBINED PDF](#)].
- Washington State Ferries (WSF) [[WA-2021-022-00 STATE FERRY GRANT](#)].

We obtained copies of approved Cost Allocation Plans and Indirect Cost Plans: [[August 2019 - PTD Grants Guidebook p.37](#)].

We determined no other state agency(ies) expended 10% or more of the total state grant award expenditures during the fiscal year.

Purpose of the program and how it operates in Washington state:

The objectives of the Formula Grants for Rural Areas (Section 5311) program are to initiate, improve, or continue public transportation service in rural areas by providing financial assistance for operating, planning, administrative expenses, and the acquisition, construction, and improvement of facilities and equipment. In addition, Section 5311(f) specifically provides for the support of rural intercity bus service. The Rural Transit Assistance Program (RTAP), Section 5311(b)(3), provides additional funding for training, technical assistance, research, and related support services to support rural transit service.

State Agencies

The Federal Transit Administration (FTA) annually publishes formula apportionments to the states in a *Federal Register* notice published within 10 days after the Department of Transportation (DOT) Appropriations Act is signed into law. The governor of each state designates a state agency to administer the program. The state is responsible for fair distribution of the funds in the state, including Indian reservations. The state may also provide transit service directly, or through contracts with private operators. The state describes its procedures for administering the program in a state management plan. The state applies to FTA for approval of a program of projects, usually annually, and reports annually to FTA on financial status and revisions to the program of projects. The state agency may be the recipient on behalf of Indian tribes that are subrecipients, but federally recognized tribes may also elect to apply to FTA as a direct recipient. FTA monitors compliance with federal requirements through administrative “State Management Reviews,” generally every three years.

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Appalachian Development Public Transportation Assistance Program

The Appalachian Development Public Transportation Assistance Program is a formula program under the Section 5311 program that provides additional funding to support public transportation in the Appalachian region. Recipients may use these funds for any purpose that is eligible under Section 5311. There are 13 eligible states that receive an allocation under this provision - Washington State is not one of them.

Not Applicable.

Tribal Transit Program

The Tribal Transit Program (TTP) under the 5311 program includes both formula and discretionary components. Federally recognized Indian tribes are eligible direct recipients and apply directly to FTA. Under the discretionary program, funds are made available annually on a competitive basis. Recipients of TTP funds may use these funds for any purpose that is eligible under Section 5311.

Not Applicable.

Subrecipients

Except for the TTP, the state selects subrecipients and monitors their compliance with federal requirements. FTA does not directly monitor the subrecipients but checks the state's procedures for monitoring subrecipients during the State Management Review. The state may impose program criteria in addition to those imposed by the FTA and may require additional reports from subrecipients. These state requirements are included in the State Management Plan. [See: State Mngt Plan_M3078_05.2021].

Source of Governing Requirements

This program is authorized by 49 USC 5311. Program regulations are in 49 CFR parts 601 through 665. Note that certain exceptions or dollar thresholds in these rules may exclude many rural transit activities. In referring to the program, FTA uses the term "rural" to include both rural and small urban areas (all areas not included in the urbanized areas designated by the US Bureau of the Census). .

Availability of Other Program Information

Information about the program may be found on the FTA website at <http://www.fta.dot.gov/>. Program Guidance and Application Instructions are contained in FTA Circulars, which may be found on the website.

Key Personnel/Audit Liaison/Departments or Divisions

- Jesse Daniels, External Audit Liaison

Significant Accounting or Information Systems

- Transit Award Management System (TrAMS) - This is an internal awards management system used to track grant award allocations and obligations. It replaced TEAM.
- TEAM - This is the old internal award management system that was replaced by TrAMS, some grant awards are still leftover this system.
- TRAINS - TRAINS is the FTA's internal accounting system used to track grant expenditures.
- Electronic Clearing House Operation System (ECHO) - This is the federal draw down system used when requesting federal reimbursements.

State of Washington

Federal Auditors/Reviewers

- No federal audits occurred during SFY '22.

Internal Audit Reports

- Federal Transit Administration (FTA) Fiscal Year 2021 Combined Triennial and State Management Review – [[WSDOT FTA Triennial State Management Review - 2021 Report](#)].

Step 2: Agency Risk Assessment and Internal Control Review

We requested information from the agency regarding their ongoing risk assessment processes, internal control reviews, and the annual assurance the agency is required to provide to OFM stating they completed these processes. The results of this inquiry are documented at B.1.PRG-Overall COSO Evaluation.

Step 3: Grant Award Numbers and Amounts

- **WA-2017-66-00** - \$23,870,593
- **WA-2018-77-00** - \$14,624,794
- **WA-2018-77-01** - \$25,565,360
- **WA-2019-901-00** - \$26,870,198
- **WA-2020-038-00** - \$44,121,608
- **WA-2020-132-01** - \$25,281,308
- **WA-2021-052-00** - \$83,136,662
- **WA-2021-130-00** - \$28,280,343
- **WA-2021-022-00_SF** - \$80,000,000

Step 4: Previous Audit Findings

There are no prior year audit findings.

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Expenditure / Revenue Analysis

Prepared By: JDP, 6/6/2022

Reviewed By: ACS, 7/28/2022

Purpose/Conclusion.*

State of Washington

Purpose:

To document the grant expenditures for the program.

Source:

Suzi Freelund - Accounting & Reporting Manager
Transportation Accounting Information System (TRAINS)
Jesse Daniels - Audit Liaison

Conclusion:

We documented the grant expenditures for the program.

Testing Strategy:

Grant Expenditures

Obtain an expenditure report for the period under audit that shows objects/subobjects of expenditures and direct/indirect costs for the program for each agency that received 10% or more of grant funds (e.g., salaries and benefits, vendor payments, travel, grants to subrecipients, etc.). Include accruals in the report (s). When requesting agency expenditure coding verify and document from two sources, one of which should be the SEFA preparer for the program. Insert Enterprise coding used to capture scope of audit expenditures. Make sure to include who provided us with the Enterprise coding that was used (source). If their audit expenditures are not captured through Enterprise (i.e., food assistance benefits) please include additional supporting documentation that will be used to determine total program expenditures.

Things to look for:

Review vendor reports for expenditures to other state agencies (looking for other agencies expending 10% or more)

Total salaries/benefits - include all object A and B and TA and TB

Procurement - Are there contracts or expenditures that the could/should be the result of procurement?

Suspension/Debarment - Are there subrecipients or vendors expending \$25,000 or more?

SubMonitoring - Does it look like they have subrecipients?

Program Income - Do revenue and expenditures seem appropriate for the grant or could there be program income? (Program income could be shown as revenue or negative expenditures.)

New step: Once the expenditure report has been run, send it to the appropriate fiscal contact at the agency and ask them to confirm it is accurate and complete.

Guidance/Criteria:

State of Washington

Record of Work Done:

Grant Expenditures

Expenditure report used to capture scope of audit expenditures for SFY22 is (See. [Preliminary Expenditure Revenue Analysis](#)). Jesse Daniels, Audit Liaison submitted the report to our Office on behalf of WSDOT.

Note: WSDOT utilizes an in-house accounting information system called TRAINS, and the expenditure activity for federal programs is not identifiable in AFRS. Therefore, we requested the Department provide us with expenditure and revenue activity reports from TRAINS for our analysis. Preliminary TRAINS reports were provided by WSDOT (Suzi Freelund) on 5/27/2022 and used to determine materiality of compliance areas for the program.

We also entered expenditure coding into the spreadsheet located at (See. [Expenditure Coding-Major Programs](#)) for use in reconciling the SEFA.

Account Coding from TRAINS:

Biennium: 2021-2023

Fiscal Year: 2022

CFDA Program Number: 20.509

Account Type: 22 (Expenditures/Expenses) and 31 (Revenue/funds received from other agencies)

Total funds expended for this program through 5/27/2022 were \$48,870,103.92. We specifically requested the Department include all disbursements including expenditure accruals.

We identified the following expenditure activities as direct and material to the program :

- Other Grants, Benefits & Client [to subrecipients] (subobject NZ) = \$26,661,541.91 (54.56%)
- Salaries and Wages (subobject TA) = \$20,674,528.80 (42.31%)

Final revenue/expenditure analysis will be documented after FY-end occurs at (See [Expenditure/Revenue Updates and Final](#)).

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Compliance Requirements

Prepared By: BZH, 9/22/2022

Reviewed By: ACS, 10/10/2022

State of Washington

Purpose/Conclusion.

Purpose:

To determine the compliance requirements that have a direct and material effect for this major program.

Source:

OMB Uniform Guidance Compliance Supplement

Conclusion:

We have determined the compliance requirements that are direct and material to the program.

Testing Strategy.

IDENTIFY DIRECT AND MATERIAL COMPLIANCE REQUIREMENTS

Determine if the requirement is direct *and* material for your auditee's award and activity (document your decisions on the attached Major Federal Program worksheet). Make sure to consider additional requirements in the grant contract/application. "Direct" means the activity is applicable/occurred for the federal award being audited while "material" is determined as:

At a Glance:

Materiality	Is material when...	Example Materiality
Quantitative	Costs or activity related to the requirement exceeds our threshold established in the planning stage, usually 5% of total program expenditures.	They procured \$100,000 of equipment during the audit period, which is 15% of the expenditures. The procurement compliance requirement is material.
Qualitative	Usually when the requirement is specifically listed in Part 4 of the Compliance Supplement. (even if it is below quantitative materiality.) Other considerations are possible.	Quantitative materiality is 5%. The Compliance Supplement includes a 3% earmark for your program. It is material even though it is less than 5%.

If you have any questions as to whether a compliance requirement should be considered direct and material consult the SWSA AIC or SWSA supervisor.

Reminders:

- If you choose not to audit a certain compliance area, you must document the reason(s) for this decision in the attached worksheet.
- Refer to the Policy/Criteria tab for more guidance and examples.

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- ARRA Alerts have been removed from this testing strategy. However, be aware that there may be a few lingering programs to which it may apply.
- The Compliance Supplement divides Part 3 (compliance requirements) into two sections to accommodate the continuing government-wide transition from the OMB Circular A-102 (Common Rule)/A-110 to Uniform Guidance (2 CFR 200). Section 3.1 covers the requirements for A-102/A-110 and Section 3.2 covers Uniform Guidance requirements (for awards issued on or after 12/26/14). The award should specify which requirements apply.

DIRECT AND MATERIAL CONSIDERATIONS FOR THE 12 BASIC COMPLIANCE REQUIREMENTS

A. Activities Allowed or Unallowed - This requirement is direct and material to most awards by its nature. Generally does not apply to:

- 1) fixed price awards (where they meet milestones instead applying costs against the award)
- 2) most fee-for-service awards (e.g. 10.555 National School Lunch Program).

B. Allowable Costs / Cost Principles: This requirement is applicable to most awards* and is direct and material when costs charged to the program meets or exceeds our threshold established in planning, usually 10%. The cost principles do not apply to (2 CFR 200.401):

- Arrangements under which federal financing is in the form of loans, scholarships, fellowships, traineeships, or other fixed amounts based on such items as education allowance or published tuition rates and fees
- For institutions of higher education, capitation awards, which are awards based on case counts or number of beneficiaries according to the terms and conditions of the federal award.
- Fixed amount awards. See also Subpart A—Acronyms and Definitions, §§200.45 Fixed amount awards and 200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts.
- Other awards under which the non-federal entity is not required to account to the federal government for actual costs incurred.

**See Appendix I to the Compliance Supplement for programs excluded from the Cost Principles*

C. Cash Management - This requirement is always direct and material to cash awards, whether the entity operates on a reimbursement or cash advance basis. It is not applicable for non-cash awards (e.g. federal equipment, real property, supplies or commodities received). You must identify and test internal controls (unless not applicable per the applicable compliance supplement).

D. D. RESERVED. The Davis-Bacon Act requirements were moved to the Special Tests and Provisions section (section N). The requirements are found on page *20.001 Wage Rate Requirements Cross-Cutting Section* of the Compliance Supplement.

E. Eligibility - This requirement is “direct” when a program has targeted participants (e.g. Section 8 housing and school Nutrition Cluster participants must be low-income). It is qualitatively material when an eligibility requirement is included in the program’s scope per the Compliance

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Supplement or award documents.

F. Equipment and Real Property Management

Equipment Management -- Grants and Cooperative Agreements - States

State must use, manage, and dispose of equipment acquired under a Federal award in accordance with State laws and procedures (2 CFR section 200.313(b)).

Real Property Management -- Grants and Cooperative Agreements - federal criteria applies 2 CFR 200.311

Determining materiality for this requirement should include qualitative measures because the audit objective encompasses testing requirements related to:

Inventory, maintenance, and safeguarding of equipment from the same program/CFDA obtained during the audit period and in the past;
Disposal of equipment or real property over \$5,000 from the same program/CFDA from assets obtained during the audit period and in the past; and

Acquisition and/or improvement of equipment or real property during the audit period.

Use auditor judgement to determine the significance of these activities in relation to the program. Consider things such as the amount of federal equipment from this program (for example a fleet of vehicles currently and/or previously purchased with the same type of federal funds would be hard to justify not being material), current purchases/construction is significant to the award project or total expenditures, etc.

G. Matching - This is "direct" when an entity is required to contribute state/local funds to "match" the federal award. It is qualitatively material when it is included in the program's scope per the Compliance Supplement or awarding documents. Also, consider that if they provide less match than required, it could result in questioned costs. See an example in the policy tab.

G. Level of Effort - This is "direct" when an entity is required to complete a minimum level of effort, such as Maintenance of Effort or Supplanting. It is qualitatively material when it is included in the program's scope per the Compliance Supplement or awarding documents.

G. Earmarking - This is "direct" when an entity is required to set aside funding for certain purposes. The requirement is qualitatively material when the requirement is included in the Compliance Supplement, despite the size of the earmark.

In general, an approved grant budget in a contract does not constitute "earmarking." Grantees must communicate with their grantor agency when they plan to deviate more than 10% among budgeted line items, but this is not the focus of earmarking. You may find earmarking related to program administration costs, which is also tied to the grant budget, but these types of earmarks are usually listed in Part 4 of the compliance supplement. Consult with the SWSA AIC or SWSA supervisor as needed.

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H. Period of Performance (formerly Availability) - It is qualitatively "direct *and* material" when the award *starts* and/or *ends* during the audit period.

*Note: We have to audit whether costs are in the period of performance as one of the cost principles (test B). However, we only identify and test key controls over the period of performance when it is direct and material. We may also perform additional risk-based testing.

I. Procurement and Suspension and Debarment

Procurement – quantitative measures are generally used in determining materiality with additional qualitative considerations. When determining whether this area is direct and material, consider the procurements that took place (or should have taken place) during the audit period (e.g., seeking quotes, advertising for bids, change orders, renewing a contract that has expired, etc.). **In order to determine whether Procurement is direct and material, you must first obtain a listing of all contracts that are subject to procurement requirements that were executed during the audit period. The total amount of these contracts (and any other expenditures that should have been properly procured) should be combined and that amount used to determine whether the Procurement is direct and material to the audit.** Also, if you believe reoccurring payments to certain vendors have never been properly procured in the past, you should examine this arrangement and consider adding them to the amount used to determine materiality.

Suspension and Debarment – Determining materiality for this requirement should include a quantitative analysis that combines the dollar value of all covered transactions (as identified in the chart below) entered into during the audit period. This applies to any vendor contract (or purchase) that exceeds \$25,000 and **all subrecipient** agreements. In some cases qualitative factors also need to be considered. For example, if the agency entered into contracts with no defined dollar values at the time of execution (i.e. fee for service) or if there were a large number of transactions that did not combine to be material, but the volume of transactions are significant enough to possibly warrant testing. Any questions regarding these qualitative factors should be brought to the SWSA supervisor or AIC.

Award made to:	Threshold
Subrecipient	No threshold. They must verify suspension and debarment for each new subaward.
Vendor/Contractor	Contracts and purchases over \$25,000. Applies to each new contract (or total purchases to one vendor/contractor during the audit period).

J. Program Income - This is "direct" when the operations of the federal program generate money (e.g. collection of loan origination fees for loan programs, inoculation fees for vaccine programs, or sale proceeds from federally purchased/improved assets for some programs.) Use

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quantitative materiality to determine if either program income revenue or program income expenditures during the audit period are material since the requirement focuses on both the collection and management of the revenue, and the associated expenditures.

K. RESERVED - There are no requirements for this section.

L. Reporting - This is "direct" and qualitatively material when the entity is required to complete reports per the Compliance Supplement or grant agreement, or submits reimbursement requests or advance requests.

CAUTION: Per the Addendum to the 2020 Compliance Supplement:

Federal Funding Accountability and Transparency Act (FFATA)

Under the requirements of the Federal Funding Accountability and Transparency Act (Pub. L. No. 109-282) (Transparency Act) that are codified in 2 CFR Part 170, recipients (i.e., direct recipients) of grants or cooperative agreements who make first tier subawards of \$25,000 or more are required to register in the Federal Funding Accountability and Transparency Act Subaward Reporting System (FSRS) and report subaward data through FSRS. Information input to FSRS is available at USASpending.gov as the publicly available website for viewing this information (<https://www.usaspending.gov/search>).

For all COVID-19 programs included in the addendum, with the exception of the Coronavirus Relief Fund, in which the reporting type of compliance requirement is marked as a Y in the Part 2 Matrix of Compliance Requirements indicating it is subject to audit, auditors must test the compliance with the reporting requirements of 2 CFR Part 170 (*referring to the Transparency Act*) using the guidance in this section (*referring to 3-L of the 2020 Compliance Supplement Addendum*) when the auditor determines reporting to be direct and material and the recipient makes first tier awards.

In addition, for audits of fiscal year ends after September 30, 2020, the requirement in the previous paragraph is extended to all selected major programs, regardless of whether COVID-19 funding is involved. That is, for all major programs in which the Part 2 matrix is marked as Y for the reporting type of compliance requirement, auditors must test compliance with the reporting requirements of 2 CFR Part 170 using the guidance in this section when the auditor determines reporting to be direct and material and the recipient makes first tier subawards. This testing is in addition to other financial, performance, or special reporting requirements that may be identified in parts 3 (section 3.L), 4, and 5. This requirement also extends to major programs not included in the 2020 *Compliance Supplement* when the auditors determine reporting to be direct and material and the recipient makes first-tier subawards.

M. Subrecipient Monitoring - This is "direct" when the entity has subrecipients. It is quantitatively material when total disbursements to subrecipients is at least 5% of the program's expenditures during the audit period.

NOTE: If you are not sure if a lower tier is a subrecipient or a contractor, consult with the auditee, the relationship should be defined in the contract/agreement (required per the Uniform Guidance). It is the substance of the award that determines how it should be treated and ultimately it is the pass-through entities responsibility to determine the relationship and identify the relationship in the awarding documents. You can refer to

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the subrecipient/contractor checklist available on INTRANET/REFERENCE GUIDE/FEDERAL if you are not sure if a lower tier party is a subrecipient or vendor.

N. Special Tests and Provisions

- a. The requirement is included in the Compliance Supplement, Part 4, for your program and:
 - 1) it applies to your entity type (state or local)
 - 2) and/or it applies to the activity of the audit period (e.g. if there is a special test for the relocation of utilities on highway right-of-ways [CFDA 20.205] but there were no utilities in the project, then it doesn't apply.)
- b. The requirement is included in the award contract between the auditee and their grantor. Limit the testing to those that:
 - 1) can result in material noncompliance and/or known questioned costs exceeding \$25,000
 - 2) affect a significant part of the program (significant dollar amounts)
 - 3) there are penalties for non-compliance, such as the entity must repay the award or the grantor will reduce future awards.

Guidance/Criteria:

COMPLIANCE SUPPLEMENT

The auditor must use the compliance supplement that is applicable for the period under audit. For example, the auditor must use the **2019** Compliance Supplement for audits of fiscal years beginning after 6/30/18. The Compliance Supplement contains guidance from the Uniform Guidance (2 CFR 200) and the OMB Circulars.

Which Compliance Requirements Do I Test?

1. Use the following sources of information to identify the compliance requirements that apply to your grant program.
 - Obtain a copy of the grant agreement(s) or contract(s) that were in effect during the audit period.
 - Obtain a report of federal expenditures for the program (sorted by object) and determine the areas in which funds were spent.
Examples: salaries and benefits, materials/supplies, equipment, travel, contracts for goods and services, construction, etc.
 - Review the Compliance Supplement available on the SAO Intranet under AUDITOR RESOURCES / REFERENCE GUIDE / FEDERAL:

Breakout of the Compliance Supplement parts:

--Part 2 (matrix of programs – this will assist you in identifying which of the 12 areas are potentially applicable to your program).

--Part 3 (this is general information on all 12 compliance areas). **NOTE:** The Compliance Supplement divides Part 3 (compliance requirements) into two sections to accommodate the continuing government-wide transition from the OMB Circular A-102 (Common Rule)/A-110 to Uniform Guidance (2 CFR 200). Section 3.1 covers the requirements for A-102/A-110 and Section 3.2 covers Uniform Guidance requirements (for awards issued on or after 12/26/14). The grant agreement/contract should specify which requirements apply.

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--Part 4 (this is program-specific guidance for certain compliance areas like allowable activities, eligibility, matching, reporting, etc. and contains a copy of the compliance matrix from Part 2 related to it)

NOTE: Part 4 will not address all of the compliance requirements - it is designed to give you specific information for certain areas that are unique to a federal program. Other areas that are more general in nature (e.g., cash management, equipment, etc.) will not be listed in Part 4, but still could be applicable to your grant (so look to Part 3).

--Part 7 (this is guidance for programs not included in Part 4 of the supplement). If available, obtain a copy of federal handbook or program guidelines (most federal websites will have this information).

2. Next, of the requirements that apply to your grant, determine those that have a direct and material effect. You can limit your testing to only those compliance areas that have a **direct** and **material** effect on the program. Even though a compliance requirement applies to the Federal program in general, it may not apply at a particular auditee, either because that auditee did not have activity subject to that type of compliance requirement or the activity does not have a material effect on a major program.

Examples:

(1) You are auditing a city that received a pass-through grant from a state agency. You look in Part 4 of the Compliance Supplement and see that a federal Financial Status Report (called the 'SF269') is listed as being applicable to the program. However, you find that this **Reporting** requirement is a responsibility of the state pass-through agency, not your city. Therefore, this compliance area is not applicable to your audit.

(2) You read the terms and conditions of the grant agreement and see that the **Period of Performance of Funding** is for three years, with a beginning date that started before your audit period and an ending date that closes after your audit period. While this requirement applies to the grant, it is not direct and material in your audit period.

(3) You find in the grant agreement that the auditee is required to comply with all state and local laws for **Procurement** of goods and services. Your review of the auditee's transactions shows only two vendor purchases totaling \$5,000. The total grant award was \$200,000. Therefore, procurement is applicable, but it is not material to your audit (i.e., transactions relating to the procurement requirement were only 2.5% of the total grant when our minimum materiality threshold was established at 5%).

(4) For **Equipment**, using the same information in #3, the total purchases were only \$5,000, 2.5% of the program. But in the last three years, the auditee has received a contract from the same program (same CFDA number) and has 100 pieces of equipment from that program with a total acquisition cost of \$300,000. On a qualitative level, there are many pieces of equipment associated with the program. Although purchases are not significant this year, there are continuing requirements on the other equipment items that we would test such as inventory procedures and disposal. Therefore we would pick the requirement as direct and material.

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(5) A grantee earned and spent \$25,000 of **Program Income** during the year. This amount is 1% of the total grant. Even though this amount meets our \$25,000 questioned cost threshold, this does not cause Program Income to be a material compliance area because it is less than 5%. (During your planning, or in the course of the audit, if you become aware of known questioned costs that exceed \$25,000 in a compliance requirement that is not otherwise material to the program, we should report this in a finding.)

MATCHING MATERIALITY EXAMPLE

This is "direct" when an entity is required to contribute state/local funds to "match" the federal award. It is always qualitatively material when it is included in the program's scope per the Compliance Supplement or contract/agreement. Also, consider that if they provide less match than required, it could result in questioned costs.

For example, a \$100,000 award was 95% federal and 5% local match. The entity applied \$95,000 to the federal award and was reimbursed. If they only had \$4,000 in allowable match costs that means:

1. \$4,000 must represent 5% of the program.
2. The total program at that point is only \$80,000 ($\$4,000/5\% = \$80,000$).
3. Allowable federal expenditures could not exceed \$76,000 ($\$80,000 \times 95\% = \$76,000$).
4. We would identify *questioned costs* of \$19,000 ($\$95,000 - \$76,000 = \$19,000$).

Record of Work Done:

The attached spreadsheet documents the determination of compliance requirements that are direct and material (quantitative materiality threshold is 5%) to this major program, see: [\[SWSA Major Program\]](#). We also determined which compliance areas were not selected for the audit. We performed the following steps:

- Reviewed OMB Uniform Guidance Compliance Supplement Part 2 compliance matrix for areas that must be considered for the program.
- Ran an expenditure report by subobject using the coding obtained from the agency to determine materiality (5% or more of total expenditures), see: [\[Preliminary Expenditure Revenue Analysis\]](#).
- Reviewed OMB Uniform Guidance Compliance Supplement Part 4 for program specific guidance.

We identified the following areas to be direct and material to the federal program and completed the corresponding Internal Control Request letters:

- Activities Allowed/Cost Principles: [\[ICRL - Activities Allowed/Cost Principles - WSDOT\]](#).
- Cash Management: [\[ICRL - Cash Management - WSDOT\]](#).
- Procurement/Suspension and Debarment: [\[ICRL - Suspension & Debarment \(subrecipients\) - WSDOT\]](#).
- Subrecipient Monitoring: [\[ICRL - Subrecipient Monitoring - WSDOT\]](#).

We determined the following areas **are not direct and material** to the program:

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- Equipment & Real Property Management
 - We requested a listing of all equipment items and/or real properties acquired with, or improved with Formula Grants. Steven Meyeroff responded on 8/9/2022 confirming the Department has no equipment or real property acquired with Formula Grants funding.

Conclusion:

We have determined the compliance requirements that are direct and material to the program.

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Expenditure/Revenue Updates and Final

Prepared By: BZH, 9/14/2022

Reviewed By: ACS, 9/22/2022

Purpose/Conclusion.:

Purpose:

To document the updated and final grant expenditures for the program.

Source:

WebIntelligence

Jesse Daniels, External Audit Liaison

Conclusion:

We documented the updated and final grant expenditures for the program.

Testing Strategy.:

If planning was performed before year-end, expenditure reports should be rerun approximately every two weeks until final. We do not have to include those updated reports in the audit, only analyze and document whether any new compliance requirements became material or went from material to not material. Document this in the Record of Work Done.

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Guidance/Criteria:

Record of Work Done:

Expenditure Updates

We obtained updated TRAINS expenditure reports from Suzi Freelund, Accounting & Reporting Manager, in order to determine whether any compliance areas changed materiality level after the initial expenditure analysis. We determined:

- 09/14/2022 - no new compliance areas became direct and material.

Final Expenditures

Our final expenditure report ran on September 14th, 2022 determined the program expended a total of \$81,873,009.31 for SFY '22 [FINAL Expenditures and Revenue]. We also reviewed the final expenditures to determine whether additional compliance requirements became direct and material. We determined no compliance areas became direct and material. We determined no new expenditure activities became direct and material.

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: SEFA Reconciliation

Prepared By: BZH, 9/22/2022

Reviewed By: ACS, 9/27/2022

Purpose/Conclusion:

Purpose:

To determine whether TRAINS accurately reflects expenditures charged to the federal grant during our audit period.

To determine whether federal grant expenditures as reported in TRAINS reconcile to SFY 2022 SEFA totals reported to OFM in the SFY 2022 Federal Disclosure Forms.

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Source:

Enterprise Reporting System

OFM Federal Disclosure Form

Web Intelligence Reporting

Jesse Daniels, External Audit Liaison

Conclusion:

We determined TRAINS accurately reflected expenditures charged to the federal grant during our audit period. No exceptions noted.

We determined that federal expenditures reported on the SEFA Federal Disclosure Forms adequately reconciled to amounts reported in AFRS during the audit period. No exceptions noted.

We updated the spreadsheet located at B.2.1 [[Expenditure Coding-Major Programs](#) SEFA vs D Forms vs AFRS tab].

Testing Strategy:

Note:

COVID-19 Expenditures: Per OMB M-20-26 and the 2020 Compliance Supplement, governments must separately identify COVID-19 expenditures on the SEFA, DCF and audit findings by identifying COVID-19 expenditures on a separate line by CFDA number with "COVID-19" as a prefix to the program name (including new COVID-19 only programs).

Donated Personal Protective Equip (PPE) – (per Appendix VII of the Addendum to the 2020 Compliance Supplement) During the emergency period of COVID-19 pandemic and as allowed under OMB Memorandum M-20-20 (April 9, 2020), federal agencies and recipients can donate PPE purchased with federal assistance funds to various entities for the COVID-19 response. The donated PPE were mostly provided without any compliance or reporting requirements or assistance listing (CFDA) information from the donors. As such, the non-federal entities that received donated PPE should provide the fair market value of the PPE at the time of receipt as a stand-alone footnote accompanying their SEFA. The amount of donated PPE should not be counted for purposes of determining the threshold for a single audit or determining the type A/B threshold for major programs, and is not required to be audited as a major program. Because donated PPE has no bearing on the single audit, the donated PPE footnote may be marked "unaudited".

COVID -19 Vaccines – The COVID-19 vaccines are not considered Federal financial assistance in accordance with 45 CFR part 75 and therefore would not be included as expenditures in the SEFA. For the purposes of the Vaccination Program, COVID-19 vaccine doses do not transfer to recipients, but, rather, remain federal property until the point at which they are administered to individuals. Therefore, it has been determined

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that the vaccines do not meet the definition of Federal financial assistance.

Step 1

Obtain an AFRS expenditure report for the federal grant(s) showing expenditures charged to the grant(s) during the state fiscal year. Also, obtain an AFRS expenditure report showing grant expenditures paid to subrecipients, if applicable.

Step 2

Document any exceptions or risks identified during the audit that could affect the SEFA reconciliation. Examples: Any risks or exceptions of the Agency's claims for reimbursement not being recorded in AFRS, or the program expenditures not being properly coded to the grant in AFRS.

Step 3

Examine any SEFA related guidance documented in the program's specific compliance supplement in section IV "Other Information." Any identified issues in Step 4 should be addressed by the auditor performing the SEFA reconciliation and should be documented in the Record of Work Done.

Step 4

Using the Federal Disclosure Forms the Department submitted to OFM, reconcile the total amount of expenditures on the Disclosure Forms to the expenditures on the AFRS report. Also, update the spreadsheet located at B.2.1 (SEFA vs D Forms vs AFRS tab).

Step 5

Conclude on whether the Federal Disclosure Forms the Department submitted to OFM accurately reflects the amount that the agency charged to the federal grant.

Guidance/Criteria:

Record of Work Done:

Step 1

These expenditures are not recorded in AFRS at the grant level. We received a TRAINS expenditure report from Jesse Daniels, External Audit Liaison, for the federal grant(s) showing expenditures charged to the grant(s) during the state fiscal year [see: FINAL Expenditures and Revenue 'By Subobject']. We confirmed the TRAINS report was run for 20.509 expenditures by Suzi Freelund, Accounting & Reporting Manager.

We also obtained a TRAINS expenditure report showing grant expenditures paid to subrecipients [see: FINAL Expenditures and Revenue 'NZ+TA only'].

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Step 2

We did not identify any possible risks or exceptions that could affect the SEFA reconciliation.

Step 3

We did not identify any SEFA related guidance in the program's specific compliance supplement in section IV "Other Information."

Step 4

Using the Federal Disclosure Forms the Department submitted to OFM, we reconciled the total amount of expenditures on the Disclosure Forms to the expenditures on the TRAINS report. We also updated the spreadsheet located at B.2.1 [[Expenditure Coding-Major Programs](#)SEFA vs D Forms vs AFRS tab].

Step 5

We concluded that the Federal Disclosure Forms the Department submitted to OFM accurately reflect the amount that the agency charged to the federal grant.

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Entrance Conference

Prepared By: BZH, 9/27/2022

Reviewed By: ACS, 10/10/2022

Purpose/Conclusion.

Purpose:

To communicate the audit scope to agency management, including auditor's and auditee's responsibilities.

Source:

Jesse Daniels, External Audit Liaison
Steven Meyeroff, FTA Compliance Administrator

Conclusion:

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We have communicated the audit scope to agency management, including auditor's and auditee's responsibilities.

Testing Strategy:

Pre-Conference:

- Send the SWSA Pre-Entrance Information Request document to the liaison.
- Set up the Entrance conference at a time convenient for entity staff as well as SAO staff
- Coordinate invitees through the liaison
- Prepare the Entrance conference document.

Present Entrance conference document. The Entrance should include discussion of the following:

Nature, timing, and extent of planned testing.

Auditor responsibilities for the engagement.

Identifies the audit manager, assistant audit manager, auditor in charge and auditors assigned to the engagement.

Procedures for informing entity management of the audit status, including problems or potential findings during the audit.

Any areas or problems that concern the entity's management.

- Discuss management responsibilities for the audit as well as the audit scope and reports to be issued.

Post Conference:

- Document the conference attendees (SAO and entity) as well as the date and time of the conference.
- Document management responsibilities, audit scope and the reports to be issued.
- Document any significant conversations that would precipitate a change in the audit plan.

Guidance/Criteria:

SAO Audit Policy 2210 - Conducting Entrance Conferences (effective 01/13/15)

BACKGROUND

Entrance conferences provide a forum for communication between auditors, entity management, the governing body and any other parties with oversight responsibility or who have contracted for or requested the engagement. These conferences serve to establish an understanding of the objectives of an engagement, management's responsibilities, our Office's responsibilities and the limitations of the engagement. Entrance conferences are also an excellent opportunity to set a tone of cooperation and open communication early in the engagement.

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REQUIREMENTS

1. Auditors will conduct timely entrance conferences.

If the entity declines an entrance conference, auditors must document the reasons for not holding the conference and the method of communicating required information. Auditors must document when and to whom information is communicated.

2. Auditors will use the applicable template(s) in preparing information for the entrance conference to ensure required communications are included.

At a minimum, the following items will be addressed as applicable during entrance conferences:

- Planned scope and timing of the engagement.
- An overview of work to be performed by other auditors or in other audits upon which we plan to rely, and the nature of our planned involvement in this other work.
- Engagement staffing.
- Estimated cost of local government or attestation engagements.
- Procedures for communicating the status of the engagement, including any significant issues, and the appropriate representative(s) of the governing body with whom to communicate.
- Any issues that concern the entity's management or those charged with governance.
- Additional information that will be communicated to the governing body related to the financial audit, if any.

3. Entrance conferences will be summarized in the engagement documentation.

Documentation will include the date, participants, and a summary of significant items discussed during the conference.

4. Auditors will communicate conference information to members of the governing body or audit committee who did not attend the entrance conference.

Auditors should document the method of communication (for example, mailing or e-mailing the meeting handout).

5. Entrance conferences will be conducted in compliance with the Open Public Meetings Act.

If a quorum attends the entrance conference, the entity is responsible for ensuring it meets requirements of the Open Public Meetings Act.

RELATED POLICIES

2130 – Inviting Officials to Entrance and Exit Conferences

REFERENCES

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Government Auditing Standards (Yellow Book) 6.47-.49
AU-C §260.07-11 – The Auditor’s Communication with those Charged with Governance
AU-C §600.48 – Special Considerations – Audits of Group Financial Statements
AT §101.46 – Attest Engagements
AT §201.10 – Agreed-Upon Procedures Engagements

Record of Work Done.:

Pre Entrance Information Request

Prior to the entrance conference we sent out the "SWSA Pre-Entrance Information Request" document to identify the primary audit contacts. Jesse Daniels, External Audit Liaison, provided the following contacts for each compliance area:

- Emily Overman, Fiscal Analyst
- Steven Meyeroff, FTA Compliance Administrator
- Cheryl Steben, Capital Accountant

Entrance Conference

We held our entrance conference with the Washington State Department of Transportation (WSDOT) on 8/31/2022. We presented the agency with the entrance document, see [[SWSA Entrance Document](#)]. The following staff attended the official entrance conference:

- Amy Scarton, Deputy Secretary
- Marshal Elizer, Assistant Secretary (Multimodal Development & Delivery)
- Allison Camden, Deputy Assistant Secretary (Multimodal Development & Delivery)
- Doug Vaughn, Chief Financial Officer
- Cindy Kay, Acting Director of Accounting & Financial Services
- Stephanie Tax, Local Programs Program Manager
- Kyle McKeon, Local Programs Engineering Services Manager
- Kurt Williams, Deputy Construction Director
- Cindy Bellus, Payroll Manager
- Garrett Webster, Assistant State Materials Quality Engineer
- Heidi Jensen, Transportation Technical Engineer
- Lew Bequette, Controller (WA State Ferries)
- Kevin Workman, Real Estate Services Administrator
- Robin Curl, Property Acquisition Specialist
- Hector Meneses, Assistant Director of Accounting & Financial Services
- Jennifer Heay, Payments and Receipts Manager
- Jay Drye, Local Programs Administrator
- Steve McKerney, Director of Internal Audit

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- Jesse Daniels, External Audit Liaison

SAO Attendees:

- Cavan Busch, Audit Manager
- Andrew Schmitz, Audit Supervisor
- Brandon Hofman, Formula Grants Auditor-in-Charge
- Anthony Welsh, Highway Planning and Construction Cluster Auditor-in-Charge

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Update Meetings

Prepared By: BZH, 3/28/2023

Reviewed By: ACS, 4/26/2023

Purpose/Conclusion.:

Purpose:

To document update meetings held with the agency.

Conclusion:

We have documented update meetings held with the agency.

Testing Strategy.:

Document any audit status update meetings held with the agency. At a minimum, include the date the meetings were held, who attended and link to the document presented at each update meeting.

Guidance/Criteria.:

Record of Work Done.:

Update Meetings

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Bi-Monthly Check-In

We held check-in meetings with DOT every other Tuesday for the duration of the audit. These meetings were held starting August 9, 2022 through March 7, 2023.

Documentation of the meetings' agenda can be seen at: [\[FY22 Formula Grants - All combined updates\]](#).

Bi-Monthly Updates

On June 13, 2022, we asked Jesse Daniels, External Audit Manager, if the Department would like update meetings, and if the Department had a preferred frequency. Jesse responded that the Department would appreciate these updates, and asked to hold them every other week.

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Disclosure of Fraud and Misconduct

Prepared By: BZH, 9/27/2022

Reviewed By: ACS, 10/10/2022

Purpose/Conclusion.:

Purpose:

To determine if the agency promptly referred to appropriate inspector general information regarding

- 1) any false claims under the False Claim Act, or
- 2) a criminal or civil violation of laws pertaining to fraud, conflict of interest, bribery, gratuity, or similar misconduct involving those funds.

There has not been any fraud identified for the Federal program.

Source:

Jesse Daniels, External Audit Liaison

Conclusion:

We confirmed with the Department that no fraud or misconduct has been identified over this program.

Testing Strategy.:

Disclosure of Fraud or Misconduct

1. Determine whether the agency identified any frauds during the audit period. If no frauds were identified, document who this

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information came from. In this case there is no need to perform steps 2-4. If fraud(s) were identified during the audit period, document the reported fraud(s) and perform all step(s) below that relate to the type of fraud(s) that was identified.

2. Document the process the agency follows to report identified client frauds. For example how does the agency report client fraud related to the Child Care Program, or TANF. SAO reports employee or sub-recipient fraud either in the SWSA report or direct reports to the federal government. We need to ensure the agency is directly reporting client fraud and how it is being done.

3. Document the process the agency follows to report identified non-client fraud (vendor, sub-recipient, employee, etc.).

4. Document the process the agency follows to report fraud related to ARRA funds. Federal guidance requires each recipient or sub-recipient awarded funds made available under the ARRA to promptly refer to the HHS Office of Inspector General any credible evidence that a principal, employee, agent, contractor, sub-recipient, subcontractor, or other person has submitted a false claim under the False Claims Act or has committed a criminal or civil violation of laws pertaining to fraud, conflict of interest, bribery, gratuity, or similar misconduct involving those funds. Additionally, all ARRA fraud reports (not allegations) submitted by SAO must be forwarded to the U.S. Government Accountability Office (GAO). Reference fraud report in your ROWD as well as document at E.1.PR.G Concluding Single Audit Procedures - ARRA Fraud.

Guidance/Criteria.

Record of Work Done.

Per Jesse Daniels, External Audit Liaison, there has not been any identified fraud or misconduct over this program.

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Interim Procedures

Prepared By: BZH, 9/19/2022

Reviewed By: ACS, 9/22/2022

Purpose/Conclusion.

Purpose:

To determine if there have been any significant changes in the internal control structure for the material compliance areas for the subsequent period extending to the end of the audit period (for those compliance areas that interim testing was performed), and to determine if additional compliance testing is necessary.

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Conclusion:

We did not perform any interim procedures.

Testing Strategy:

This step applies to those situations where the auditor is obtaining an understanding of the internal control structure, assessing control risk, and testing compliance before the audit period has ended (i.e., interim testing).

The intent of this step is to identify any significant changes in the internal control structure that may have occurred from the date you performed interim testing and the end of the audit period. Significant changes could require re-evaluation of the key control activities and the associated assessed risk level and change the nature, timing or extent of substantive tests.

STEPS:

1a. For the compliance areas you are testing, confirm with the entity whether there have been any significant changes in the internal control structure that may have occurred from the date you performed interim testing and the end of the audit period.

If entity management indicates there have been no significant changes, document the conversation and conclude that no further work is required.

If the grant management staff indicates that there were significant changes, go on to step 1b.

1b. Determine whether any compliance tests should be expanded to incorporate the transactions and activity that took place in the period after your interim testing. For example, if you are testing Earmarking, you may need to consider the entire year's activity before making a conclusion about compliance. Similarly, if testing Period of Availability, you may need to examine some transactions that took place after year end.

2. Document the significant changes in the internal control structure for the material compliance area(s) with the goal of re-assessing the risk level.

3. If the risk has increased, and the results of the prior tests will not be representative of the conditions, then further tests must be planned and completed to cover the remaining period.

4. Conclude on any further work required in steps 2 and 3.

Guidance/Criteria:

Record of Work Done:

We began work on the program after July 1, 2022, therefore, no interim procedures were performed. However, we did obtain preliminary expenditure and revenue data prior to FY22-close, and we followed up on 9/7 to obtain final expenditures prior to performing field work. No additional work is necessary.

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Procedure Step: Control Environment and Risk Assessment (COSO)

Prepared By: BZH, 2/21/2023

Reviewed By: ACS, 2/22/2023

Purpose/Conclusion:

Purpose:

To gain an understanding of the control environment and risk assessment processes that are in place at the program level and to identify any internal control risks related to them

Source:

Jesse Daniels, External Audit Liaison

Cindy Kay, Acting Director of Account and Financial Services/ Internal Control Officer

Conclusion:

We have gained an understanding of the control environment and risk assessment processes that are in place at the program level and to identify any internal control risks related to them.

We did not identify any risks specifically related to Formula Grants the program based on our understanding of the control environment and risk assessment internal control structures.

Testing Strategy:

Control Environment and Risk Assessment (COSO)

The purpose of this step is to determine what/if internal control elements related to the Control Environment and Risk Assessment COSO elements are in place over the program. (Note: Some of these elements may be documented at the *Department level* in our "Overall COSO Evaluation" step located at B.1.PR.G.). This information is to be used to help assess inherent risk and to possibly help in identifying the cause of exceptions (if any are identified). (This step should be performed very early in the audit process so identified risks can be incorporated into the inherent risk

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assessment for each compliance requirement.

The first step in this process is to talk to the Internal Control Officer (ICO) for the agency (every agency is required to have one). If the agency has multiple SWSA programs being audited, determine if this discussion has already occurred. If it has, determine if your program information was already identified. If it has not, document the program level information from the ICO for **all** SWSA programs being audited at the agency. If responsibilities have been designated to the program level, the auditor for each program will follow up. The ICO for each agency being audited is documented in a tracking spreadsheet located at B.1 "Internal Control Survey Results". The ICO should be able to provide an overview of the Control Environment and Risk Assessment process, including providing information such as:

- Who is responsible for ensuring internal controls addressing all federal program requirements are in place and operating effectively at the **program level** for this program?
- Has management specifically assigned this responsibility and delegated the authority necessary to implement the internal controls at the program level?
- If authority was delegated, are there written policies and/or procedures documenting the delegation?
- Does management evaluate performance and hold individuals accountable for their internal control responsibilities?
- Has management clearly identified the program objectives in order to be able to identify risks?
- Does management identify, analyze and **respond** to identified risks?

(From the GAO Green Book)

Control Environment Overview

The control environment is the foundation for an internal control system. It provides the discipline and structure, which affect the overall quality of internal control. It influences how objectives are defined and how control activities are structured. The oversight body and management establish and maintain an environment throughout the entity that sets a positive attitude toward internal control.

Principles

1. The oversight body and management should demonstrate a commitment to integrity and ethical values.
2. The oversight body should oversee the entity's internal control system.
3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.
4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.
5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

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Risk Assessment Overview

Having established an effective control environment, management assesses the risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses. Management assesses the risks the entity faces from both external and internal sources.

Principles

6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.
7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.
8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.
9. Management should identify, analyze, and respond to significant changes that could impact the internal control system.

Guidance/Criteria:

(From the GAO Green Book)

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8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.
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Record of Work Done:

Control Environment

We inquired with Cindy Kay, Acting Director of Accounting and Financial Services (AFS)/ Internal Control Officer (ICO), and Jesse Daniels, External Audit Liaison, to gain an understanding of the overall control environment at the Department and the risk assessment processes that are in place at the program level to identify and respond to internal control risks.

1. *Who is responsible for ensuring internal controls addressing all federal program requirements are in place and operating effectively at the program level for this program?*
2. *Has management specifically assigned this responsibility and delegated the authority necessary to implement the internal controls at the program level?*

Per the Department's response, the designated ICO for SFY22 is Cindy Kay, Acting Director of Accounting and Financial Services (AFS), as outlined in WSDOT Secretary's Executive Order E 1012.04, Delegation of Authority, Section VI., A., 5. a. (1). Under direction of the ICO, Suzi Freeland, Accounting and Reporting Manager is managing the Internal Control program, which will formalize internal control assessment processes and tools that can be utilized across the diverse divisions, regions, and business activities within the Department. Program level control is designated to Assistant Secretaries and other direct reports to the Secretary's office for their organization within the Department. Chapter 3 of the "WSDOT Accounting Policy Manual" defines the Director of AFS as the individual responsible for oversight of internal controls.

3. *If authority was delegated, are there written policies and/or procedures documenting the delegation?*

Chapter 3 of the "WSDOT Accounting Policy Manual" defines who the ICO is, defines the roll of the Financial Systems and Controls Manager and designates their responsibilities, and designates responsibilities to the organization heads. Per Jesse, the role was split into two roles, with the Accounting and Reporting Manager overseeing account, reporting operations and the internal control program. The other position, Senior Financial Systems and Consulting Manager, does not oversee or have responsibility for the internal control program.

4. *Does management evaluate performance and hold individuals accountable for their internal control responsibilities?*

Per Jesse, each organization with the Department is responsible for establishing and maintaining effective systems of internal controls for their division, which would include how individuals effectively perform those controls.

Risk Assessment

1. *Has management clearly identified the program objectives in order to be able to identify risks?*

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2. How does management identify, analyze and respond to identified risks?

We inquired about the Department's risk assessment process and how this process is carried out. Jesse Daniels previously held the position of Internal Control Manager and in 2018 developed the program that is still in place today. The internal control manager role is now held by Suzi Freelund, Accounting and Reporting Manager of Accounting and Financial Services. Suzi is the sole representative from WSDOT working actively with OFM and our Office to develop a Risk Assessment and Review Plan that adequately addresses OFM's requirements for state agencies. The internal control monitoring efforts include developing a risk assessment/internal control questionnaire and submitting the assessment to managers within each of the Department's programs for completion. We obtained a copy of the most recent questionnaire. The ICO and internal control manager were reviewing responses with Internal Audit and Risk Management to determine what follow-up actions were necessary, such as program outreach, training, or policy implementation.

Per Secretary's Executive Order Number: E 1038.08 the Department's Transportation Safety and Systems Analysis Division is authorized to lead and administer the Enterprise Risk Management program. Per our review of the assessment, we did not identify any possible risks that could effect the Formula Grants for Rural Areas program.

Conclusion

We did not identify any risks specifically related to Formula Grants the program based on our understanding of the control environment and risk assessment internal control structures.

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Procedure Step: COVID 19 - GAGAS Audit Alert - Internal Control

Prepared By: BZH, 2/21/2023

Reviewed By: ACS, 2/22/2023

Purpose/Conclusion.*

Purpose:

To identify potential internal controls risks that resulted from the COVID-19 pandemic.

Source:

Jesse Daniels, External Audit Liaison

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Conclusion:

After discussing the information below with management, we did not identify any risks for the program related to the COVID-19 pandemic or changes to the Department's internal control environment.

Testing Strategy:

COVID 19 - GAGAS Audit Alert - Internal Control

Testing Strategy

1. Ask program management the following questions regarding how the COVID-19 pandemic may have affected the entity's systems of internal control and environment.

1. Did the agency create any new programs, processes or systems to use or disburse program funds during the COVID-19 pandemic?
 2. Were any new laws or regulations implemented related to the use or disbursement of program funds as part of the response to the COVID-19 pandemic?
 3. Were program staff furloughed or laid off? If so, did this affect the agency's ability to materially comply with any compliance requirements selected for audit?
 4. Did the agency make any changes to its internal control systems that affected the agency's ability to comply with any compliance requirements selected for audit?
 5. Were internal controls operating effectively throughout the period given pressures and accelerated timelines in the COVID-19 pandemic environment?

2. Assess the responses from management and consider whether additional procedures may need to be performed for any of the direct and material compliance requirements. The auditor should be alerted for areas of waste or abuse of both program funds and COVID-19 pandemic related funds that could be the result of internal control deficiencies.

3. Discuss these considerations with the audit supervisor and AIC.

Guidance/Criteria:

2020 COVID-19 GAGAS Audit Alert - published by the GAO
(B.1.16)

Record of Work Done:

COVID 19 - GAGAS Audit Alert - Internal Control

Michael Hutchinson, Assistant Audit Manager, emailed Jesse Daniels, External Audit Liaison, on September 28, 2022 to verify if any internal controls were changed or added over Formula Grants for Rural Areas program (ALN 20.509) or the Highway Planning and Construction Cluster program (ALN 20.205,

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20.219, 20.224 and 23.003) for SFY22 as they related to the Covid-19 pandemic. Michael also met with the Department to discuss the Covid-related controls, and the Department informed him that no controls were changed or added for the audit period.

1. Inquiry of management

a. Did the agency create any new programs, processes or systems to use or disburse program funds during the COVID-19 pandemic?

Response: The Accounting & Financial Services Division established unique Work Operations codes for all programs to identify COVID-related expenses. Construction projects administered by the Regional Offices could not use specific Work Operations codes, so in some instances, unique work orders established to identify COVID related expenses. Payments and Receipts Unit developed new vendor payment process to document and distribute payment vouchers. All payment vouchers have to be printed on mainframe printer in an office. Payments and receipts team scan in pdf the supporting documents. Team will then print payment voucher and then attach supporting documents. They will then move digitally to get approved and processed. Email approval is attached as back up (This email back up includes details such as "I approve invoice #1234 for the amount of \$99.99").

b. Were any new laws or regulations implemented related to the use or disbursement of program funds as part of the response to the COVID-19 pandemic?

Response: No new laws or regulations. Formal guidance for COVID-19 costs was provided by OFM.

c. Were program staff furloughed or laid off? If so, did this affect the agency's ability to materially comply with any compliance requirements selected for audit?

Response: No staff furloughs occurred affecting the Department's ability to comply with the program's requirements. Partial furloughs occurred at the direction of executive management wherein staff were reduced one paid work day each month in order to avoid full furloughs. The Department was not significantly impacted by these furloughs.

d. Did the agency make any changes to its internal control systems that affected the agency's ability to comply with any compliance requirements selected for audit?

Response: No changes were made to internal control systems. With existing staff they were able to manage the COVID-19 pandemic.

e. Were internal controls operating effectively throughout the period given pressures and accelerated timelines in the COVID-19 pandemic environment?

Response: Yes. WSDOT was able to meet deadlines.

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2. Additional procedures do not need to be performed.
3. After discussing the information below with the audit supervisor, we did not identify any risks for the program related to the COVID-19 pandemic or changes to the Department's internal control environment.

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Procedure Step: A-B. Activities Allowed/Cost Principles - Controls

Prepared By: BZH, 10/31/2022

Reviewed By: ACS, 12/1/2022

Purpose/Conclusion.:

Purpose:

To gain an understanding of the internal controls the agency has in place to provide reasonable assurance that Federal awards are expended only for allowable activities and that expenditures charged to the Federal award are allowable and in accordance with the applicable cost principles.

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal award requirements related to allowable activities and cost principles.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Steven Meyeroff, FTA Compliance Administrator

Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Activities Allowed and Cost Principles, we assessed preliminary control risk as low.

Testing Strategy.:

A-B. Activities Allowed/Cost Principles - **Post Uniform Guidance Awards**

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

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See steps to assess risk and risk factor considerations are listed in the **Inherent and Internal Control Risk Guidance** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review scope of work

Allowable Activities - Determine which activities and types of costs are specifically allowed or unallowed, by reviewing the following:

1. Award agreement or approved application for scope of work, terms and conditions, and approved budget.
2. Part 4 of the Compliance Supplement that applies to your audit period.
3. Available program guidelines or handbooks. (Ex. WSDOT's LAG Manual)
4. If above information is not available, look to the federal regulations (contact the single audit specialist if you need assistance with this).

Requirements for Cost Principles are found as follows:

Pre-UG: OMB Circular A-87

UG: 2 CFR 200, Subpart E.

Please be familiar with these requirements as not all are listed below; only parts emphasized in the Compliance Supplement are listed below.

Quantitatively Material

Identify the expenditure activities that are directly charged to the program and are quantitatively material (more than 5%).

Direct Costs

Payroll Expenditures: When payroll costs are selected for our single audit, our focus is on whether the portion of payroll charged to the program (allocation) is supported by appropriate time and effort and meets the cost principles. Note that awarding agencies may require specific forms of documentation to support payroll charged to its award.

Compensated Absences (leave cash-outs or accrual): The entity may include employees' use of leave (which is included in their regular salary payments). If the entity charges any **leave cash-outs** or the **accrual of leave** to the grant, there are special rules, see extra guidance in the policy tab. There is a high risk the costs are unallowable.

Non-Payroll Expenditures: Generally, auditors should test internal controls and compliance for non-payroll expenditures when those costs are quantitatively material (5%) to the program.

Automated Controls: If you identify key internal controls that are automated, consult with the SWSA Supervisor or SWSA AIC to determine whether to request automated control work from Team IT audit.

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Indirect Costs

Determine whether the agency has recovered indirect costs via an indirect cost rate or cost allocation plan and, if so, how much was expended. If indirect costs are material to the program the auditor must test the internal controls (and compliance) over them when those costs are quantitatively material (5%) to the program.

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement. These are discussed in the **policy tab** in further detail, for when indirect costs are material to the program.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

Special – Review In-process Proposals: If the entity is preparing an Indirect Cost Rate Proposal during the audit period in order to submit it to the federal cognizant agency, we are required to review the accuracy of the base data and calculations.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) Activities Allowed: grant funds are used only for allowable activities (this may include review of expenditures, program monitoring, preparing the reimbursement requests, establishment of programs);

(b) Cost Principles: direct and indirect costs charged to the grant comply with the cost principles set forth in 2 CFR 200 Subpart E (this may or may not be the same control activity for (a))

(c) Activities Allowed-Indirect Costs: if material (5%), the entity uses the proper indirect cost rate (per approved plan or rate, de minimis only when it is

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applicable, or another rate established by contract). Controls should also focus on how the entity properly calculates the direct cost base that the indirect rate is applied to. For instance, the controls should ensure that they are using only allowable types of costs in the MTDC or other direct base as applicable, that those costs are not used twice or that they occurred during the contract's period of performance. Note: These controls are likely **different** than those in (a) and possibly (b).

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as "**LOW**" when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria.:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Basic Cost Principles (2 CFR 200.402 – 409)

DEFINITIONS

Cost means an amount as determined on a cash, accrual, or other basis of accounting acceptable to the Federal awarding or cognizant agency.

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Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are needed and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

Direct costs are those that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization). Examples of Direct Costs: payroll costs of employees who perform work that is directly related to the grant program; the cost of supplies and materials used for the purpose of the grant; equipment and other approved capital expenditures made for the grant; or professional services contracted to accomplish specific grant/contract objectives.

Indirect costs are those costs incurred for a common or institution-wide objective that benefits more than one grant program or project. Such costs are not readily assignable to the cost objective specifically benefited. Examples of Indirect Costs: depreciation and use allowances of non-federal equipment and buildings; facility operation and maintenance (lights, heat, phone, janitorial, grounds, etc); and general administrative expenses such as accounting, payroll, legal and data processing expenses.

GENERAL COST PRINCIPLES AFFECTING ALLOWABILITY OF COSTS (2 CFR 200.403)

- (a) Be **necessary** and **reasonable** for the performance of the Federal award and be allocable thereto under these principles.
- (b) Conform to any **limitations** or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- (c) Be **consistent** with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- (d) Be **accorded consistent treatment**. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.
- (f) **Not be included as a cost or used to meet cost sharing or matching requirements** of any other federally-financed program in either the current or a prior period. See also §200.306 Cost sharing or matching paragraph (b).
- (g) Be **adequately documented**. See also §§200.300 Statutory and national policy requirements through 200.309 Period of performance of this part.

What is a Reasonable Cost (§200.404)? (cost principles)

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.

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Other factors that must be considered in determining whether a cost is reasonable are:

whether the cost is generally considered as ordinary and necessary to the operation of the grantee or the performance of the federal award/program;

the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, federal, state and other laws and regulations, and terms and conditions of other federal awards, or sponsored agreements;

market prices for comparable goods and services;

whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the grantee, its employees, where applicable its students or membership, the public at large, and the federal government;

whether the grantee significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal awards costs.

EXAMPLES:

1. A grantee is planning to purchase computers and printers with federal funds. The purchasing agent obtained phone quotes from three contractors. One contractor has a direct family relationship with the grantee's purchasing agent. It so happens that this contractor's quote was 20% higher than the other two. The grantee should not contract with this contractor because the price is unreasonable and has a conflict of interest (regardless of the price).

2. A grantee has been permitted in its grant contract to lease a vehicle so that it can travel within its region to deliver grant-related services to clients. The grantee has obtained quotes for a standard 4-door sedan and a luxury 4-wheel drive SUV that is twice the cost of the sedan. Which vehicle should the grantee choose? This is not to say a 4-wheel drive is not necessary or reasonable, but the price may dictate the type or model of vehicle.

What is an Allocable Cost (§200.405)? (cost principles)

A cost is considered allocable if the goods or services involved are chargeable or assignable to to the federal award or cost objective (i.e., a specific function, project, sponsored agreement, service, or grant) in accordance with the relative benefits received.

Any cost allocable to a particular federal award may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by federal statutes, regulations, or terms and conditions of federal awards, or for other reasons.

If a grantee intends to recover the portion of its indirect costs (overhead, central administration, etc.) that relates to its grant programs, Uniform

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Guidance requires the grantee to develop a central service cost allocation plan and/or indirect cost rate proposal. Requirements pertaining to central service cost allocation plans and indirect cost proposals are found in Appendix III-VII to Part 200 (Uniform Guidance).

EXAMPLES:

1. An employee works on two different federal grant projects. The time spent on each project varies from day to day. This employee must keep monthly time and effort records that account for actual time spent on each project. By tracking actual effort, each grant will be charged its fair share of the costs.
2. A grantee held a training workshop for its employees. Included in the cost of the workshop was room rental, food, and travel. The workshop included a session that was specific to a federal program and a session that covered general personnel and human effectiveness training. The grantee should allocate the cost of the training among all programs/divisions that benefited from the training. Next, it should charge the allocated amount only to those awards that specifically allow for this type of cost.

Applicable Credits (§200.406) (cost principles)

A "credit" means a receipt or reduction in expenditures that offset or reduce direct or indirect cost items. Examples include:

- purchase discounts;
- rebates or allowances;
- recoveries or indemnities on losses;
- insurance refunds or rebates; and
- adjustments of overpayments or erroneous charges.

When such credits are applicable to allowable costs, they must be credited to the federal award either as a cost reduction or a cash refund. In some instances, the amounts received from the federal government to finance a grantee's activities or service operations should be treated as applicable credits.

EXAMPLE:

A grantee paid a contractor for materials it needed for a project. It was determined later that the vendor had over-billed the grantee and was issuing a refund check. This refund should be netted against the total amount charged to the grant as a cost reduction. If the grant project had already been closed out, the refund should be remitted to the grantor agency that sponsored the project. Consult with the grantor agency in such a case.

Prior written approval (§200.407) (cost principles)

Under any given Federal award, the reasonableness and allocability of certain items of costs may be difficult to determine. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, the non-Federal entity may seek the prior written approval of the cognizant agency for indirect costs or the Federal awarding agency in advance of the incurrence of special or unusual costs. Prior written

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approval should include the timeframe or scope of the agreement. The absence of prior written approval on any element of cost will not, in itself, affect the reasonableness or allocability of that element, unless prior approval is specifically required for allowability as described under certain circumstances in the following sections of this part:

- (a) §200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts, paragraph (b)(5);
- (b) §200.306 Cost sharing or matching;
- (c) §200.307 Program income;
- (d) §200.308 Revision of budget and program plans;
- (e) §200.311 Real property;
- (f) §200.313 Equipment;
- (g) §200.332 Fixed amount subawards;
- (h) §200.413 Direct costs, paragraph (c);
- (i) §200.430 Compensation—personal services, paragraph (h);
- (j) §200.431 Compensation—fringe benefits;
- (k) §200.438 Entertainment costs;
- (l) §200.439 Equipment and other capital expenditures;
- (m) §200.440 Exchange rates;
- (n) §200.441 Fines, penalties, damages and other settlements;
- (o) §200.442 Fund raising and investment management costs;
- (p) §200.445 Goods or services for personal use;
- (q) §200.447 Insurance and indemnification;
- (r) §200.454 Memberships, subscriptions, and professional activity costs, paragraph (c);
- (s) §200.455 Organization costs;
- (t) §200.456 Participant support costs;
- (u) §200.458 Pre-award costs;
- (v) §200.462 Rearrangement and reconversion costs;
- (w) §200.467 Selling and marketing costs;
- (x) §200.470 Taxes (including Value Added Tax); and
- (y) §200.474 Travel costs.

Consistency (2 CFR §200.403(d) (cost principles)

A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

EXAMPLE:

A grantee has five departments. It allocates the cost of its basic telephone service to each department based on the number of telephones in each

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department. Each department should treat the telephone cost consistently for all grants it administers. That is, if a department has 3 grant programs, that department should treat this telephone cost as either a direct cost or indirect cost for all 3 grants, but not a mix of each. Next, if treated as a direct cost, a department should only request reimbursement for this type of cost if permitted under the terms of its grant agreement(s).

Grant Agreement Limitations (§200.408) (cost principles)

To be allowable, the cost being charged must conform to any limitations or exclusions set forth in the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

EXAMPLE:

A grantee paid for a television advertisement to promote its new grant-funded health program. However, the approved grant contract limited the cost of advertising to brochures and radio ads. Therefore, the grantee should not include the cost of the television advertisement in its request for reimbursement even though "advertising" is an otherwise allowable cost according to Circular A-87.

Adequate Supporting Documentation (2 CFR §200.403(g) (cost principles)

Amounts charged to federal awards must be supported by source documentation, including:

- payroll reports
- time and attendance records
- invoice vouchers from subrecipients
- receiving reports
- original vendor invoices
- cost allocation plans

(Documentation may be in an electronic form, but make sure the integrity of the electronic documentation can be maintained for the duration of the applicable record retention period).

EXAMPLE:

A grantee made a year-end adjustment to a federal award using a journal voucher entry. The accounting entry must be supported by adequate documentation that demonstrates both allowability and allocability.

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

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Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

ADDITIONAL TESTING SELECTION INFO & EXAMPLES

<i>Selection Options</i>		
Method	Process	Next Steps
Sampling	This is the preferred method for large populations (over 365). Use sampling tool from teammate.	Get the sample tool from Teammate. Take the sampling training if needed.
Haphazard Selection	May use for populations less than 365. Auditor haphazardly picks transactions. It feels random but only true "random" samples can be done by the computer in the sampling method.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab)
Judgmental Selection	May use for populations less than 365. The auditor has a specific reason, associated with a risk, to pick certain or certain transactions. Explain risks in the ROWD and how transactions not selected are lower risk.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab). See examples there.

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Judgmental Population	First, the auditor has a specific reason, associated with a risk, to pick certain types of transactions (judgmental population). Explain risks in the ROWD and how populations not selected are lower risk (you can refer to the testing strategy if we have done this for you already). Next, the auditor selects transaction from the judgmental population using the sampling method above.	Get sample tool from Teammate. Take training for the form if needed.
All quantitatively material transactions	Use only when a few very large transactions make up the majority of grant activity. You will test all of these material transactions.	Keep in mind: If 10% or more of the population is made up of <i>other</i> types of costs, those transactions should be tested in some way, as well.

DUAL PURPOSE TESTING EXAMPLE

For allowable costs the key control is, "The Business Manager reviews the reimbursement request, reconciling the items requested to invoices to determine they are supported and allowable." You will test it by reperforming the Business Manager's review to determine if it is effective in preventing and detecting noncompliance. You may check the requests to see if they have the Business Manager's signature of approval but that will only tell you if they consistently do it, which is important. However, you should reperform the control.

To complete compliance testing you are tracing expenditures from the requests to support to determine if they are supported and allowable per the program.

In this case, for testing both controls and compliance you are completing the same process. However, you need to document that you tested both and clearly show the conclusion of each even though they are related. Control testing should conclude whether the control was effective in preventing or detecting noncompliance and compliance testing whether the entity was in compliance.

INDIRECT COST UNDERSTANDING OF RATES/ALLOCATIONS

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

1. Rate Provided by Grantor: The federal grantor or PTE can give the entity an indirect cost rate in the award, usually outlined in the budget

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section and based on the availability of funding. There is no separate or formal rate agreement and it is not considered negotiated.

2. Use PTE Negotiated Rate: The federal grantor, PTE or federal guidance can require the entity to use PTE's negotiated indirect cost rate. This requirement can be found in the Compliance Supplement and federal pass-through guidance. The PTE will place the rate in their award with the entity. This is common for school districts.

3. De Minimis Indirect Cost Rate: If the entity elects to use the de minimis rate, a flat 10% (of Modified Total Direct Costs), in their grant application, no direct or pass-through grantor can deny its use so long as the entity qualifies.

Restrictions: The entity can use the method so long as they have **never** had a negotiated indirect cost rate or allocation plan approved by the federal cognizant agency **or** the PTE.

UPDATED GUIDANCE: Federal guidance now clarifies that negotiated rates and allocation plans negotiated by **PTEs** can prevent the use of the de minimis rate.

Consistency: If used, the entity must use the de minimis method for all of their Uniform Guidance federal programs that allow indirect costs.

Rate: Indirect costs are calculated as base costs multiplied by a flat 10% rate that does not require a true-up to actual indirect expenses.

Base Used: The 10% is multiplied by the modified total direct costs (MTDC) base.

<i>MTDC Base</i>	
Includes	Excludes
Direct Salaries & Wages	Equipment & Capital Expenditures
Direct Fringe Benefits	Charges for Patient Care
Materials & Supplies	Participant Support Costs
Services	Rental Costs
Travel	Tuition remission, Scholarships & Fellowships
Up to \$25,000 of <i>each</i> subaward (regardless of the period of performance)	The portion of each subaward in excess of \$25,000

4. Negotiated Rates & Allocation Plans – Cognizant Agency: Only major governments are required to obtain a cognizant agency approved negotiated rate or allocation plan. Smaller governments can opt to do so. The "cognizant agency for indirect costs" is designated as:

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For central service cost allocation plans: the federal agency with the largest dollar value of *total* federal awards

For indirect cost rates and cost allocation plans: the federal agency with the largest dollar value of *direct* federal awards

Once designated, the federal entity remains the cognizant agency for five years. Under this method, the entity will be awarded a formal contract for the rate/allocation. All awarding agencies must accept the rate/allocation plan when the entity elects to use it in their program application.

Various allocation plans can be approved, but there are four types of rates:

1. **Provisional**: The provisional rate is temporary and expires upon the completion of the federal award. It requires a true-up to actual expenditures by the end of the project or whenever the entity obtains a final rate. The rate is adjusted by using the final rate.
2. **Final**: The rate is permanent and is calculated after the actual costs are known (i.e. at the conclusion of the federal project). It is used to adjust the indirect costs from the provisional rate.
3. **Predetermined**: This is a permanent rate and is calculated using actual costs from previous periods. It does not require a true-up to correspond with actual current year costs. The rate is effective between two to five years.
4. **Fixed**: This is a permanent rate and is calculated using actual costs from previous periods. It requires a true-up to correspond with actual current year costs. The variance between the costs used to create the rate and the actual costs incurred during the year the rate was used is carried-forward as an adjustment to the current rate. The entity will either recover or “pay back” the variance going forward. The rate is effective for two years and then can be annually renewed.

5. Negotiated Rates & Allocation Plans – PTE: Indirect Cost Rate Proposals and Cost Allocation Plans are not required by UG to be submitted to/approved by PTE's, but the PTEs may require it. Usually a formal contract for the rate/allocation is not issued and they just review and/or approve the plan instead. Other pass-through entities are not required accept the rate/allocation plan but they can choose to accept it.

METHODS OF INDIRECT COST RATE CALCULATION

(1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:

(a) *Simplified Method* – This method is applicable where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

Multiple Allocation Base Method – This method is applicable where a governmental unit's department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the

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relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)

(c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)

(d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a State or local government or unit's department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency's Federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP must be either submitted to the cognizant agency for indirect cost for review, negotiation

Record of Work Done.

Inherent Risk of Noncompliance

Step 1

We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review scope of work

We reviewed the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine which activities and costs are allowed or unallowed. We identified the following:

Indirect Costs

The 5311 grant awards do not have indirect costs applied to their awards; therefore, indirect costs are not applied to the related subawards.

Material Expenditures

We identified the following expenditure activities that are directly charged to the program and are quantitatively material (more than 5%): [FINAL Expenditures and Revenue].

Subobject NZ:

\$	39,466,938.00	48.21%
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Subobject TA:

\$	37,890,302.18	46.28%
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Total	Total (%)
\$ 77,357,240.18	94.48%

We tested subobject TA separately at [\[Payroll - Activities Allowed/Cost Principles - Controls\]](#).

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

We requested and reviewed all of the Department's written policies and procedures related to Activities Allowed/Cost Principles as part of gaining an understanding of internal controls [see: [WSDOT Consolidated Grant Guidebook \(March 2022 update\)](#)].

We documented the Department's response to our request for their Understanding of Controls [see: [ICRL - Activities Allowed/Cost Principles - WSDOT](#)].

We met with the following staff from the Department of Transportation on September 16th, 2022 to gain an understanding of their key internal controls:

- Jesse Daniels, External Audit Liaison
- Steven Meyeroff, FTA Compliance Administrator
- Cherryl Steben, Transportation Planning Specialist 5

Andrew Schmitz, Audit Supervisor, and Brandon Hofman, Audit Lead, were in attendance from SAO.

WSDOT provides general terms and conditions to subrecipient agreements (awards) outlined in its "Consolidated Grant Guidebook". This manual is issued each biennium (when new subrecipient agreements are awarded) to all subrecipients receiving funding under the Section 5311 - Formula Grants for Rural Areas Program (Key Control #1) (Information/Communication).

We noted the Guide references the following information regarding financial management of award funds:

- Chapter 1 - Requirements and Guidelines for All Projects
- Chapter 2 - Operating, Planning and Mobility Management Projects
- Chapter 3 - Guidelines for Capital (Vehicle and Equipment) Projects

Regardless of the funding source assigned to a project, WSDOT requires all organizations to follow the cost principles, standards and administrative requirements outlined in the following federal regulations:

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- Administrative requirements are located in Title 49 CFR Chapter VI Part 601.3
- Accounting requirements in the Office of Management and Budget (OMB) requirements codified under Title 2 CFR Chapter II Part 200 Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards.

The reimbursement process begins with the Fiscal Unit outlining in the subrecipient agreement (award) the scope of the grantee's project, including costs eligible for reimbursement under the federal (FTA) award. Subrecipients must submit status reports to PTD for each quarter of the contract period.

After the project is initially approved by WSDOT, and funding has been obligated to the subrecipient, capital project invoices (Referred to as "Claims" circa Mar 2022) can be submitted to WSDOT when vehicle procurement costs are incurred by the subrecipient. See an example of a claim on pg. 108. Claims must contain the following required fields:

- Project Title
- Organization Name and Vendor ID Number (either assigned by WSDOT, or DES Statewide Vendor Registration #)
- Invoice Date
- Contract Award Date
- RFP date (solicitation date)
- Contract Completion Date
- Agreement Number (this refers to the recipient's agreement with WSDOT)
- Billing Period
- Vehicle/Equipment Description (including gross vehicle weight, and passenger seating capacity)
- VIN/Serial #
- Vehicle Manufacturer Name
- Acceptance Date
- Cost
- Factory Visit Trip Cost (required to inspect vehicle at manufacturer's site upon procuring contract to purchase), including applicable sales taxes*
- Local (recipient) Share

**Note: The grantee is required to deduct the transit portion of sales taxes paid to vehicle manufacturers, as this is not eligible for reimbursement by WSDOT under state law.*

In addition to the fields listed above for Claims, the subrecipient is required under the WSDOT Consolidated Grant Guidebook the following supporting documents:

- Manufacturer's Post-Delivery "Buy America" Compliance Certification
- Federal Motor Vehicle Safety Standards Certification of Compliance (from the manufacturer)
- Road Test Form
- Vehicle Visual Inspection Report
- Vehicle Registration Certificate

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- Copy of subrecipient's proof of vehicle insurance coverage
- Original manufacturer's invoice
- Itemized receipts to support miscellaneous other costs (including factory trip visit costs, destination fees, and miscellaneous taxes or surcharges related to the procurement[s]).

Claims are received by different DOT staff depending on what kind of project is being funded. As mentioned above, 5311 Grants can fund all types of projects, Operating, Planning and Mobility projects, or Capital projects.

Capital Project Claims are received by the Capital Projects Staff from the subrecipient, and reviewed for allowable activities. They perform a detailed review of all supporting documentation attached to the Claim to determine if the costs concur with the terms & conditions of the subrecipient's Capital Project Agreement, and that all items are adequately supported. The Business Planner (Cheryl Dodge) then prepares a Payment Voucher (PV) document in TRAINS and assigns account coding to the PV, then forwards the draft PV to the Capital Program Delivery and Business Services Manager (Firas Makhoul) to review for processing payment. **The Capital Program Delivery and Business Services Manager review the PV document to make sure the appropriate Work Order # has been charged for the subrecipient (based on FTA agreement #), activities billed by the subrecipient occurred within the period of performance of the award, and that there is federal funding available to fund the reimbursement request. (Key Control #2) (Control Activities).**

Operating, Planning, and Mobility Project Claims are received by the Operating Projects staff from the subrecipient, and reviewed for allowable activities. If the claim is \$500,000 or greater, it will first be reviewed by a Community Liaison. Operating Projects staff performs a detailed review of all supporting documentation attached to the Claim to determine if the costs concur with the terms & conditions of the subrecipient's Operating Project Agreement, and that all items are adequately supported. They have a first level of review for operating invoices/claims. PTD does not require as detailed of backup documentation for operating invoices as opposed to capital. **Grants Manager Jill Nordstrom reviews and approves all claims on operating, planning and mobility projects. If Jill is unavailable, Firas Makhoul reviews and approves these claims (Key Control #3) (Control Activities).**

The Payments and Receipts Manager (Jennifer Heay), receives the request and stores it in a document queue, where one of the three Fiscal Analysts under the Payments and Receipts Manager's supervision review the PV for appropriate account coding. **The Fiscal Analyst, or Payments and Receipts Manager must sign the bottom of the PV document to indicate authorization for payment (Key Control #4) (Control Activities)** before processing the transaction in TRAINS and requesting a vendor warrant to be generated in AFRS.

Summary of Key Controls

Key Control #1 - WSDOT provides general terms and conditions to subrecipient agreements (awards) outlined in its "Consolidated Grant Guidebook". This manual is issued each biennium (when new subrecipient agreements are awarded) to all subrecipients receiving funding under the Section 5311 - Formula Grants for Rural Areas Program **(Information/Communication)**.

Key Control #2 - The Capital Program Delivery and Business Services Manager review the PV document to make sure the appropriate Work Order # has been charged for the subrecipient (based on FTA agreement #), activities billed by the subrecipient occurred within the period of performance of the award, and that there is federal funding available to fund the reimbursement request **(Control Activities)**.

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Key Control #3 - Grants Manager Jill Nordstrom reviews and approves Operating, Planning, and Mobility Projects. If Jill is unavailable, Firas Makhoul reviews and approves these claims (**Control Activities**).

Key Control #4 - The Fiscal Analyst, or Payments and Receipts Manager must sign the bottom of the PV document to indicate authorization for payment (**Control Activities**).

Evaluation of Results: We did not identify any control deficiencies.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: A-B. Activities Allowed/Cost Principles - Tests of Controls

Prepared By: BZH, 11/22/2022

Reviewed By: ACS, 12/7/2022

Purpose/Conclusion.

Purpose:

To identify the key internal controls and test these controls to determine if the controls are in place and operating as intended.
To provide a final control risk assessment based upon our testing of the key internal controls.

Source:

Jesse Daniels, External Audit Liaison
Doyle Dilley, Consultant Management Team
Cheryl Steben, Funding / Compliance / GMS support
Steven Meyeroff, FTA Compliance Administrator

Conclusion:

Based on our understanding of internal controls over Activities Allowed and Cost Principles, we tested the key controls. Based on our testing, internal controls

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are in place and operating as intended to prevent material noncompliance with federal requirements. **Final risk assessment is low.**

Testing Strategy:

A-B. Activities Allowed/Cost Principles - **Post Uniform Guidance Awards**

Step 5: Test Internal Controls

If preliminary control risk is:

LOW: Test the key internal controls to determine whether they are effective in preventing and detecting noncompliance with the requirement.

HIGH: Do not test the controls, report the issue in a finding as a “significant deficiency” or “material weakness” as appropriate.

About tests of controls: To determine whether the key controls are effective, the auditor should obtain evidence about how controls were applied at relevant times during the period under audit, the consistency with which they were applied, and by whom or by what means they were applied.

Provide Details: When documenting your testing in the ROWD, you should provide enough details so that an experienced auditor could re-perform the same test and reach the same conclusion. **See Inherent and Internal Control Risk Guidance** for what tests of controls generally include.

Remember, for a non-automated control, a “walk through” of the grantee’s process is not considered sufficient testing. A walk-through only provides an understanding of the design of a system – it does not provide evidence that the controls are effective.

-Dual purpose testing – consider whether the control can be tested in conjunction with a test of compliance to increase audit efficiency. If dual-purpose testing is performed, you must clearly document the results of control tests and compliance tests.

-If a key control is automated, control testing must include testing of both the automated control and related general controls. See additional information in the planning guide.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

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Step 6: Assess Final Control Risk (CR)

After testing the key controls, assess final control risk. This assessment must be either low or high. If you conclude that final control risk is high, this should be reported in a finding as a “significant deficiency” or “material weakness” as appropriate.

Note: Reassessment of final control risk is required under Step 5 when noncompliance is found.

Step 7: Assess the Risk of Material Non-Compliance (combined IR and CR)

Assess the risk of material noncompliance for this compliance requirement to help determine the nature and extent of compliance testing necessary to give an opinion on this program. The risk is based on auditor judgment in consideration of the inherent risk and control risk. Assess risk as Low, Moderate or High.

High does not result in a finding, but the auditor should consider the risk when designing the nature and extent of compliance testing.

Guidance/Criteria.7

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

----- Basic Cost Principles (2 CFR 200.402 – 409)

DEFINITIONS

Cost means an amount as determined on a cash, accrual, or other basis of accounting acceptable to the Federal awarding or cognizant agency.

Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are needed and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

Direct costs are those that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization). Examples of Direct Costs: payroll costs of employees who perform work that is directly related to the grant program; the cost of supplies and materials used for the purpose of the grant; equipment and other approved capital expenditures made for the grant; or professional services contracted to accomplish specific grant/contract objectives.

Indirect costs are those costs incurred for a common or institution-wide objective that benefits more than one grant program or project. Such costs are not readily assignable to the cost objective specifically benefited. Examples of Indirect Costs: depreciation and use allowances of non-federal equipment and buildings; facility operation and maintenance (lights, heat, phone, janitorial, grounds, etc);and general administrative expenses such as accounting, payroll, legal and data processing expenses.

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GENERAL COST PRINCIPLES AFFECTING ALLOWABILITY OF COSTS (2 CFR 200.403)

- (a) Be **necessary** and **reasonable** for the performance of the Federal award and be allocable thereto under these principles.
- (b) Conform to any **limitations** or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- (c) Be **consistent** with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- (d) Be **accorded consistent treatment**. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.
- (f) **Not be included as a cost or used to meet cost sharing or matching requirements** of any other federally-financed program in either the current or a prior period. See also §200.306 Cost sharing or matching paragraph (b).
- (g) Be **adequately documented**. See also §§200.300 Statutory and national policy requirements through 200.309 Period of performance of this part.

What is a Reasonable Cost (§200.404)? (cost principles)

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.

Other factors that must be considered in determining whether a cost is reasonable are:

whether the cost is generally considered as ordinary and necessary to the operation of the grantee or the performance of the federal award/program;

the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, federal, state and other laws and regulations, and terms and conditions of other federal awards, or sponsored agreements;

market prices for comparable goods and services;

whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the grantee, its employees, where applicable its students or membership, the public at large, and the federal government;

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whether the grantee significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal awards costs.

EXAMPLES:

1. A grantee is planning to purchase computers and printers with federal funds. The purchasing agent obtained phone quotes from three contractors. One contractor has a direct family relationship with the grantee's purchasing agent. It so happens that this contractor's quote was 20% higher than the other two. The grantee should not contract with this contractor because the price is unreasonable and has a conflict of interest (regardless of the price).

2. A grantee has been permitted in its grant contract to lease a vehicle so that it can travel within its region to deliver grant-related services to clients. The grantee has obtained quotes for a standard 4-door sedan and a luxury 4-wheel drive SUV that is twice the cost of the sedan. Which vehicle should the grantee choose? This is not to say a 4-wheel drive is not necessary or reasonable, but the price may dictate the type or model of vehicle.

What is an Allocable Cost (§200.405)? (cost principles)

A cost is considered allocable if the goods or services involved are chargeable or assignable to the federal award or cost objective (i.e., a specific function, project, sponsored agreement, service, or grant) in accordance with the relative benefits received.

Any cost allocable to a particular federal award may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by federal statutes, regulations, or terms and conditions of federal awards, or for other reasons.

If a grantee intends to recover the portion of its indirect costs (overhead, central administration, etc.) that relates to its grant programs, Uniform Guidance requires the grantee to develop a central service cost allocation plan and/or indirect cost rate proposal. Requirements pertaining to central service cost allocation plans and indirect cost proposals are found in Appendix III-VII to Part 200 (Uniform Guidance).

EXAMPLES:

1. An employee works on two different federal grant projects. The time spent on each project varies from day to day. This employee must keep monthly time and effort records that account for actual time spent on each project. By tracking actual effort, each grant will be charged its fair share of the costs.

2. A grantee held a training workshop for its employees. Included in the cost of the workshop was room rental, food, and travel. The workshop included a session that was specific to a federal program and a session that covered general personnel and human effectiveness training. The grantee should allocate the cost of the training among all programs/divisions that benefited from the training. Next, it should charge the allocated amount only to those awards that specifically allow for this type of cost.

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Applicable Credits (§200.406) (cost principles)

A "credit" means a receipt or reduction in expenditures that offset or reduce direct or indirect cost items. Examples include:

- purchase discounts;
- rebates or allowances;
- recoveries or indemnities on losses;
- insurance refunds or rebates; and
- adjustments of overpayments or erroneous charges.

When such credits are applicable to allowable costs, they must be credited to the federal award either as a cost reduction or a cash refund. In some instances, the amounts received from the federal government to finance a grantee's activities or service operations should be treated as applicable credits.

EXAMPLE:

A grantee paid a contractor for materials it needed for a project. It was determined later that the vendor had over-billed the grantee and was issuing a refund check. This refund should be netted against the total amount charged to the grant as a cost reduction. If the grant project had already been closed out, the refund should be remitted to the grantor agency that sponsored the project. Consult with the grantor agency in such a case.

Prior written approval (§200.407) (cost principles)

Under any given Federal award, the reasonableness and allocability of certain items of costs may be difficult to determine. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, the non-Federal entity may seek the prior written approval of the cognizant agency for indirect costs or the Federal awarding agency in advance of the incurrence of special or unusual costs. Prior written approval should include the timeframe or scope of the agreement. The absence of prior written approval on any element of cost will not, in itself, affect the reasonableness or allocability of that element, unless prior approval is specifically required for allowability as described under certain circumstances in the following sections of this part:

- (a) §200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts, paragraph (b)(5);
- (b) §200.306 Cost sharing or matching;
- (c) §200.307 Program income;
- (d) §200.308 Revision of budget and program plans;
- (e) §200.311 Real property;
- (f) §200.313 Equipment;
- (g) §200.332 Fixed amount subawards;
- (h) §200.413 Direct costs, paragraph (c);
- (i) §200.430 Compensation—personal services, paragraph (h);
- (j) §200.431 Compensation—fringe benefits;

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- (k) §200.438 Entertainment costs;
- (l) §200.439 Equipment and other capital expenditures;
- (m) §200.440 Exchange rates;
- (n) §200.441 Fines, penalties, damages and other settlements;
- (o) §200.442 Fund raising and investment management costs;
- (p) §200.445 Goods or services for personal use;
- (q) §200.447 Insurance and indemnification;
- (r) §200.454 Memberships, subscriptions, and professional activity costs, paragraph (c);
- (s) §200.455 Organization costs;
- (t) §200.456 Participant support costs;
- (u) §200.458 Pre-award costs;
- (v) §200.462 Rearrangement and reconversion costs;
- (w) §200.467 Selling and marketing costs;
- (x) §200.470 Taxes (including Value Added Tax); and
- (y) §200.474 Travel costs.

Consistency (2 CFR §200.403(d) (cost principles)

A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

EXAMPLE:

A grantee has five departments. It allocates the cost of its basic telephone service to each department based on the number of telephones in each department. Each department should treat the telephone cost consistently for all grants it administers. That is, if a department has 3 grant programs, that department should treat this telephone cost as either a direct cost or indirect cost for all 3 grants, but not a mix of each. Next, if treated as a direct cost, a department should only request reimbursement for this type of cost if permitted under the terms of its grant agreement(s).

Grant Agreement Limitations (§200.408) (cost principles)

To be allowable, the cost being charged must conform to any limitations or exclusions set forth in the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

EXAMPLE:

A grantee paid for a television advertisement to promote its new grant-funded health program. However, the approved grant contract limited the cost of advertising to brochures and radio ads. Therefore, the grantee should not include the cost of the television advertisement in its request for reimbursement even though "advertising" is an otherwise allowable cost according to Circular A-87.

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Adequate Supporting Documentation (2 CFR §200.403(g) (cost principles)

Amounts charged to federal awards must be supported by source documentation, including:

- payroll reports
- time and attendance records
- invoice vouchers from subrecipients
- receiving reports
- original vendor invoices
- cost allocation plans

(Documentation may be in an electronic form, but make sure the integrity of the electronic documentation can be maintained for the duration of the applicable record retention period).

EXAMPLE:

A grantee made a year-end adjustment to a federal award using a journal voucher entry. The accounting entry must be supported by adequate documentation that demonstrates both allowability and allocability.

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger

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populations.

ADDITIONAL TESTING SELECTION INFO & EXAMPLES

<i>Selection Options</i>		
Method	Process	Next Steps
Sampling	This is the preferred method for large populations (over 365). Use sampling tool from teammate.	Get the sample tool from Teammate. Take the sampling training if needed.
Haphazard Selection	May use for populations less than 365. Auditor haphazardly picks transactions. It feels random but only true "random" samples can be done by the computer in the sampling method.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab)
Judgmental Selection	May use for populations less than 365. The auditor has a specific reason, associated with a risk, to pick certain or certain transactions. Explain risks in the ROWD and how transactions not selected are lower risk.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab). See examples there.
Judgmental Population	First, the auditor has a specific reason, associated with a risk, to pick certain types of transactions (judgmental population). Explain risks in the ROWD and how populations not selected are lower risk (you can refer to the testing strategy if we have done this for you already). Next, the auditor selects transaction from the judgmental population using the sampling method above.	Get sample tool from Teammate. Take training for the form if needed.
All quantitatively material transactions	Use only when a few very large transactions make up the majority of grant activity. You will test all of these material transactions.	Keep in mind: If 10% or more of the population is made up of <i>other</i> types of costs, those transactions should be tested in some way, as well.

DUAL PURPOSE TESTING EXAMPLE

For allowable costs the key control is, "The Business Manager reviews the reimbursement request, reconciling the items requested to invoices to determine they are supported and allowable." You will test it by reperforming the Business Manager's review to determine if it is effective in preventing and detecting noncompliance. You may check the requests to see if they have the Business Manager's signature of approval but that will only tell you if they consistently do it, which is important. However, you should reperform the control.

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To complete compliance testing you are tracing expenditures from the requests to support to determine if they are supported and allowable per the program.

In this case, for testing both controls and compliance you are completing the same process. However, you need to document that you tested both and clearly show the conclusion of each even though they are related. Control testing should conclude whether the control was effective in preventing or detecting noncompliance and compliance testing whether the entity was in compliance.

INDIRECT COST UNDERSTANDING OF RATES/ALLOCATIONS

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

1. Rate Provided by Grantor: The federal grantor or PTE can give the entity an indirect cost rate in the award, usually outlined in the budget section and based on the availability of funding. There is no separate or formal rate agreement and it is not considered negotiated.

2. Use PTE Negotiated Rate: The federal grantor, PTE or federal guidance can require the entity to use PTE's negotiated indirect cost rate. This requirement can be found in the Compliance Supplement and federal pass-through guidance. The PTE will place the rate in their award with the entity. This is common for school districts.

3. De Minimis Indirect Cost Rate: If the entity elects to use the de minimis rate, a flat 10% (of Modified Total Direct Costs), in their grant application, no direct or pass-through grantor can deny its use so long as the entity qualifies.

Restrictions: The entity can use the method so long as they have **never** had a negotiated indirect cost rate or allocation plan approved by the federal cognizant agency **or** the PTE.

UPDATED GUIDANCE: Federal guidance now clarifies that negotiated rates and allocation plans negotiated by **PTEs** can prevent the use of the de minimis rate.

Consistency: If used, the entity must use the de minimis method for all of their Uniform Guidance federal programs that allow indirect costs.

Rate: Indirect costs are calculated as base costs multiplied by a flat 10% rate that does not require a true-up to actual indirect expenses.

Base Used: The 10% is multiplied by the modified total direct costs (MTDC) base.

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<i>MTDC Base</i>	
Includes	Excludes
Direct Salaries & Wages	Equipment & Capital Expenditures
Direct Fringe Benefits	Charges for Patient Care
Materials & Supplies	Participant Support Costs
Services	Rental Costs
Travel	Tuition remission, Scholarships & Fellowships
Up to \$25,000 of <i>each</i> subaward (regardless of the period of performance)	The portion of each subaward in excess of \$25,000

[4. Negotiated Rates & Allocation Plans – Cognizant Agency](#): Only major governments are required to obtain a cognizant agency approved negotiated rate or allocation plan. Smaller governments can opt to do so. The “cognizant agency for indirect costs” is designated as:

[For central service cost allocation plans](#): the federal agency with the largest dollar value of **total** federal awards

[For indirect cost rates and cost allocation plans](#): the federal agency with the largest dollar value of **direct** federal awards

Once designated, the federal entity remains the cognizant agency for five years. Under this method, the entity will be awarded a formal contract for the rate/allocation. All awarding agencies must accept the rate/allocation plan when the entity elects to use it in their program application.

Various allocation plans can be approved, but there are four types of rates:

1. **Provisional**: The provisional rate is temporary and expires upon the completion of the federal award. It requires a true-up to actual expenditures by the end of the project or whenever the entity obtains a final rate. The rate is adjusted by using the final rate.
2. **Final**: The rate is permanent and is calculated after the actual costs are known (i.e. at the conclusion of the federal project). It is used to adjust the indirect costs from the provisional rate.
3. **Predetermined**: This is a permanent rate and is calculated using actual costs from previous periods. It does not require a true-up to correspond with actual current year costs. The rate is effective between two to five years.
4. **Fixed**: This is a permanent rate and is calculated using actual costs from previous periods. It requires a true-up to correspond with actual current year costs. The variance between the costs used to create the rate and the actual costs incurred during the year the rate was used is carried-forward as an adjustment to the current rate. The entity will either recover or “pay back” the variance going forward.

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The rate is effective for two years and then can be annually renewed.

[5. Negotiated Rates & Allocation Plans – PTE](#): Indirect Cost Rate Proposals and Cost Allocation Plans are not required by UG to be submitted to/approved by PTE's, but the PTEs may require it. Usually a formal contract for the rate/allocation is not issued and they just review and/or approve the plan instead. Other pass-through entities are not required accept the rate/allocation plan but they can choose to accept it.

METHODS OF INDIRECT COST RATE CALCULATION

(1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:

(a) *Simplified Method* – This method is applicable where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

Multiple Allocation Base Method – This method is applicable where a governmental unit's department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)

(c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)

(d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a State or local government or unit's department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency's Federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP must be either submitted to the cognizant agency for indirect cost for review, negotiation

Record of Work Done.*

Internal Control Testing

Step 5

Key Control #1 - WSDOT provides general terms and conditions to subrecipient agreements (awards) outlined in its "Consolidated Grant Guidebook". This manual is issued each biennium (when new subrecipient agreements are awarded) to all subrecipients receiving funding under the Section 5311 - Formula Grants for Rural Areas Program (Information/Communication).

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- To test the identified key internal control, we reviewed the Consolidated Grant Guidebook published on the WSDOT website, as well as the prior Biennium issuance to ensure the Guidebook was being replaced each Biennium, as required. We reviewed the Guidebook and verified this key control to be working as intended.

No Exceptions Identified.

Key Control #2 - The Capital Program Delivery and Business Services Manager review the PV document to make sure the appropriate Work Order # has been charged for the subrecipient (based on FTA agreement #), activities billed by the subrecipient occurred within the period of performance of the award, and that there is federal funding available to fund the reimbursement request (Control Activities).

Key Control #3 - Grants Manager Jill Nordstrom reviews and approves Operating, Planning, and Mobility Projects. If Jill is unavailable, Firas Makhoul reviews and approves these claims (Control Activities).

Key Control #4 - The Fiscal Analyst, or Payments and Receipts Manager must sign the bottom of the PV document to indicate authorization for payment (Control Activities).

To test key controls #2, #3, and #4 we received a TRAINS expenditure report from the Department. We filtered our data by subobject NZ and performed vertical analysis of the expenditure data. We identified 216 transactions greater than \$0. Using this population, we consulted the *SWSA Small Population Sampling Spreadsheet* and we identified 3 Individually Significant Items (ISIs) (which we did not subject to control testing) and a sampling population of 22 Payment Vouchers. Jesse Daniels, External Audit Liaison, provided us with our 22 samples, along with backup documentation and work order approval via WATECH Secure File Transfer. [see: [SWSA Sampling - Activities Allowed \(NZ\) Control/Compliance Testing](#)].

We verified each Payment Voucher was billed to a Work Order #, and we verified either Jill Nordstrom or Firas Makhoul signed each Payment Voucher on behalf of Grants Management. We also verified an approved authority from the fiscal department signed each PV authorizing the transaction for processing.

No Exceptions Identified.

Evaluation of Results: We did not identify any control deficiencies.

Final Control Risk Assessment

Step 6

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will place reliance on the controls, based on our control testing above.

Risk of Material Noncompliance

Step 7

LOW – By combining our inherent risk assessment and internal control testing we have determined the risk of material noncompliance to be low. We will design our compliance testing based on this assessment.

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C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: A-B. Activities Allowed/Cost Principles - Compliance

Prepared By: BZH, 1/10/2023

Reviewed By: ACS, 1/26/2023

Purpose/Conclusion:

Purpose:

To determine if federal awards are expended only for allowable activities and that the costs of goods and services charged to federal awards are allowable and in accordance with the applicable cost principles.

Source:

Jesse Daniels, External Audit Liaison
Doyle Dilley, Consultant Management Team
Cheryl Steben, Funding / Compliance / GMS support
Steven Meyeroff, FTA Compliance Administrator

Conclusion:

The agency was in material compliance with federal requirements for Activities Allowed/Cost Principles.
No Exceptions Identified.

Testing Strategy:

Test Compliance

A. Direct Costs

1. Determine the method for how transactions are to be selected for testing. Options include:
 - Sampling – This is the required method for large populations (over 365). Use the Single Audit Sampling Template available in the TeamStore. Additional information on sampling can be found in the Training System or by consulting a sampling specialist. Sampling should be used whenever practical.

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- Haphazard Selection - Auditor haphazardly picks transactions. This method is statistically valid but should only be used when random sampling is not possible.
- High risk transactions - The auditor has a specific reason, associated with a risk, to pick certain types or specific transactions. Explain risks in the ROWD and how and why tested transactions were selected.
- **All individually material transactions - Testing all individually significant transactions (5% or more) in the population is required.**

Reminders:

- Material noncompliance with the requirement exists when questioned costs are at least 5% of the program expenditures. Therefore, we should not ignore types of costs that exceed 5% of the program, individually or in aggregate (by control system or type). (This rule does not apply if the auditor is using the sampling method for the entire population.)
- Consider expanding testing if errors are identified. This may not be necessary if sampling is used since it allows for an extrapolation of errors to the entire population.
- The auditor should be alert for large transfers of funds from state or local programs into the federal program. Transferred costs may not have met federal requirements (adequate support, federal procurement, period of performance, not allowable, etc.).

1. Selected Expenditures:

Test selected expenditures for compliance with the activities allowed and the Uniform Guidance cost principles using the A-B Expenditure Testing spreadsheet. All of the attributes are included on the spreadsheet. You can document your testing using the SA sampling spreadsheet available in the TeamStore, or a combination of both.

Was the expenditure or cost:

Activities allowed and Unallowed

(a) Made for an allowable activity under the program and agreement guidelines?

Allowable costs / Cost principles (*stop here if the program is a loan, since cost principles do not apply to loans, unless specifically included in the contract)

(b) Received prior written approval from the awarding agency, if required. – See the policy tab for a list of items that require prior written approval.

(c) Did not consist of improper payments, including (1) payments that should not have been made or that were made in incorrect amounts (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements; (2) payments that do not account for credit for applicable discounts; (3) duplicate payments; (4) payments that were made to an ineligible party or for an ineligible good or service; and (5) payments for goods or services not received (except for such payments

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where authorized by law).

(d) Were necessary, reasonable and allocable under 2 CFR, subpart E. (i.e. Does the nature and amount of the cost exceed that which would be considered prudent. Is the cost of a type that is ordinary and necessary for the operation of the program? Is it properly allocated to the program?)

(e) Were allowable under limitations or exclusions set forth in 2 CFR 200 Subpart E as to type and/or amount. (Search Subpart E or criteria related to specific items of cost that the auditor is reviewing.)

(f) Were consistent with policies and procedures that apply uniformly to Federal and non-Federal activities (i.e., is the federal government being charged the same amount as if non-federal funds were being used to pay the cost)?

(g) Given consistent treatment within and between accounting periods? (Consistency in accounting requires that costs incurred for the same purpose, in like circumstances, be treated as either direct costs only or indirect costs only with respect to final cost objectives.)

(h) Were not included as a cost of other federally-supported activities of the current or a prior period.

(i) Costs were not used to meet the cost-sharing or matching requirements of another Federal program, except where authorized by Federal statute.

(j) Supported by adequate documentation? (e.g., approved purchase orders, receiving reports, vendor invoices, canceled checks, time and effort records, current cost allocation plans, etc. Documentation may be in an electronic form)

(k) The transaction occurred within the period of performance. (Can be used as additional period of performance testing, but not the only testing for that requirement.)

2. [Applicable Credits](#):

Inquire with the grant or program coordinators, review financial reports or other activities to identify credit transactions (refunds, reimbursements, discounts, liquidated damages, etc.). Select some credits and determine if they reduced program costs for reimbursement (i.e. reduced a subsequent billing) or repaid the amount to the grantor since the credit must be passed along.

3. [Impact of improper payments or unallowable costs](#)

The auditor *should* consider the impact errors would have for "directly associated costs." Directly associated costs are incurred solely as a result of incurring another cost and would not have been incurred if the other cost had not happened. For example, fringe benefits are "directly associated" with payroll costs. When an unallowable cost is incurred, directly associated costs are also unallowable.

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B. Indirect Costs (Federally Negotiated Cost Allocation Plans, Indirect Cost Rates and De Minimis Cost Rate)

Required: You must test if indirect costs are at least 5% of the federal expenditures during the audit period.

1. **Method:** Select the testing strategy in the policy tab that matches the entity's method.

Rates Provided in Contract (including PTE's negotiated rate)

Minimis Indirect Cost Rate

Negotiated Rates & Allocation Plans – from Federal Cognizant Agency

Negotiated Rates & Allocation Plans – from Pass-Through Entity

2. **Impact of improper payments or unallowable costs**

The auditor *should* consider the impact indirect cost errors would have for "directly associated costs." Directly associated costs are incurred solely as a result of incurring another cost and would not have been incurred if the other cost had not happened.

3. **Special Audit Procedures for Indirect Cost Rate Proposals (ICRP):**

Reminder: If the entity is preparing an ICRP *during* the audit period to submit it to the *federal cognizant agency or its designee*, we are required to review the accuracy of the base data and calculations. The Compliance Supplement does not require this test for indirect cost rate/allocation plans negotiated with pass-through agencies.

Interim Testing: If the audit is completed before the ICRP is completed, consider performing interim testing on the cost pools and allocation bases and complete the testing in the next year's audit. For audit exceptions from interim testing, corrective action may be taken earlier to minimize questioned costs in the completed testing.

Tests: If this situation applies to you, use the testing strategy in the policy tab.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

Evaluation of Results: Did you identify any noncompliance? If so, **you must:**

1. Determine and document the magnitude of the noncompliance on the program as a whole or for this compliance area (5% materiality threshold).
2. Document the reason for the noncompliance.
3. Consider whether additional testing is needed to provide reasonable assurance of detecting material noncompliance (e.g. is the risk of material noncompliance increased for the activities or costs that you did not test?).
4. Reassess the final control risk. Generally, noncompliance is the result of a control deficiency; therefore, it is necessary to reconsider the effectiveness of the internal controls.] (Include this wording) After compliance testing we consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the

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SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**. This **did/did not** change our final control risk, see final control risk at ([link to controls](#)).

Note: Netting Questioned Costs: If you find the entity overbilled and underbilled the program, you *cannot* net them to determine total questioned costs. Overbilled amounts represent unallowable costs that are used to determine the level of non-compliance. Underbilled amounts just represent the availability of other costs that are considered allowable.

Guidance/Criteria:

INDIRECT COST COMPLIANCE TESTS – BY TYPE OF RATE/ALLOCATION

Select the testing criteria below that match the entity's method (De Minimis Cost Rate, Federally Negotiated Cost Allocation Plans/Rates and other indirect rates).

Rates Provided in Contract (including PTE's negotiated rate)

Reminder: Use these tests only for those indirect cost rates that are not negotiated. The rate is just provided by the grantor or the entity is required to use someone else's negotiated rate.

1. Rate: (Pre-UG & UG)

Select reimbursement requests using the small population table and determine whether the rate used was the one provided in the award contract. They are allowed to charge a smaller rate in most instances.

Alternatively, you can check the project end total direct costs vs. indirect costs to determine if, by the end of the project, the indirect cost proportion was the same as the rate provided in the award contract.

2. Base & Calculation: (Pre-UG & UG)

If the contract requires the awardee to use a modified base, such as certain direct costs have to be excluded, use your selection from test #1 and determine whether the appropriate base was used.

De Minimis Indirect Cost Rate – UG only

1. Restrictions: (UG only)

Determine if the entity is allowed to use the method. You are only required to check that they have not had a negotiated rate for the three fiscal years before the current audit period. The auditor may want to record this information in the FAWF for the future.

2. Consistency: (UG only)

Inquire with the grant managers throughout the entity, including at other departments if applicable, to determine if they use the de minimis method for all UG awards that include indirect costs.

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3. [Base & Calculation](#): (*UG only*)

Select reimbursement requests using the small population table and determine if the items included in the MTDC were allowable per the Uniform Guidance requirements in the Understanding section.

Negotiated Rates & Allocation Plans – from Federal Cognizant Agency

1. [Rate](#): (*Pre-UG & UG*)

Obtain and read the indirect cost rate agreement (ICRA) in effect during the audit period that was **approved** by the cognizant agency. Select reimbursement requests using the small population table and determine whether the rate used was the one from the approved ICRA.

2. [Base & Calculation](#): (*Pre-UG & UG*)

Determine if the cost base used was appropriate, such as:

- it includes only the types of costs mentioned in the ICRA,

- the costs were related to the program (allowable and meet the cost principles),

- the costs included are consistently treated in the current year as they were in the base year (e.g. the allocation base is total direct costs, verify that the audit year direct costs do not include items that were treated as indirect costs in the base year, as documented in the rate agreement), etc.

3. [Provisional Rate](#): (*Pre-UG & UG*)

If the entity had a **provisional rate**, determined if the amount was trued-up accurately per supported actual costs through the final rate at the end of the project (as applicable depending on the period covered by audit.)

4. [Fixed Rate](#): (*Pre-UG & UG*)

If the entity had a **fixed rate**, determine if the rate was trued-up on the required timeline, the true-up is accurate per supported actual costs, and the carry-forward is properly calculated.

Negotiated Rates & Allocation Plans – from Pass-Through Entity

1. [Rate](#): (*Pre-UG & UG*)

Obtain and read the rate/allocation proposal in effect during the audit period that was **approved** by a pass-through entity. Select reimbursement requests using the small population table and determine whether the rate used was the one from the approved rate/allocation proposal.

2. [Base & Calculation](#): (*Pre-UG & UG*)

Determine if the cost base used was appropriate, such as:

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it includes only the types of costs mentioned in the approved proposal,
the costs were related to the program (allowable and meet the cost principles),
the costs included are consistently treated in the current year as they were in the base year (e.g. the allocation base is total direct costs, verify that the audit year direct costs do not include items that were treated as indirect costs in the base year, as documented in the rate agreement), etc.

INDIRECT COST TESTS – INDIRECT COST RATE PROPOSAL SPECIAL TESTS (UG Only)

Reminder: If the entity is preparing an ICRP *during* the audit period to submit it to the *federal cognizant agency or its designee*, we are required to review the accuracy of the base data and calculations. The Compliance Supplement does not require this test for indirect cost rate/allocation plans negotiated with pass-through agencies.

Interim Testing: If the audit is completed before the ICRP is completed, consider performing interim testing the cost pools and allocation bases and complete the testing in the next year's audit. For audit exceptions from interim testing, corrective action may be taken earlier to minimize questioned costs in the completed testing.

(a) **Plan Elements:** Verify that the ICRP includes these required elements:

Rates proposed	Required certification statement.
Subsidiary worksheets and other doc. reconciled and cross-referenced to financial data that support proposed rates.	Approx. amount of direct costs related to federal awards. Show salaries/wages separate from other direct costs.
Copy of financial data (annual reports, budgets, etc.) on which the rates are based.	Organizational structure chart, identifying duties or all agency units.

*Refer to the next section in the policy tab below additional detail.

(b) **Indirect Cost Pool - Exclusions:** Determine if these unallowable costs were excluded from the indirect cost pool:

<i>Indirect Cost Pool</i>
Costs Exclude
Capital expenditures
General government costs not allocable to federal awards
Unallowable per law or regulation

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Unallowable per the Cost Principles and 2 CFR 200.420
Unallowable per terms/conditions of the federal award

- (c) [Indirect Cost Pool – Changes](#): Identify significant changes in expense categories between the prior ICRP and the current ICRP. Test a sample of transactions to verify the allowability of the costs.
- (d) [Indirect Cost Pool – Central Service](#): Trace the central service costs in the indirect cost pool to the approved State/local government or central service cost allocation plan, or to plans on file when the entity is not required to include the plan in their ICRP.
- (e) [Direct Cost Base – Allocability](#): (1) Determine that the proposed direct cost base(s) include all activities that benefit from the indirect costs being allocated.
- (f) [Direct Cost Base – Exp. Other than Salaries/Wages](#): If the base is not limited to direct salaries /wages, determine that distorting items are excluded from the base:

<i>Direct Cost Base</i>	
Distorting Items	
Capital expenditures	
Charges for patient care	
Participant Support Costs	
Rental Costs	
Tuition remission, Scholarships & Fellowships	
The portion of each subaward in excess of \$25,000	
General government costs not allocable to federal awards	
Unallowable per law or regulation	<i>However,</i> unallowable costs must be included if they represent activities to which indirect costs are properly allocable.
Unallowable per the Cost Principles and 2 CFR 200.420	
Unallowable per terms/conditions of the federal award	

- (g) [Direct Cost Base – Relatable Base](#): Determine the appropriateness of the allocation base (e.g., salaries and wages, modified total direct costs). The base should be relatable to the indirect costs being allocated.
- (h) [Payroll Records](#): Examine employee compensation records to determine if:
1. payroll records are accurate (2 CFR 200.430),

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2. salaries/wages are allowable
3. salaries/wages are properly allocated in the plan to the activities to which they were charged (paid from).

(i) Multiple Allocation Base Method: If the ICRP was prepared using the multiple allocation base method, test statistical data (e.g., square footage, audit hours, salaries and wages) to determine if the proposed allocation or rate bases are reasonable, updated as necessary, and do not contain any material omissions.

INDIRECT COSTS – DETAIL OF ICRP ELEMENTS

The elements are outline in 2 CFR 200 Appendix VII, Paragraph D:

"2. Documentation of Proposals - The following must be included with each indirect cost proposal:

- a. The rates proposed, including subsidiary work sheets and other relevant data, cross referenced and reconciled to the financial data noted in subsection b. Allocated central service costs will be supported by the summary table included in the approved central service cost allocation plan. This summary table is not required to be submitted with the indirect cost proposal if the central service cost allocation plan for the same fiscal year has been approved by the cognizant agency for indirect costs and is available to the funding agency.
- b. A copy of the financial data (financial statements, comprehensive annual financial report, executive budgets, accounting reports, etc.) upon which the rate is based. Adjustments resulting from the use of unaudited data will be recognized, where appropriate, by the Federal cognizant agency for indirect costs in a subsequent proposal.
- c. The approximate amount of direct base costs incurred under Federal awards. These costs should be broken out between salaries and wages and other direct costs.
- d. A chart showing the organizational structure of the agency during the period for which the proposal applies, along with a functional statement(s) noting the duties and/or responsibilities of all units that comprise the agency. (Once this is submitted, only revisions need be submitted with subsequent proposals.)

3. Required certification - Each indirect cost rate proposal must be accompanied by a certification in the following form:

Certificate of Indirect Costs

This is to certify that I have reviewed the indirect cost rate proposal submitted herewith and to the best of my knowledge and belief:

(1) All costs included in this proposal [identify date] to establish billing or final indirect costs rates for [identify period covered by rate] are allowable in accordance with the requirements of the Federal award(s) to which they apply and the provisions of this Part. Unallowable

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costs have been adjusted for in allocating costs as indicated in the indirect cost proposal

(2) All costs included in this proposal are properly allocable to Federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently and the Federal Government will be notified of any accounting changes that would affect the predetermined rate.

I declare that the foregoing is true and correct...[signatures]"

Record of Work Done:

Test Compliance

A. Direct Costs [SWSA A-B Expenditure Testing; SWSA Sampling - Activities Allowed (NZ) Control/Compliance Testing].

The Department sent us a TRAINS expenditure report. We sorted our expenditure data by NZ, performed vertical analysis and identified 216 transactions greater than \$0. Using this population, we consulted the *SWSA Small Population Sampling Spreadsheet* to identify 3 Individually Significant Items (ISIs) which we separately tested for compliance. and a sample of 22 Payment Vouchers were selected for testing from the remaining population.

We verified that each expenditure was for an allowable activity under the award, each expenditure had documentation evidencing management approval, was necessary and reasonable, and was within the period of performance of the agreement.

No exceptions identified.

B. Indirect Costs (Federally Negotiated Cost Allocation Plans, Indirect Cost Rates and De Minimis Cost Rate)

Not applicable for this program. We determined the Department did not charge indirect costs to the program during the audit period. Pass further analysis.

Evaluation of Results: We did not identify any noncompliance

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Payroll - Activities Allowed/Cost Principles - Controls

Prepared By: BZH, 2/22/2023

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Reviewed By: ACS, 2/22/2023

Purpose/Conclusion.

Purpose:

To gain an understanding of the internal controls the agency has in place to provide reasonable assurance that Federal awards are expended only for allowable activities and that expenditures charged to the Federal award are allowable and in accordance with the applicable cost principles.

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal award requirements related to allowable activities and cost principles.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

John Bernhard, Director of budget and program management.

Lewis Bequette, Controller WSF

Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Activities Allowed and Cost Principles, we assessed preliminary control risk as low.

Testing Strategy.

A-B. Activities Allowed/Cost Principles - **Post Uniform Guidance Awards**

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the **Inherent and Internal Control Risk Guidance** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Review scope of work

Allowable Activities - Determine which activities and types of costs are specifically allowed or unallowed, by reviewing the following:

1. Award agreement or approved application for scope of work, terms and conditions, and approved budget.

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2. Part 4 of the Compliance Supplement that applies to your audit period.
3. Available program guidelines or handbooks. (Ex. WSDOT's LAG Manual)
4. If above information is not available, look to the federal regulations (contact the single audit specialist if you need assistance with this).

Requirements for Cost Principles are found as follows:

Pre-UG: OMB Circular A-87

UG: 2 CFR 200, Subpart E.

Please be familiar with these requirements as not all are listed below; only parts emphasized in the Compliance Supplement are listed below.

Quantitatively Material

Identify the expenditure activities that are directly charged to the program and are quantitatively material (more than 5%).

Direct Costs

Payroll Expenditures: When payroll costs are selected for our single audit, our focus is on whether the portion of payroll charged to the program (allocation) is supported by appropriate time and effort and meets the cost principles. Note that awarding agencies may require specific forms of documentation to support payroll charged to its award.

Compensated Absences (leave cash-outs or accrual): The entity may include employees' use of leave (which is included in their regular salary payments). If the entity charges any **leave cash-outs** or the **accrual of leave** to the grant, there are special rules, see extra guidance in the policy tab. There is a high risk the costs are unallowable.

Non-Payroll Expenditures: Generally, auditors should test internal controls and compliance for non-payroll expenditures when those costs are quantitatively material (5%) to the program.

Automated Controls: If you identify key internal controls that are automated, consult with the SWSA Supervisor or SWSA AIC to determine whether to request automated control work from Team IT audit.

Indirect Costs

Determine whether the agency has recovered indirect costs via an indirect cost rate or cost allocation plan and, if so, how much was expended. If indirect costs are material to the program the auditor must test the internal controls (and compliance) over them when those costs are quantitatively material (5%) to the program.

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement. These are discussed in the **policy tab** in further detail, for when indirect costs are material to the program.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method

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4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

Special – Review In-process Proposals: If the entity is preparing an Indirect Cost Rate Proposal during the audit period in order to submit it to the federal cognizant agency, we are required to review the accuracy of the base data and calculations.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) Activities Allowed: grant funds are used only for allowable activities (this may include review of expenditures, program monitoring, preparing the reimbursement requests, establishment of programs);

(b) Cost Principles: direct and indirect costs charged to the grant comply with the cost principles set forth in 2 CFR 200 Subpart E (this may or may not be the same control activity for (a))

(c) Activities Allowed-Indirect Costs: if material (5%), the entity uses the proper indirect cost rate (per approved plan or rate, de minimis only when it is applicable, or another rate established by contract). Controls should also focus on how the entity properly calculates the direct cost base that the indirect rate is applied to. For instance, the controls should ensure that they are using only allowable types of costs in the MTDC or other direct base as applicable, that those costs are not used twice or that they occurred during the contract's period of performance. Note: These controls are likely **different** than those in (a) and possibly (b).

Evaluation of Results: Did you identify any control deficiencies? If yes, you must:

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

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Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as “LOW” when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee’s internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Basic Cost Principles (2 CFR 200.402 – 409)

DEFINITIONS

Cost means an amount as determined on a cash, accrual, or other basis of accounting acceptable to the Federal awarding or cognizant agency.

Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are needed and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

Direct costs are those that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization). Examples of Direct Costs: payroll costs of employees who perform work that is directly related to the grant program; the cost of supplies and materials used for the purpose of the grant; equipment and other approved capital expenditures made for the grant; or professional services contracted to accomplish specific grant/contract objectives.

Indirect costs are those costs incurred for a common or institution-wide objective that benefits more than one grant program or project. Such

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costs are not readily assignable to the cost objective specifically benefited. Examples of Indirect Costs: depreciation and use allowances of non-federal equipment and buildings; facility operation and maintenance (lights, heat, phone, janitorial, grounds, etc);and general administrative expenses such as accounting, payroll, legal and data processing expenses.

GENERAL COST PRINCIPLES AFFECTING ALLOWABILITY OF COSTS (2 CFR 200.403)

- (a) Be **necessary** and **reasonable** for the performance of the Federal award and be allocable thereto under these principles.
- (b) Conform to any **limitations** or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- (c) Be **consistent** with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- (d) Be **accorded consistent treatment**. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.
- (f) **Not be included as a cost or used to meet cost sharing or matching requirements** of any other federally-financed program in either the current or a prior period. See also §200.306 Cost sharing or matching paragraph (b).
- (g) Be **adequately documented**. See also §§200.300 Statutory and national policy requirements through 200.309 Period of performance of this part.

What is a Reasonable Cost (§200.404)? (cost principles)

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.

Other factors that must be considered in determining whether a cost is reasonable are:

whether the cost is generally considered as ordinary and necessary to the operation of the grantee or the performance of the federal award/program;

the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, federal, state and other laws and regulations, and terms and conditions of other federal awards, or sponsored agreements;

market prices for comparable goods and services;

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whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the grantee, its employees, where applicable its students or membership, the public at large, and the federal government;

whether the grantee significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal awards costs.

EXAMPLES:

1. A grantee is planning to purchase computers and printers with federal funds. The purchasing agent obtained phone quotes from three contractors. One contractor has a direct family relationship with the grantee's purchasing agent. It so happens that this contractor's quote was 20% higher than the other two. The grantee should not contract with this contractor because the price is unreasonable and has a conflict of interest (regardless of the price).

2. A grantee has been permitted in its grant contract to lease a vehicle so that it can travel within its region to deliver grant-related services to clients. The grantee has obtained quotes for a standard 4-door sedan and a luxury 4-wheel drive SUV that is twice the cost of the sedan. Which vehicle should the grantee choose? This is not to say a 4-wheel drive is not necessary or reasonable, but the price may dictate the type or model of vehicle.

What is an Allocable Cost (§200.405)? (cost principles)

A cost is considered allocable if the goods or services involved are chargeable or assignable to the federal award or cost objective (i.e., a specific function, project, sponsored agreement, service, or grant) in accordance with the relative benefits received.

Any cost allocable to a particular federal award may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by federal statutes, regulations, or terms and conditions of federal awards, or for other reasons.

If a grantee intends to recover the portion of its indirect costs (overhead, central administration, etc.) that relates to its grant programs, Uniform Guidance requires the grantee to develop a central service cost allocation plan and/or indirect cost rate proposal. Requirements pertaining to central service cost allocation plans and indirect cost proposals are found in Appendix III-VII to Part 200 (Uniform Guidance).

EXAMPLES:

1. An employee works on two different federal grant projects. The time spent on each project varies from day to day. This employee must keep monthly time and effort records that account for actual time spent on each project. By tracking actual effort, each grant will be charged its fair share of the costs.

2. A grantee held a training workshop for its employees. Included in the cost of the workshop was room rental, food, and travel. The workshop included a session that was specific to a federal program and a session that covered general personnel and human effectiveness training. The

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grantee should allocate the cost of the training among all programs/divisions that benefited from the training. Next, it should charge the allocated amount only to those awards that specifically allow for this type of cost.

Applicable Credits (§200.406) (cost principles)

A "credit" means a receipt or reduction in expenditures that offset or reduce direct or indirect cost items. Examples include:

- purchase discounts;
- rebates or allowances;
- recoveries or indemnities on losses;
- insurance refunds or rebates; and
- adjustments of overpayments or erroneous charges.

When such credits are applicable to allowable costs, they must be credited to the federal award either as a cost reduction or a cash refund. In some instances, the amounts received from the federal government to finance a grantee's activities or service operations should be treated as applicable credits.

EXAMPLE:

A grantee paid a contractor for materials it needed for a project. It was determined later that the vendor had over-billed the grantee and was issuing a refund check. This refund should be netted against the total amount charged to the grant as a cost reduction. If the grant project had already been closed out, the refund should be remitted to the grantor agency that sponsored the project. Consult with the grantor agency in such a case.

Prior written approval (§200.407) (cost principles)

Under any given Federal award, the reasonableness and allocability of certain items of costs may be difficult to determine. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, the non-Federal entity may seek the prior written approval of the cognizant agency for indirect costs or the Federal awarding agency in advance of the incurrence of special or unusual costs. Prior written approval should include the timeframe or scope of the agreement. The absence of prior written approval on any element of cost will not, in itself, affect the reasonableness or allocability of that element, unless prior approval is specifically required for allowability as described under certain circumstances in the following sections of this part:

- (a) §200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts, paragraph (b)(5);
- (b) §200.306 Cost sharing or matching;
- (c) §200.307 Program income;
- (d) §200.308 Revision of budget and program plans;
- (e) §200.311 Real property;
- (f) §200.313 Equipment;
- (g) §200.332 Fixed amount subawards;

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- (h) §200.413 Direct costs, paragraph (c);
- (i) §200.430 Compensation—personal services, paragraph (h);
- (j) §200.431 Compensation—fringe benefits;
- (k) §200.438 Entertainment costs;
- (l) §200.439 Equipment and other capital expenditures;
- (m) §200.440 Exchange rates;
- (n) §200.441 Fines, penalties, damages and other settlements;
- (o) §200.442 Fund raising and investment management costs;
- (p) §200.445 Goods or services for personal use;
- (q) §200.447 Insurance and indemnification;
- (r) §200.454 Memberships, subscriptions, and professional activity costs, paragraph (c);
- (s) §200.455 Organization costs;
- (t) §200.456 Participant support costs;
- (u) §200.458 Pre-award costs;
- (v) §200.462 Rearrangement and reconversion costs;
- (w) §200.467 Selling and marketing costs;
- (x) §200.470 Taxes (including Value Added Tax); and
- (y) §200.474 Travel costs.

Consistency (2 CFR §200.403(d) (cost principles)

A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

EXAMPLE:

A grantee has five departments. It allocates the cost of its basic telephone service to each department based on the number of telephones in each department. Each department should treat the telephone cost consistently for all grants it administers. That is, if a department has 3 grant programs, that department should treat this telephone cost as either a direct cost or indirect cost for all 3 grants, but not a mix of each. Next, if treated as a direct cost, a department should only request reimbursement for this type of cost if permitted under the terms of its grant agreement(s).

Grant Agreement Limitations (§200.408) (cost principles)

To be allowable, the cost being charged must conform to any limitations or exclusions set forth in the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

EXAMPLE:

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A grantee paid for a television advertisement to promote its new grant-funded health program. However, the approved grant contract limited the cost of advertising to brochures and radio ads. Therefore, the grantee should not include the cost of the television advertisement in its request for reimbursement even though "advertising" is an otherwise allowable cost according to Circular A-87.

Adequate Supporting Documentation (2 CFR §200.403(g) (cost principles)

Amounts charged to federal awards must be supported by source documentation, including:

- payroll reports
- time and attendance records
- invoice vouchers from subrecipients
- receiving reports
- original vendor invoices
- cost allocation plans

(Documentation may be in an electronic form, but make sure the integrity of the electronic documentation can be maintained for the duration of the applicable record retention period).

EXAMPLE:

A grantee made a year-end adjustment to a federal award using a journal voucher entry. The accounting entry must be supported by adequate documentation that demonstrates both allowability and allocability.

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24

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365 (daily)	13	20	28
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Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

ADDITIONAL TESTING SELECTION INFO & EXAMPLES

<i>Selection Options</i>		
Method	Process	Next Steps
Sampling	This is the preferred method for large populations (over 365). Use sampling tool from teammate.	Get the sample tool from Teammate. Take the sampling training if needed.
Haphazard Selection	May use for populations less than 365. Auditor haphazardly picks transactions. It feels random but only true "random" samples can be done by the computer in the sampling method.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab)
Judgmental Selection	May use for populations less than 365. The auditor has a specific reason, associated with a risk, to pick certain or certain transactions. Explain risks in the ROWD and how transactions not selected are lower risk.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab). See examples there.
Judgmental Population	First, the auditor has a specific reason, associated with a risk, to pick certain types of transactions (judgmental population). Explain risks in the ROWD and how populations not selected are lower risk (you can refer to the testing strategy if we have done this for you already). Next, the auditor selects transaction from the judgmental population using the sampling method above.	Get sample tool from Teammate. Take training for the form if needed.
All quantitatively material transactions	Use only when a few very large transactions make up the majority of grant activity. You will test all of these material transactions.	Keep in mind: If 10% or more of the population is made up of <i>other</i> types of costs, those transactions should be tested in some way, as well.

DUAL PURPOSE TESTING EXAMPLE

For allowable costs the key control is, "The Business Manager reviews the reimbursement request, reconciling the items requested to invoices to determine they are supported and allowable." You will test it by reperforming the Business Manager's review to determine if it is effective in

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preventing and detecting noncompliance. You may check the requests to see if they have the Business Manager's signature of approval but that will only tell you if they consistently do it, which is important. However, you should reperform the control.

To complete compliance testing you are tracing expenditures from the requests to support to determine if they are supported and allowable per the program.

In this case, for testing both controls and compliance you are completing the same process. However, you need to document that you tested both and clearly show the conclusion of each even though they are related. Control testing should conclude whether the control was effective in preventing or detecting noncompliance and compliance testing whether the entity was in compliance.

INDIRECT COST UNDERSTANDING OF RATES/ALLOCATIONS

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

1. Rate Provided by Grantor: The federal grantor or PTE can give the entity an indirect cost rate in the award, usually outlined in the budget section and based on the availability of funding. There is no separate or formal rate agreement and it is not considered negotiated.

2. Use PTE Negotiated Rate: The federal grantor, PTE or federal guidance can require the entity to use PTE's negotiated indirect cost rate. This requirement can be found in the Compliance Supplement and federal pass-through guidance. The PTE will place the rate in their award with the entity. This is common for school districts.

3. De Minimis Indirect Cost Rate: If the entity elects to use the de minimis rate, a flat 10% (of Modified Total Direct Costs), in their grant application, no direct or pass-through grantor can deny its use so long as the entity qualifies.

Restrictions: The entity can use the method so long as they have **never** had a negotiated indirect cost rate or allocation plan approved by the federal cognizant agency **or** the PTE.

UPDATED GUIDANCE: Federal guidance now clarifies that negotiated rates and allocation plans negotiated by **PTEs** can prevent the use of the de minimis rate.

Consistency: If used, the entity must use the de minimis method for all of their Uniform Guidance federal programs that allow indirect costs.

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Rate: Indirect costs are calculated as base costs multiplied by a flat 10% rate that does not require a true-up to actual indirect expenses.

Base Used: The 10% is multiplied by the modified total direct costs (MTDC) base.

<i>MTDC Base</i>	
Includes	Excludes
Direct Salaries & Wages	Equipment & Capital Expenditures
Direct Fringe Benefits	Charges for Patient Care
Materials & Supplies	Participant Support Costs
Services	Rental Costs
Travel	Tuition remission, Scholarships & Fellowships
Up to \$25,000 of <i>each</i> subaward (regardless of the period of performance)	The portion of each subaward in excess of \$25,000

4. Negotiated Rates & Allocation Plans – Cognizant Agency: Only major governments are required to obtain a cognizant agency approved negotiated rate or allocation plan. Smaller governments can opt to do so. The “cognizant agency for indirect costs” is designated as:

For central service cost allocation plans: the federal agency with the largest dollar value of ***total*** federal awards

For indirect cost rates and cost allocation plans: the federal agency with the largest dollar value of ***direct*** federal awards

Once designated, the federal entity remains the cognizant agency for five years. Under this method, the entity will be awarded a formal contract for the rate/allocation. All awarding agencies must accept the rate/allocation plan when the entity elects to use it in their program application.

Various allocation plans can be approved, but there are four types of rates:

1. **Provisional:** The provisional rate is temporary and expires upon the completion of the federal award. It requires a true-up to actual expenditures by the end of the project or whenever the entity obtains a final rate. The rate is adjusted by using the final rate.
2. **Final:** The rate is permanent and is calculated after the actual costs are known (i.e. at the conclusion of the federal project). It is used to adjust the indirect costs from the provisional rate.
3. **Predetermined:** This is a permanent rate and is calculated using actual costs from previous periods. It does not require a true-up to correspond with actual current year costs. The rate is effective between two to five years.

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4. **Fixed:** This is a permanent rate and is calculated using actual costs from previous periods. It requires a true-up to correspond with actual current year costs. The variance between the costs used to create the rate and the actual costs incurred during the year the rate was used is carried-forward as an adjustment to the current rate. The entity will either recover or “pay back” the variance going forward. The rate is effective for two years and then can be annually renewed.

5. Negotiated Rates & Allocation Plans – PTE: Indirect Cost Rate Proposals and Cost Allocation Plans are not required by UG to be submitted to/approved by PTE's, but the PTEs may require it. Usually a formal contract for the rate/allocation is not issued and they just review and/or approve the plan instead. Other pass-through entities are not required accept the rate/allocation plan but they can choose to accept it.

METHODS OF INDIRECT COST RATE CALCULATION

(1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:

(a) *Simplified Method* – This method is applicable where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

Multiple Allocation Base Method – This method is applicable where a governmental unit's department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)

(c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)

(d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a State or local government or unit's department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency's Federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP must be either submitted to the cognizant agency for indirect cost for review, negotiation

Record of Work Done:

Inherent Risk of Noncompliance

Step 1

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We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review scope of work

We reviewed the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine which activities and costs are allowed or unallowed. We identified the following:

Indirect Costs

There are no indirect costs to consider for this audit area.

Material Expenditures

We identified the following expenditure activities that are directly charged to the program and are quantitatively material (more than 5%): [FINAL Expenditures and Revenue].

Subobject NZ:

\$	39,466,938.00	48.21%
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Subobject TA:

\$	37,890,302.18	46.28%
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Total	Total (%)
\$ 77,357,240.18	94.48%

We tested subobject NZ separately at [A-B. Activities Allowed/Cost Principles - Controls].

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

We requested and reviewed all of the Department's written policies and procedures related to Payroll as part of gaining an understanding of internal controls [see: GL 116 Journal Voucher Process 210621].

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We documented the Department's response to our request for their Understanding of Controls regarding payroll [see: [ICRL - Activities Allowed-Cost Principles](#) [WSF](#)].

We met with the following staff from Washington State Ferries on November 9th, 2022 to gain an understanding of their key internal controls:

- John Bernhard, Director of budget and program management.
- Lewis Bequette, Controller WSF
- Jesse Daniels, External Audit Liaison

WSF operates transit service in both the Seattle-Tacoma-Everett Urbanized Area (STE-UZA) as well as Rural routes in varied areas across the State. WSF 5311 Formula Grants for Rural Areas billings are limited by net operating expenses in the rural areas of the state. The determination of net operating expenses is based on operating expenses incurred minus any operating fares collected. In order to simplify the administration of the grant, with the use of CARES and CRSSA, WSF has limited its claiming for federal reimbursement to salaries and benefits to the people actually operating the vessels on the rural routes. This includes both vessel operations staff, as well as terminal workers.

We asked John Bernhard to describe the process of reviewing and approving these time charges to the federal award. John explained that originally, the payroll transactions were processed in accordance with the Department's standard process, which is as follows:

1. Ferries operations staff have to complete time cards (certifications), to submit to their direct supervisor in the Vessel or Terminal program. WSF has switched to a digital time card system using Marine Labor system.
2. The supervisor reviews and approves the time certification, approving for processing.
3. Time certifications are routed to a Capital Accountant, who enters the time information into the Marine Labor system, which interfaces with TRAINS.

Staff time certifications are reviewed and approved by the employee's direct supervisor for processing, to ensure all time charges are allowable and supported. (Key Control #1) (Control Activities).

WSF identifies groups of vessel staff timesheets that are allowable to be charged to the grant. WSF collects the total cost as a state appropriation while determining how much of that can be transferred to a federal appropriation based on how much they are allowed to charge to the grant (net operating expenses). Ann Garman, Transportation Planning Specialist 5, tracks in WSDOT's Labor Data Mart (Mart) the route(s) each vessel worked and how many days each route was worked in order to determine which routes are rural and which routes are urban. Once this information has been gathered, WSF will prorate a share of the cost based on the determination of route(s) ran and days spent and journal voucher a bundle of the allowable timesheets into federal appropriations. Ann keeps documentation of all the JVs in the Mart. The Mart contains information like what work, what vessel, what job they perform, what terminals they are operating out of.

Every vessel will have a minimum of 2 work orders. Work order codes are established in TRAINS and coded to specific groups to ensure costs are accurately

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accounted for. Washington State Ferries will then allow these payroll costs to become state appropriations. Once these work orders hit the state accounting record, the Ferries division will JV the expenditures and allocate it to becoming a federal expenditure. This process is done manually:

- A Director's Business Manager will prepare a JV request, and include the following information:
 - Operating Program X: organization
 - Grant number and phase
 - Work Order Group Category, Group Number, and Group Title
 - Brief explanation of why the JV is being requested.
- To ensure accuracy, the Operating Program Manager, Work Order Manager, and WSF Accounting and Grants Manager must all concur with the JV. **The Operating Program Manager will then approve the JV request and then send it to WSF Accounting for processing. (Key Control #2) (Control Activities).**
- All JV transfers must be reviewed, approved and forwarded to WSDOT by the appropriate Program Manager(s) and the Budget Director, if necessary. Directors and their staff should not process JV requests outside this process.

Once the expenditures are recognized as federal, WSDOT will prepare their monthly ECHO draw and send what the Ferries charged to WSF. WSF reviews this ECHO draw request to ensure it aligns with what they have JV'd, and the Director of Budget and Program Management, John Bernhard, signs off and gives it back to WSF Accounting (AFS).

Summary of key internal controls

Key Control #1 - Staff time certifications are reviewed and approved by the employee's direct supervisor for processing, to ensure all time charges are allowable and supported. (Control Activities)

Key Control #2 - To ensure accuracy, the appropriate Operating Program Manager will approve the JV request and send it to WSF Accounting for processing. (Control Activities)

Evaluation of Results:

We did not identify any control deficiencies.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Payroll - Activities Allowed/Cost Principles - Tests of Controls

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Prepared By: BZH, 2/27/2023

Reviewed By: ACS, 3/7/2023

Purpose/Conclusion:

Purpose:

To identify the key internal controls and test these controls to determine if the controls are in place and operating as intended.
To provide a final control risk assessment based upon our testing of the key internal controls.

Source:

John Bernhard, Director of budget and program management.
Lewis Bequette, Controller WSF
Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Activities Allowed and Cost Principles, we tested the key controls. Based on our testing, internal controls are in place and operating as intended to prevent material noncompliance with federal requirements. **Final risk assessment is low.**

Testing Strategy:

A-B. Activities Allowed/Cost Principles - **Post Uniform Guidance Awards**

Step 5: Test Internal Controls

If preliminary control risk is:

LOW: Test the key internal controls to determine whether they are effective in preventing and detecting noncompliance with the requirement.

HIGH: Do not test the controls, report the issue in a finding as a “significant deficiency” or “material weakness” as appropriate.

About tests of controls: To determine whether the key controls are effective, the auditor should obtain evidence about how controls were applied at relevant times during the period under audit, the consistency with which they were applied, and by whom or by what means they were applied.

Provide Details: When documenting your testing in the ROWD, you should provide enough details so that an experienced auditor could re-perform the same test and reach the same conclusion. **See Inherent and Internal Control Risk Guidance** for what tests of controls generally include.

Remember, for a non-automated control, a “walk through” of the grantee’s process is not considered sufficient testing. A walk-through only provides

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an understanding of the design of a system – it does not provide evidence that the controls are effective.

-Dual purpose testing – consider whether the control can be tested in conjunction with a test of compliance to increase audit efficiency. If dual-purpose testing is performed, you must clearly document the results of control tests and compliance tests.

-If a key control is automated, control testing must include testing of both the automated control and related general controls. See additional information in the planning guide.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.

2. Document the rationale for a LOW or HIGH risk assessment.]

Step 6: Assess Final Control Risk (CR)

After testing the key controls, assess final control risk. This assessment must be either low or high. If you conclude that final control risk is high, this should be reported in a finding as a “significant deficiency” or “material weakness” as appropriate.

Note: Reassessment of final control risk is required under Step 5 when noncompliance is found.

Step 7: Assess the Risk of Material Non-Compliance (combined IR and CR)

Assess the risk of material noncompliance for this compliance requirement to help determine the nature and extent of compliance testing necessary to give an opinion on this program. The risk is based on auditor judgment in consideration of the inherent risk and control risk. Assess risk as Low, Moderate or High.

High does not result in a finding, but the auditor should consider the risk when designing the nature and extent of compliance testing.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

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Basic Cost Principles (2 CFR 200.402 – 409)

DEFINITIONS

Cost means an amount as determined on a cash, accrual, or other basis of accounting acceptable to the Federal awarding or cognizant agency.

Cost objective means a function, organizational subdivision, contract, grant, or other work unit for which cost data are needed and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

Direct costs are those that can be identified specifically with a particular final cost objective (i.e., a particular award, project, service, or other direct activity of an organization). Examples of Direct Costs: payroll costs of employees who perform work that is directly related to the grant program; the cost of supplies and materials used for the purpose of the grant; equipment and other approved capital expenditures made for the grant; or professional services contracted to accomplish specific grant/contract objectives.

Indirect costs are those costs incurred for a common or institution-wide objective that benefits more than one grant program or project. Such costs are not readily assignable to the cost objective specifically benefited. Examples of Indirect Costs: depreciation and use allowances of non-federal equipment and buildings; facility operation and maintenance (lights, heat, phone, janitorial, grounds, etc); and general administrative expenses such as accounting, payroll, legal and data processing expenses.

GENERAL COST PRINCIPLES AFFECTING ALLOWABILITY OF COSTS (2 CFR 200.403)

- (a) Be **necessary** and **reasonable** for the performance of the Federal award and be allocable thereto under these principles.
- (b) Conform to any **limitations** or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- (c) Be **consistent** with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- (d) Be **accorded consistent treatment**. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.
- (f) **Not be included as a cost or used to meet cost sharing or matching requirements** of any other federally-financed program in either the current or a prior period. See also §200.306 Cost sharing or matching paragraph (b).
- (g) Be **adequately documented**. See also §§200.300 Statutory and national policy requirements through 200.309 Period of performance of this part.

What is a Reasonable Cost (§200.404)? (cost principles)

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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.

Other factors that must be considered in determining whether a cost is reasonable are:

whether the cost is generally considered as ordinary and necessary to the operation of the grantee or the performance of the federal award/program;

the restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, federal, state and other laws and regulations, and terms and conditions of other federal awards, or sponsored agreements;

market prices for comparable goods and services;

whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the grantee, its employees, where applicable its students or membership, the public at large, and the federal government;

whether the grantee significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the federal awards costs.

EXAMPLES:

1. A grantee is planning to purchase computers and printers with federal funds. The purchasing agent obtained phone quotes from three contractors. One contractor has a direct family relationship with the grantee's purchasing agent. It so happens that this contractor's quote was 20% higher than the other two. The grantee should not contract with this contractor because the price is unreasonable and has a conflict of interest (regardless of the price).

2. A grantee has been permitted in its grant contract to lease a vehicle so that it can travel within its region to deliver grant-related services to clients. The grantee has obtained quotes for a standard 4-door sedan and a luxury 4-wheel drive SUV that is twice the cost of the sedan. Which vehicle should the grantee choose? This is not to say a 4-wheel drive is not necessary or reasonable, but the price may dictate the type or model of vehicle.

What is an Allocable Cost (§200.405)? (cost principles)

A cost is considered allocable if the goods or services involved are chargeable or assignable to the federal award or cost objective (i.e., a specific function, project, sponsored agreement, service, or grant) in accordance with the relative benefits received.

Any cost allocable to a particular federal award may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions

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imposed by federal statutes, regulations, or terms and conditions of federal awards, or for other reasons.

If a grantee intends to recover the portion of its indirect costs (overhead, central administration, etc.) that relates to its grant programs, Uniform Guidance requires the grantee to develop a central service cost allocation plan and/or indirect cost rate proposal. Requirements pertaining to central service cost allocation plans and indirect cost proposals are found in Appendix III-VII to Part 200 (Uniform Guidance).

EXAMPLES:

1. An employee works on two different federal grant projects. The time spent on each project varies from day to day. This employee must keep monthly time and effort records that account for actual time spent on each project. By tracking actual effort, each grant will be charged its fair share of the costs.
2. A grantee held a training workshop for its employees. Included in the cost of the workshop was room rental, food, and travel. The workshop included a session that was specific to a federal program and a session that covered general personnel and human effectiveness training. The grantee should allocate the cost of the training among all programs/divisions that benefited from the training. Next, it should charge the allocated amount only to those awards that specifically allow for this type of cost.

Applicable Credits (§200.406) (cost principles)

A "credit" means a receipt or reduction in expenditures that offset or reduce direct or indirect cost items. Examples include:

- purchase discounts;
- rebates or allowances;
- recoveries or indemnities on losses;
- insurance refunds or rebates; and
- adjustments of overpayments or erroneous charges.

When such credits are applicable to allowable costs, they must be credited to the federal award either as a cost reduction or a cash refund. In some instances, the amounts received from the federal government to finance a grantee's activities or service operations should be treated as applicable credits.

EXAMPLE:

A grantee paid a contractor for materials it needed for a project. It was determined later that the vendor had over-billed the grantee and was issuing a refund check. This refund should be netted against the total amount charged to the grant as a cost reduction. If the grant project had already been closed out, the refund should be remitted to the grantor agency that sponsored the project. Consult with the grantor agency in such a case.

Prior written approval (§200.407) (cost principles)

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Under any given Federal award, the reasonableness and allocability of certain items of costs may be difficult to determine. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, the non-Federal entity may seek the prior written approval of the cognizant agency for indirect costs or the Federal awarding agency in advance of the incurrence of special or unusual costs. Prior written approval should include the timeframe or scope of the agreement. The absence of prior written approval on any element of cost will not, in itself, affect the reasonableness or allocability of that element, unless prior approval is specifically required for allowability as described under certain circumstances in the following sections of this part:

- (a) §200.201 Use of grant agreements (including fixed amount awards), cooperative agreements, and contracts, paragraph (b)(5);
- (b) §200.306 Cost sharing or matching;
- (c) §200.307 Program income;
- (d) §200.308 Revision of budget and program plans;
- (e) §200.311 Real property;
- (f) §200.313 Equipment;
- (g) §200.332 Fixed amount subawards;
- (h) §200.413 Direct costs, paragraph (c);
- (i) §200.430 Compensation—personal services, paragraph (h);
- (j) §200.431 Compensation—fringe benefits;
- (k) §200.438 Entertainment costs;
- (l) §200.439 Equipment and other capital expenditures;
- (m) §200.440 Exchange rates;
- (n) §200.441 Fines, penalties, damages and other settlements;
- (o) §200.442 Fund raising and investment management costs;
- (p) §200.445 Goods or services for personal use;
- (q) §200.447 Insurance and indemnification;
- (r) §200.454 Memberships, subscriptions, and professional activity costs, paragraph (c);
- (s) §200.455 Organization costs;
- (t) §200.456 Participant support costs;
- (u) §200.458 Pre-award costs;
- (v) §200.462 Rearrangement and reconversion costs;
- (w) §200.467 Selling and marketing costs;
- (x) §200.470 Taxes (including Value Added Tax); and
- (y) §200.474 Travel costs.

Consistency (2 CFR §200.403(d) (cost principles)

A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

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EXAMPLE:

A grantee has five departments. It allocates the cost of its basic telephone service to each department based on the number of telephones in each department. Each department should treat the telephone cost consistently for all grants it administers. That is, if a department has 3 grant programs, that department should treat this telephone cost as either a direct cost or indirect cost for all 3 grants, but not a mix of each. Next, if treated as a direct cost, a department should only request reimbursement for this type of cost if permitted under the terms of its grant agreement(s).

Grant Agreement Limitations (§200.408) (cost principles)

To be allowable, the cost being charged must conform to any limitations or exclusions set forth in the terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

EXAMPLE:

A grantee paid for a television advertisement to promote its new grant-funded health program. However, the approved grant contract limited the cost of advertising to brochures and radio ads. Therefore, the grantee should not include the cost of the television advertisement in its request for reimbursement even though “advertising” is an otherwise allowable cost according to Circular A-87.

Adequate Supporting Documentation (2 CFR §200.403(g) (cost principles)

Amounts charged to federal awards must be supported by source documentation, including:

- payroll reports
- time and attendance records
- invoice vouchers from subrecipients
- receiving reports
- original vendor invoices
- cost allocation plans

(Documentation may be in an electronic form, but make sure the integrity of the electronic documentation can be maintained for the duration of the applicable record retention period).

EXAMPLE:

A grantee made a year-end adjustment to a federal award using a journal voucher entry. The accounting entry must be supported by adequate documentation that demonstrates both allowability and allocability.

SMALL POPULATION – SELECTION SIZE

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Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
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Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

ADDITIONAL TESTING SELECTION INFO & EXAMPLES

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Method	Process	Next Steps
Sampling	This is the preferred method for large populations (over 365). Use sampling tool from teammate.	Get the sample tool from Teammate. Take the sampling training if needed.
Haphazard Selection	May use for populations less than 365. Auditor haphazardly picks transactions. It feels random but only true "random" samples can be done by the computer in the sampling method.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab)
Judgmental Selection	May use for populations less than 365. The auditor has a specific reason, associated with a risk, to pick certain or certain transactions. Explain risks in the ROWD and how transactions not selected are lower risk.	Use policy 3240 table in the policy tab to determine minimum selection size (policy tab). See examples there.

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Judgmental Population	First, the auditor has a specific reason, associated with a risk, to pick certain types of transactions (judgmental population). Explain risks in the ROWD and how populations not selected are lower risk (you can refer to the testing strategy if we have done this for you already). Next, the auditor selects transaction from the judgmental population using the sampling method above.	Get sample tool from Teammate. Take training for the form if needed.
All quantitatively material transactions	Use only when a few very large transactions make up the majority of grant activity. You will test all of these material transactions.	Keep in mind: If 10% or more of the population is made up of <i>other</i> types of costs, those transactions should be tested in some way, as well.

DUAL PURPOSE TESTING EXAMPLE

For allowable costs the key control is, "The Business Manager reviews the reimbursement request, reconciling the items requested to invoices to determine they are supported and allowable." You will test it by reperforming the Business Manager's review to determine if it is effective in preventing and detecting noncompliance. You may check the requests to see if they have the Business Manager's signature of approval but that will only tell you if they consistently do it, which is important. However, you should reperform the control.

To complete compliance testing you are tracing expenditures from the requests to support to determine if they are supported and allowable per the program.

In this case, for testing both controls and compliance you are completing the same process. However, you need to document that you tested both and clearly show the conclusion of each even though they are related. Control testing should conclude whether the control was effective in preventing or detecting noncompliance and compliance testing whether the entity was in compliance.

INDIRECT COST UNDERSTANDING OF RATES/ALLOCATIONS

Overview: There are five general methods used in federal programs to apply indirect costs to the award, as identified in the auditee's agreement.

1. Rate provided by the grantor
2. Required to use the pass-through entity's (PTE's) negotiated indirect cost rate
3. De Minimis Indirect Cost Rate method
4. Negotiated rate or cost allocation plan approved by the cognizant agency
5. Negotiated rate or cost allocation plan approved or accepted by the pass-through entity (PTE)

1. Rate Provided by Grantor: The federal grantor or PTE can give the entity an indirect cost rate in the award, usually outlined in the budget

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section and based on the availability of funding. There is no separate or formal rate agreement and it is not considered negotiated.

2. Use PTE Negotiated Rate: The federal grantor, PTE or federal guidance can require the entity to use PTE's negotiated indirect cost rate. This requirement can be found in the Compliance Supplement and federal pass-through guidance. The PTE will place the rate in their award with the entity. This is common for school districts.

3. De Minimis Indirect Cost Rate: If the entity elects to use the de minimis rate, a flat 10% (of Modified Total Direct Costs), in their grant application, no direct or pass-through grantor can deny its use so long as the entity qualifies.

Restrictions: The entity can use the method so long as they have **never** had a negotiated indirect cost rate or allocation plan approved by the federal cognizant agency **or** the PTE.

UPDATED GUIDANCE: Federal guidance now clarifies that negotiated rates and allocation plans negotiated by **PTEs** can prevent the use of the de minimis rate.

Consistency: If used, the entity must use the de minimis method for all of their Uniform Guidance federal programs that allow indirect costs.

Rate: Indirect costs are calculated as base costs multiplied by a flat 10% rate that does not require a true-up to actual indirect expenses.

Base Used: The 10% is multiplied by the modified total direct costs (MTDC) base.

<i>MTDC Base</i>	
Includes	Excludes
Direct Salaries & Wages	Equipment & Capital Expenditures
Direct Fringe Benefits	Charges for Patient Care
Materials & Supplies	Participant Support Costs
Services	Rental Costs
Travel	Tuition remission, Scholarships & Fellowships
Up to \$25,000 of <i>each</i> subaward (regardless of the period of performance)	The portion of each subaward in excess of \$25,000

4. Negotiated Rates & Allocation Plans – Cognizant Agency: Only major governments are required to obtain a cognizant agency approved negotiated rate or allocation plan. Smaller governments can opt to do so. The "cognizant agency for indirect costs" is designated as:

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For central service cost allocation plans: the federal agency with the largest dollar value of *total* federal awards

For indirect cost rates and cost allocation plans: the federal agency with the largest dollar value of *direct* federal awards

Once designated, the federal entity remains the cognizant agency for five years. Under this method, the entity will be awarded a formal contract for the rate/allocation. All awarding agencies must accept the rate/allocation plan when the entity elects to use it in their program application.

Various allocation plans can be approved, but there are four types of rates:

1. **Provisional**: The provisional rate is temporary and expires upon the completion of the federal award. It requires a true-up to actual expenditures by the end of the project or whenever the entity obtains a final rate. The rate is adjusted by using the final rate.
2. **Final**: The rate is permanent and is calculated after the actual costs are known (i.e. at the conclusion of the federal project). It is used to adjust the indirect costs from the provisional rate.
3. **Predetermined**: This is a permanent rate and is calculated using actual costs from previous periods. It does not require a true-up to correspond with actual current year costs. The rate is effective between two to five years.
4. **Fixed**: This is a permanent rate and is calculated using actual costs from previous periods. It requires a true-up to correspond with actual current year costs. The variance between the costs used to create the rate and the actual costs incurred during the year the rate was used is carried-forward as an adjustment to the current rate. The entity will either recover or “pay back” the variance going forward. The rate is effective for two years and then can be annually renewed.

5. Negotiated Rates & Allocation Plans – PTE: Indirect Cost Rate Proposals and Cost Allocation Plans are not required by UG to be submitted to/approved by PTE's, but the PTEs may require it. Usually a formal contract for the rate/allocation is not issued and they just review and/or approve the plan instead. Other pass-through entities are not required accept the rate/allocation plan but they can choose to accept it.

METHODS OF INDIRECT COST RATE CALCULATION

(1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:

(a) *Simplified Method* – This method is applicable where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

Multiple Allocation Base Method – This method is applicable where a governmental unit's department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the

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relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)

(c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)

(d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a State or local government or unit's department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency's Federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP must be either submitted to the cognizant agency for indirect cost for review, negotiation

Record of Work Done."

Internal Control Testing

Step 5

During our gaining of understanding **over controls**, we learned WSF identifies groups of vessel staff timesheets that are allowable to be charged to the grant. WSF collects the total cost as a state appropriation while determining how much of that can be transferred to a federal appropriation based on how much they are allowed to charge to the grant (net operating expenses).

Because of this, we determined the Amount of each transaction actually applied to the FTA Award, since the Department was instructed to deduct farebox revenues, and any other operating revenues received from its maintenance and operating expenses before claiming federal reimbursement. Payroll did not reflect this amount, as the Department moves these expenditures in TRAINS through a Journal Voucher process, so we confirmed the total time charges that would have been allocated to the WA-2021-022-00_SF Award and the total amount JV'd to that award as a percentage, then applied that percentage (multiplied by the payroll amount). We then treated this as the actual amount charged to the federal award in each sample (88 percent).

Key Control #1 - Staff time certifications are reviewed and approved by the employee's direct supervisor for processing, to ensure all time charges are allowable and supported.

To test the identified key internal controls we used the testing spreadsheet located at [[SWSA Sampling - Activities Allowed \(TA\) Control/Compliance Testing](#)] to determine the required sample size. We used the list of JVs identified in key control #2, and obtained a line-item list of payroll charges by employee ID. We grouped transactions from DOTTime by employee, work date, and job class code, which produced a total population of 87,952 unique line items [see: [DOTTime payroll data \(for all JV's\)](#)] for a total of \$39,481,102. We consulted the *SWSA Control Statistical Sampling* Spreadsheet and selected a sample of 59 employee time charges.

For each time charge, we verified that the corresponding timesheet was signed and approved by a WSF supervisor. ***No Exceptions Identified***

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Key Control #2 - To ensure accuracy, the appropriate Operating Program Manager will approve the JV request and send it to WSF Accounting for processing.

To test this key control, we identified a list of Journal Vouchers (with prefix "JV36") that were specifically used to transfer the state employee payroll appropriations as federal appropriations. We used that list and identified our total population of 15 JVs. We consulted the *SWSA Small Population Sampling Spreadsheet* and identified our sample population of 6 JVs. [see: [SWSA Sampling - Activities Allowed \(TA\) Control/Compliance Testing](#)].

We reviewed each JV in our sample and verified the Operating Program Manager had approved the request, indicated by their electronic signature on the JV document. In addition, we noted the Budget Director emailed AFS staff indicating the JV's were approved for processing.

No Exceptions Identified

Evaluation of Results: We did not identify any control deficiencies.

Final Control Risk Assessment

Step 6

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will place reliance on the controls, based on our control testing above.

Risk of Material Noncompliance

Step 7

LOW – By combining our inherent risk assessment and internal control testing we have determined the risk of material noncompliance to be low. We will design our compliance testing based on this assessment.

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: Payroll - Activities Allowed/Cost Principles - Compliance

Prepared By: BZH, 2/27/2023

Reviewed By: ACS, 3/7/2023

Purpose/Conclusion:

Purpose:

To determine if federal awards are expended only for allowable activities and that the costs of goods and services charged to federal awards are allowable and in accordance with the applicable cost principles.

Source:

State of Washington

John Bernhard, Director of budget and program management.
Lewis Bequette, Controller WSF
Jesse Daniels, External Audit Liaison

Conclusion:

The agency was in material compliance with federal requirements for Activities Allowed/Cost Principles. We did not identify any noncompliance.

Testing Strategy:

Test Compliance

A. Direct Costs

1. Determine the method for how transactions are to be selected for testing. Options include:
 - Sampling – This is the required method for large populations (over 365). Use the Single Audit Sampling Template available in the TeamStore. Additional information on sampling can be found in the Training System or by consulting a sampling specialist. Sampling should be used whenever practical.
 - Haphazard Selection - Auditor haphazardly picks transactions. This method is statistically valid but should only be used when random sampling is not possible.
 - High risk transactions - The auditor has a specific reason, associated with a risk, to pick certain types or specific transactions. Explain risks in the ROWD and how and why tested transactions were selected.
 - **All individually material transactions - Testing all individually significant transactions (5% or more) in the population is required.**

Reminders:

- Material noncompliance with the requirement exists when questioned costs are at least 5% of the program expenditures. Therefore, we should not ignore types of costs that exceed 5% of the program, individually or in aggregate (by control system or type). (This rule does not apply if the auditor is using the sampling method for the entire population.)
- Consider expanding testing if errors are identified. This may not be necessary if sampling is used since it allows for an extrapolation of errors to the entire population.
- The auditor should be alert for large transfers of funds from state or local programs into the federal program. Transferred costs may not have met federal requirements (adequate support, federal procurement, period of performance, not allowable, etc.).

1. Selected Expenditures:

Test selected expenditures for compliance with the activities allowed and the Uniform Guidance cost principles using the A-B Expenditure Testing spreadsheet. All of the attributes are included on the spreadsheet. You can document your testing using the SA sampling spreadsheet available in the TeamStore, or a combination of both.

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Was the expenditure or cost:

Activities allowed and Unallowed

(a) Made for an allowable activity under the program and agreement guidelines?

Allowable costs / Cost principles (*stop here if the program is a loan, since cost principles do not apply to loans, unless specifically included in the contract)

(b) Received prior written approval from the awarding agency, if required. – See the policy tab for a list of items that require prior written approval.

(c) Did not consist of improper payments, including (1) payments that should not have been made or that were made in incorrect amounts (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements; (2) payments that do not account for credit for applicable discounts; (3) duplicate payments; (4) payments that were made to an ineligible party or for an ineligible good or service; and (5) payments for goods or services not received (except for such payments where authorized by law).

(d) Were necessary, reasonable and allocable under 2 CFR, subpart E. (i.e. Does the nature and amount of the cost exceed that which would be considered prudent. Is the cost of a type that is ordinary and necessary for the operation of the program? Is it properly allocated to the program?)

(e) Were allowable under limitations or exclusions set forth in 2 CFR 200 Subpart E as to type and/or amount. (Search Subpart E or criteria related to specific items of cost that the auditor is reviewing.)

(f) Were consistent with policies and procedures that apply uniformly to Federal and non-Federal activities (i.e., is the federal government being charged the same amount as if non-federal funds were being used to pay the cost)?

(g) Given consistent treatment within and between accounting periods? (Consistency in accounting requires that costs incurred for the same purpose, in like circumstances, be treated as either direct costs only or indirect costs only with respect to final cost objectives.)

(h) Were not included as a cost of other federally-supported activities of the current or a prior period.

(i) Costs were not used to meet the cost-sharing or matching requirements of another Federal program, except where authorized by Federal statute.

(j) Supported by adequate documentation? (e.g., approved purchase orders, receiving reports, vendor invoices, canceled checks, time and

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effort records, current cost allocation plans, etc. Documentation may be in an electronic form)

(k) The transaction occurred within the period of performance. (Can be used as additional period of performance testing, but not the only testing for that requirement.)

2. Applicable Credits:

Inquire with the grant or program coordinators, review financial reports or other activities to identify credit transactions (refunds, reimbursements, discounts, liquidated damages, etc.). Select some credits and determine if they reduced program costs for reimbursement (i.e. reduced a subsequent billing) or repaid the amount to the grantor since the credit must be passed along.

3. Impact of improper payments or unallowable costs

The auditor *should* consider the impact errors would have for “directly associated costs.” Directly associated costs are incurred solely as a result of incurring another cost and would not have been incurred if the other cost had not happened. For example, fringe benefits are “directly associated” with payroll costs. When an unallowable cost is incurred, directly associated costs are also unallowable.

B. Indirect Costs (Federally Negotiated Cost Allocation Plans, Indirect Cost Rates and De Minimis Cost Rate)

Required: You must test if indirect costs are at least 5% of the federal expenditures during the audit period.

1. Method: Select the testing strategy in the policy tab that matches the entity’s method.

Rates Provided in Contract (including PTE’s negotiated rate)

Minimis Indirect Cost Rate

Negotiated Rates & Allocation Plans – from Federal Cognizant Agency

Negotiated Rates & Allocation Plans – from Pass-Through Entity

2. Impact of improper payments or unallowable costs

The auditor *should* consider the impact indirect cost errors would have for “directly associated costs.” Directly associated costs are incurred solely as a result of incurring another cost and would not have been incurred if the other cost had not happened.

3. Special Audit Procedures for Indirect Cost Rate Proposals (ICRP):

Reminder: If the entity is preparing an ICRP *during* the audit period to submit it to the *federal cognizant agency or its designee*, we are required to review the accuracy of the base data and calculations. The Compliance Supplement does not require this test for indirect cost

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rate/allocation plans negotiated with pass-through agencies.

Interim Testing: If the audit is completed before the ICRP is completed, consider performing interim testing on the cost pools and allocation bases and complete the testing in the next year's audit. For audit exceptions from interim testing, corrective action may be taken earlier to minimize questioned costs in the completed testing.

Tests: If this situation applies to you, use the testing strategy in the policy tab.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

Evaluation of Results: Did you identify any noncompliance? If so, **you must:**

1. Determine and document the magnitude of the noncompliance on the program as a whole or for this compliance area (5% materiality threshold).
2. Document the reason for the noncompliance.
3. Consider whether additional testing is needed to provide reasonable assurance of detecting material noncompliance (e.g. is the risk of material noncompliance increased for the activities or costs that you did not test?).
4. Reassess the final control risk. Generally, noncompliance is the result of a control deficiency; therefore, it is necessary to reconsider the effectiveness of the internal controls.] (Include this wording) After compliance testing we consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**. This **did/did not** change our final control risk, see final control risk at ([link to controls](#)).

Note: **Netting Questioned Costs:** If you find the entity overbilled and underbilled the program, you *cannot* net them to determine total questioned costs. Overbilled amounts represent unallowable costs that are used to determine the level of non-compliance. Underbilled amounts just represent the availability of other costs that are considered allowable.

Guidance/Criteria.

INDIRECT COST COMPLIANCE TESTS – BY TYPE OF RATE/ALLOCATION

Select the testing criteria below that match the entity's method (De Minimis Cost Rate, Federally Negotiated Cost Allocation Plans/Rates and other indirect rates).

Rates Provided in Contract (including PTE's negotiated rate)

Reminder: Use these tests only for those indirect cost rates that are not negotiated. The rate is just provided by the grantor or the entity is required to use someone else's negotiated rate.

1. **Rate:** (*Pre-UG & UG*)

Select reimbursement requests using the small population table and determine whether the rate used was the one provided in the award contract. They are allowed to charge a smaller rate in most instances.

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Alternatively, you can check the project end total direct costs vs. indirect costs to determine if, by the end of the project, the indirect cost proportion was the same as the rate provided in the award contract.

2. [Base & Calculation](#): *(Pre-UG & UG)*

If the contract requires the awardee to use a modified base, such as certain direct costs have to be excluded, use your selection from test #1 and determine whether the appropriate base was used.

De Minimis Indirect Cost Rate – UG only

1. [Restrictions](#): *(UG only)*

Determine if the entity is allowed to use the method. You are only required to check that they have not had a negotiated rate for the three fiscal years before the current audit period. The auditor may want to record this information in the FAWF for the future.

2. [Consistency](#): *(UG only)*

Inquire with the grant managers throughout the entity, including at other departments if applicable, to determine if they use the de minimis method for all UG awards that include indirect costs.

3. [Base & Calculation](#): *(UG only)*

Select reimbursement requests using the small population table and determine if the items included in the MTDC were allowable per the Uniform Guidance requirements in the Understanding section.

Negotiated Rates & Allocation Plans – from Federal Cognizant Agency

1. [Rate](#): *(Pre-UG & UG)*

Obtain and read the indirect cost rate agreement (ICRA) in effect during the audit period that was **approved** by the cognizant agency. Select reimbursement requests using the small population table and determine whether the rate used was the one from the approved ICRA.

2. [Base & Calculation](#): *(Pre-UG & UG)*

Determine if the cost base used was appropriate, such as:

- it includes only the types of costs mentioned in the ICRA,

- the costs were related to the program (allowable and meet the cost principles),

- the costs included are consistently treated in the current year as they were in the base year (e.g. the allocation base is total direct costs, verify that the audit year direct costs do not include items that were treated as indirect costs in the base year, as documented in the rate agreement), etc.

3. [Provisional Rate](#): *(Pre-UG & UG)*

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If the entity had a **provisional rate**, determined if the amount was trued-up accurately per supported actual costs through the final rate at the end of the project (as applicable depending on the period covered by audit.)

4. **Fixed Rate:** (*Pre-UG & UG*)

If the entity had a **fixed rate**, determine if the rate was trued-up on the required timeline, the true-up is accurate per supported actual costs, and the carry-forward is properly calculated.

Negotiated Rates & Allocation Plans – from Pass-Through Entity

1. **Rate:** (*Pre-UG & UG*)

Obtain and read the rate/allocation proposal in effect during the audit period that was **approved** by a pass-through entity. Select reimbursement requests using the small population table and determine whether the rate used was the one from the approved rate/allocation proposal.

2. **Base & Calculation:** (*Pre-UG & UG*)

Determine if the cost base used was appropriate, such as:

- it includes only the types of costs mentioned in the approved proposal,

- the costs were related to the program (allowable and meet the cost principles),

- the costs included are consistently treated in the current year as they were in the base year (e.g. the allocation base is total direct costs, verify that the audit year direct costs do not include items that were treated as indirect costs in the base year, as documented in the rate agreement), etc.

INDIRECT COST TESTS – INDIRECT COST RATE PROPOSAL SPECIAL TESTS (*UG Only*)

Reminder: If the entity is preparing an ICRP *during* the audit period to submit it to the *federal cognizant agency or its designee*, we are required to review the accuracy of the base data and calculations. The Compliance Supplement does not require this test for indirect cost rate/allocation plans negotiated with pass-through agencies.

Interim Testing: If the audit is completed before the ICRP is completed, consider performing interim testing the cost pools and allocation bases and complete the testing in the next year's audit. For audit exceptions from interim testing, corrective action may be taken earlier to minimize questioned costs in the completed testing.

(a) **Plan Elements:** Verify that the ICRP includes these required elements:

Rates proposed	Required certification statement.
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Subsidiary worksheets and other doc. reconciled and cross-referenced to financial data that support proposed rates.	Approx. amount of direct costs related to federal awards. Show salaries/wages separate from other direct costs.
Copy of financial data (annual reports, budgets, etc.) on which the rates are based.	Organizational structure chart, identifying duties or all agency units.

*Refer to the next section in the policy tab below additional detail.

- (b) [Indirect Cost Pool - Exclusions](#): Determine if these unallowable costs were excluded from the indirect cost pool:

<i>Indirect Cost Pool</i>
Costs Exclude
Capital expenditures
General government costs not allocable to federal awards
Unallowable per law or regulation
Unallowable per the Cost Principles and 2 CFR 200.420
Unallowable per terms/conditions of the federal award

- (c) [Indirect Cost Pool – Changes](#): Identify significant changes in expense categories between the prior ICRP and the current ICRP. Test a sample of transactions to verify the allowability of the costs.

- (d) [Indirect Cost Pool – Central Service](#): Trace the central service costs in the indirect cost pool to the approved State/local government or central service cost allocation plan, or to plans on file when the entity is not required to include the plan in their ICRP.

- (e) [Direct Cost Base – Allocability](#): (1) Determine that the proposed direct cost base(s) include all activities that benefit from the indirect costs being allocated.

- (f) [Direct Cost Base – Exp. Other than Salaries/Wages](#): If the base is not limited to direct salaries /wages, determine that distorting items are excluded from the base:

<i>Direct Cost Base</i>	
Distorting Items	
Capital expenditures	

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Charges for patient care	
Participant Support Costs	
Rental Costs	
Tuition remission, Scholarships & Fellowships	
The portion of each subaward in excess of \$25,000	
General government costs not allocable to federal awards	
Unallowable per law or regulation	<i>However, unallowable costs must be included if they represent activities to which indirect costs are properly allocable.</i>
Unallowable per the Cost Principles and 2 CFR 200.420	
Unallowable per terms/conditions of the federal award	

(g) Direct Cost Base – Relatable Base: Determine the appropriateness of the allocation base (e.g., salaries and wages, modified total direct costs). The base should be relatable to the indirect costs being allocated.

(h) Payroll Records: Examine employee compensation records to determine if:

1. payroll records are accurate (2 CFR 200.430),
2. salaries/wages are allowable
3. salaries/wages are properly allocated in the plan to the activities to which they were charged (paid from).

(i) Multiple Allocation Base Method: If the ICRP was prepared using the multiple allocation base method, test statistical data (e.g., square footage, audit hours, salaries and wages) to determine if the proposed allocation or rate bases are reasonable, updated as necessary, and do not contain any material omissions.

INDIRECT COSTS – DETAIL OF ICRP ELEMENTS

The elements are outline in 2 CFR 200 Appendix VII, Paragraph D:

"2. Documentation of Proposals - The following must be included with each indirect cost proposal:

- a. The rates proposed, including subsidiary work sheets and other relevant data, cross referenced and reconciled to the financial data noted in subsection b. Allocated central service costs will be supported by the summary table included in the approved central service cost allocation plan. This summary table is not required to be submitted with the indirect cost proposal if the central service cost allocation plan for the same fiscal year has been approved by the cognizant agency for indirect costs and is available to the funding agency.
- b. A copy of the financial data (financial statements, comprehensive annual financial report, executive budgets, accounting reports, etc.)

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upon which the rate is based. Adjustments resulting from the use of unaudited data will be recognized, where appropriate, by the Federal cognizant agency for indirect costs in a subsequent proposal.

- c. The approximate amount of direct base costs incurred under Federal awards. These costs should be broken out between salaries and wages and other direct costs.
- d. A chart showing the organizational structure of the agency during the period for which the proposal applies, along with a functional statement(s) noting the duties and/or responsibilities of all units that comprise the agency. (Once this is submitted, only revisions need be submitted with subsequent proposals.)

3. Required certification - Each indirect cost rate proposal must be accompanied by a certification in the following form:

Certificate of Indirect Costs

This is to certify that I have reviewed the indirect cost rate proposal submitted herewith and to the best of my knowledge and belief:

(1) All costs included in this proposal [identify date] to establish billing or final indirect costs rates for [identify period covered by rate] are allowable in accordance with the requirements of the Federal award(s) to which they apply and the provisions of this Part. Unallowable costs have been adjusted for in allocating costs as indicated in the indirect cost proposal

(2) All costs included in this proposal are properly allocable to Federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently and the Federal Government will be notified of any accounting changes that would affect the predetermined rate.

I declare that the foregoing is true and correct...[signatures]"

Record of Work Done.*

Transaction testing for Activities Allowed [SWSA Sampling - Activities Allowed (TA) Control/Compliance Testing].

We used a line-item list of payroll charges by employee ID that we identified during our testing of key controls [Payroll - Activities Allowed/Cost Principles - Tests of Controls]. We grouped transactions from DOTTime by employee, work date, and job class code, which produced a total population of 87,952 unique line items [see: DOTTime payroll data (for all JV's)]. We reconciled this report with the TRAINS expenditure report for subobject TA to ensure the totals matched prior to sampling. We consulted the *SWSA Control Statistical Sampling* Spreadsheet and identified our sampling population of 59 employee time charges. Based on the distribution of individual time charges and amounts, we did not believe stratification was justified in this instance. We determined the Amount of each transaction actually applied to the FTA Award as 88 percent. [see: Payroll - Activities Allowed/Cost Principles - Tests of Controls].

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We identified in the grant award that WSF has explicit permission to charge when identifying their net operating expenses and use this grant to fund that number. WSF staff has elected to use this grant to fund only a portion of their staff payroll charges. We verified that these timesheets were verified by the employees direct supervisor; the expenditure was allowable under the grant based on the employee's route worked, and the job class of the employee. ***No Exceptions Identified***

Cost Principles [SWSA A-B Expenditure Testing].

For each of our 59 sample transactions, we obtained time summaries, as well as position description forms for the employees, JV documents from the WSF Budget group, and tested the following:

- The employee's job class work code corresponds to an approved code in the grant award
- The number of hours reported in DOTTime is supported by the employee timesheet
- The amount charged to the grant is for time worked on the approved vessel/route and at the correct rate
- The amount charged to the grant accounts for any applicable rebates, credits, or payroll adjustments due to error
- The amount appears to be charged to the correct Work Order group in TRAINS

We determined the Department was in material compliance with federal requirements for Allowable Costs/Cost Principles. ***No Exceptions Identified***

Evaluation of Results: We did not identify any noncompliance.

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: C. Cash Management - Controls

Prepared By: BZH, 1/9/2023

Reviewed By: ACS, 1/23/2023

Purpose/Conclusion.

Purpose:

To gain an understanding of the internal controls the agency has established over Cash Management.

To identify key internal controls the agency has established to prevent or detect noncompliance with Federal award requirements related to cash management.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

State of Washington

Source:

- Emily Overman, Project Support & Receivables Assistant Manager
- Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Cash Management, we assessed preliminary control risk as low.

Testing Strategy:

Reminder: Cash management is always direct and material whether the entity operates on a reimbursement or cash advance basis. (The only exception is for a non-cash award, e.g. federal equipment, real property, supplies or commodities received.)

Note: Entities may receive awards funded on a reimbursement basis, as well as awards funded through advance payments. For such entities, the auditor should plan the audit to address the objectives of both payment methods, i.e., the auditor should include audit procedures to separately assess and test internal control and compliance for the reimbursement and advance payment methods.

Cash Management - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the **Inherent and Internal Control Risk Guidance** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

CMIA Agreement

- (a) Determine whether the program is subject to the CMIA (Cash Management Improvement Act) agreement made between the U.S. Treasury and OFM (see attached pdf file in planning at **B.1.4**). This will typically only apply to larger programs over \$20 million.
- (b) If the program is subject to the OFM/Treasury CMIA agreement, obtain an understanding of funding technique prescribed for the program. Review Part 4 of Compliance Supplement for any program-specific requirements.
- (c) If the program is not subject to the CMIA, review Part 4 of Compliance Supplement for any program-specific requirements.

Awards to Subrecipients

State of Washington

Determine whether the agency made any awards to subrecipients.

Review Part 4 of the Compliance Supplement that applies to your audit period, the grant agreement, and/or program regulations to determine the method of payment for the federal program (i.e., cash advance or cost reimbursement). If a grantee states that it is paid on a "cost reimbursement" basis, determine whether the grantee is permitted to request its funding from the grantor before it actually disburses its own cash to pay project/program costs.

Information for all other awards (generally):

A. CASH ADVANCE – Some programs allow the grantee to draw down funding before program expenses are incurred or paid. The requests the auditee submits to their grantor should identify it as an advance request. The entity must:

- (1) Create and maintain written policies that address how it will comply with the cash advance requirements (UG only). The auditor does not need to determine whether the written procedures are sufficient. Sufficiency is up to the interpretation of the grantee unless the awarding agency has provided guidance.
- (2) Disburses the grant funding as soon as possible after it is received;
- (3) Limits its cash advance requests to its immediate needs; and
- (4) Tracks interest earned from cash advances. They must remit interest earned over \$100 for Pre-UG and over \$500 for UG.

B. COST REIMBURSEMENT – This occurs when the grantee incurs costs before the federal funds are received. Either situation could occur (even for the same program, transaction by transaction):

1. Costs are incurred but not paid before federal funds are received (like a cash advance): This pertains to those contracts or program regulations that **do not specifically require** the grantee to disburse its own funds before it requests reimbursement. For example, if a grantee incurs an expense (e.g., ordering supplies and receiving a vendor invoice), but does not disburse any of its own funds (paying the invoice) until after it submits a request to the grantor and receives its federal funding, the grantee is essentially receiving a cash advance. Thus, the grantee could potentially be maintaining an excess cash balance and earning interest. The same could be applied if the entity collects an improper payment or later receives a rebate, discount, refund on returned items, etc. that they keep – as an advance – rather than returning the funds to the grantor if the cost had already been reimbursed.

NOTE: The awarding agency may have regulations and/or guidance in these cases as to the specific amount of time the entity has from receipt of the funds to disburse the funds. For example, OSPI requires 3 days from receipt of funds to disburse. If the awarding agency does not have guidance on this, use auditor judgement to determine if the amount of time between receipt of funds and disbursement is reasonable and consistent with the entities disbursement policies and procedures.

2. Costs are incurred and paid before federal funds are received: This is a true cost reimbursement. The focus of the auditor's review is that the entity has controls to ensure they maintain a cost reimbursement basis – only requesting transactions that have been paid – and are in compliance with the requirement. The audit objective from the Compliance Supplement is, "For grants and cooperative agreements to non-Federal entities that are paid on a reimbursement basis, supporting documentation shows that the costs for which reimbursement was requested were paid prior to the date of the reimbursement request."

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Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.*

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

(a) CMIA programs - Identify and document the key internal controls used by the agency to comply with the CMIA funding technique to (1) ensure cash advances are limited to its immediate cash needs, (2) minimize the time elapsing between receiving the funds and expending the funds, and (3) assure that subrecipients are minimizing the time elapsing between receipt of the funds and expenditure of the funds.

(b) non-CMIA programs - Identify and document the key internal controls used by the auditee to (1) ensure cash advances are limited to its immediate cash needs, (2) minimize the time elapsing between receiving the funds and expending the funds, and (3) assure that subrecipients are minimizing the time elapsing between receipt of the funds and expenditure of the funds.

Gain an understanding of the grantee's internal controls and identify the key controls over its requests for federal funding as follows.

Cash Advances - our focus is on the controls that ensure:

- (1) The grantee established written procedures to minimize the time between receipt and disbursement of funds and ensures those procedures are up-to-date with federal requirements in subsequent years.
- (2) the grantee is disbursing the funding as soon as possible after it is received,
- (3) the grantee is limiting its cash advance requests to its immediate needs
- (4) the grantee is tracking interest earned from cash advances and remitting any interest over \$500 back to the grantor.

Cost Reimbursement (incurred but not paid before reimbursed)

- (1) the grantee is disbursing the funding as soon as possible after it is received,
- (2) the grantee is limiting its cash advance requests to its immediate needs
- (3) the grantee is tracking interest earned from cash advances and remitting any interest over \$500 back to the grantor.

Cost Reimbursement (incurred and paid before reimbursed – true reimbursement)

- (1) the grantee ensures it only requests costs that have been paid.

For example, the person responsible for creating the reimbursement request includes only costs paid based upon their tracking spreadsheet, because they generate a report for only costs that have been paid, or generates detailed transaction reports and includes items based on the date paid.

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***Note:** If the auditee usually maintains a true cost reimbursement but has some transactions (occasionally or as special situations) that are incurred but not paid before reimbursement, the controls of each should be addressed.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as “**LOW**” when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee’s internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

(Deficiencies Identified: Use the decision matrix in the “Major Federal Program” spreadsheet to determine the likelihood and the magnitude of potential or actual noncompliance. Your assessment must be clearly documented – use the terms from the spreadsheet (e.g. more than remote, etc.).)

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

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a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

Record of Work Done:

Inherent Risk of Noncompliance

Step 1

We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Not subject to the CMIA Agreement

This program cluster is not subject to the CMIA, therefore, we reviewed Part 4 of Compliance Supplement for any program-specific requirement. We found no such requirements, however we did note there are specific requirements pertaining to reimbursement requests outlined in the FTA Master Agreement: [FTA-Master-Agreement-v29-2022-02-07].

Payment Procedures Using ECHO.

The Recipient agrees that if payment is made through ECHO-Web using an ECHO Control Number, it will comply with the “FTA ECHO-Web User Manual,” April 2016, and it will withdraw federal assistance only to pay the eligible costs of implementing the Award.

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1. *Major Withdrawals.*
1. When a single withdrawal will exceed \$50,000,000, the Recipient agrees to notify the appropriate FTA Regional or Program Office at least three (3) days before the withdrawal is anticipated.
2. *Immediate Use.*
1. The Recipient agrees that it will not withdraw federal assistance until needed for immediate payment of those expenses and will use that federal assistance to pay for expenses that implement the Award no later than three (3) days after receipt, except as an authorized official of the Federal Government permits otherwise in writing.
3. *Limits.*
1. The Recipient agrees that it will not withdraw more than the sum of federal assistance the Federal Government has awarded or the current available balance for its Award, the accompanying Underlying Agreement, and any Amendments thereto, whichever is less.
4. *Control.*
1. The Recipient agrees to provide for the control and accountability of all federal assistance for its Award, the accompanying Underlying Agreement, and any Amendments thereto.
5. *Reporting.*
1. Unless an authorized FTA official determines otherwise in writing, the Recipient agrees to report its cash payments and balances promptly.
6. *Penalties.*
1. If the Recipient fails to comply with this section of this Master Agreement, it agrees that it may incur or be subjected to penalties, including, but not limited to, the following:
 - i. Access to ECHO-Web. The Federal Government may revoke or suspend the Recipient's ECHO Control Number and access to the ECHO-Web if the Federal Government determines that:
 1. Fraud, waste, mismanagement, or abuse exists in the Recipient's use and application of federal assistance;
 2. The Recipient has failed to use federal assistance it withdrew to pay costs incurred that implement the Underlying Agreement within three (3) days of withdrawing that federal assistance;
 3. The Recipient has failed to return withdrawn but unspent federal assistance to the Federal Government within a reasonable time;
 4. The Recipient has failed to establish procedures to minimize the time between advances of federal assistance and payments of costs incurred that implement the Underlying Agreement;
 5. The Recipient has been awarded Federal assistance through a Cooperative Agreement with FTA and will use the eInvoicing or DELPHI Mark View System as its payment method instead of the ECHO-Web System (see section 7(g)); or
 6. For Grants requiring a more detailed review of supporting documentation before receiving federal assistance, and as determined by the FTA Manager for the Award, the Recipient will use eInvoicing (see section 7(g)).
 2. *Interest.*
 - i. The Recipient agrees to pay interest to the Federal Government on any federal assistance withdrawn prematurely, 35 irrespective of whether the federal assistance has been deposited in an interest-bearing account.

State of Washington

1. A State or State Instrumentality. If the Recipient is a state or state instrumentality, it agrees to pay interest calculated as provided in section 5(b) of the Cash Management Improvement Act of 1990, as amended, 31 U.S.C. § 6503(b), and U.S. Department of Treasury (U.S. Treasury) regulations, “Rules and Procedures for Efficient Federal-State Funds Transfers,” 31 CFR Part 205.
2. Other than a State or State Instrumentality. If the Recipient is not a state or state instrumentality, it agrees to pay prejudgment common law interest determined by the Federal Government, as authorized by joint U.S. Treasury and U.S. Department of Justice (joint U.S. Treasury and U.S. DOJ) regulations, “Standards for the Administrative Collection of Claims,” 31 C.F.R. § 901.9(i). The Federal Government may determine the amount of interest due, based on the amount of interest the Recipient demonstrates it earned on its premature withdrawals of federal assistance, the amount of interest based on the “Treasury tax and loan account” rate prescribed under 31 U.S.C. § 3717 for debts owed to the United States, or an amount of interest as the Federal Government otherwise determines.

The Recipient as a “Pass-Through” Entity.

If the Recipient is providing a subaward to a Subrecipient to carry out all or part of its Award, the Recipient agrees to obtain the agreement of each Subrecipient to comply with U.S. DOT’s administrative requirements, as set forth above. More information can be found at [<https://www.transit.dot.gov/>].

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

Gaining an Understanding

Step 3

We received from the Department our internal control request letter on September 12th, 2022 [] from Jesse Daniels, External Audit Liason. We identified four key controls.

We met with the Department of Transportation (Department) on **9/14/22** to provide us with an overview and confirmation of its key internal controls to ensure compliance with Cash Management requirements. We met with the following staff:

- Emily Overman, Fiscal Analyst
- Jesse Daniels, External Audit Liaison

Grant funds awarded under section 5311 are drawn on a reimbursement basis with no cash received in advance from the Federal Transit Authority (FTA). Transactions for a prior month can post up until the eighth working day of the current month. The Department waits to initiate the draw request until after the 10th of that same month to allow sufficient time for transaction posting. Draw requests in ECHO are made on a once a month basis.

The Capital Accountant or Fiscal Analyst for either respective program, Washington State Ferries (WSF) or Public Transportation Division (PTD), reconcile Cognos-generated expenditure data to TRAINS invoices to ensure expenditure information for the reimbursement period is accurate and complete. (Key Control #1) (Control Activities). The difference between these reports is sent as a draw request to the Department, more specifically Emily

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Overman, Project Support & Receivables Assistant Manager.

The Fiscal Analyst will create a cover-sheet and fill in the Echo PO Number, TRAMS Grant Number, Project Number, and amount to bill with all the TRAINS invoice(s) attached, and send it to the Expenditures Manager. **The Expenditures Manager reviews and approves the invoice by signing the cover-sheet, authorizing the reimbursement request. (Key Control #2) (Control Activities).**

After authorization, the Fiscal Analyst reconciles the invoice totals with the total reimbursement request to ensure the numbers march. **The Fiscal Analyst accesses ECHO to create the draw down request from the federal government. The Fiscal Analyst takes a screenshot of the request and copies the invoice/cover-sheet approval, then compiles those together in a draw folder for review by the Project Support & Receivables Manager. (Key Control #3) (Control Activities).**

The Fiscal Analyst will forward the draw request packet to their supervisor, the Manager of Project, Support, & Receivables (PSR Manager). **The Project Support & Receivables Manager reviews, verifies, and signs each draw request prior to the request submission in ECHO. (Key Control #4) (Control Activities).** Once the draw is processed, the Department receives a confirmation number from the FTA, and retains the draw confirmation.

Evaluation of Results: We did not identify any control deficiencies.

Key Internal Controls Identified:

Key Control #1: The Capital Accountant or Fiscal Analyst for either respective program, Washington State Ferries (WSF) or Public Transportation Division (PTD), reconcile Cognos-generated expenditure data to TRAINS invoices to ensure expenditure information for the reimbursement period is accurate and complete. (Control Activities).

Key Control #2: The Expenditures Manager reviews and approves the invoice by signing the cover-sheet, authorizing the reimbursement request. (Control Activities).

Key Control #3: The Fiscal Analyst accesses ECHO to create the draw down request from the federal government. The Fiscal Analyst takes a screenshot of the request and copies the invoice/cover-sheet approval, then compiles those together in a draw folder for review by the Project Support & Receivables Manager. (Control Activities).

Key Control #4: The Project Support & Receivables Manager reviews, verifies, and signs each draw request prior to the request submission in ECHO. (Control Activities).

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

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C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: C. Cash Management - Tests of Controls
Prepared By: BZH, 1/9/2023
Reviewed By: ACS, 1/23/2023

Purpose/Conclusion.

Purpose:

To identify the key internal controls and test these controls to determine if the controls are in place and operating as intended.
To provide a final control risk assessment based upon our testing of the key internal controls.

Source:

Emily Overman, Project Support & Receivables Assistant Manager
Jesse Daniels, External Audit Liaison

Conclusion:

Based on our understanding of internal controls over Cash Management, we tested the key controls. Based on our testing, internal controls are in place and operating as intended to prevent material noncompliance with federal requirements. **Final risk assessment is low.**

Testing Strategy.

Reminder: Cash management is always direct and material whether the entity operates on a reimbursement or cash advance basis. (The only exception is for a non-cash award, e.g. federal equipment, real property, supplies or commodities received.)

Note: Entities may receive awards funded on a reimbursement basis, as well as awards funded through advance payments. For such entities, the auditor should plan the audit to address the objectives of both payment methods, i.e., the auditor should include audit procedures to separately assess and test internal control and compliance for the reimbursement and advance payment methods.

Cash Management - Post Uniform Guidance Awards

Step 5: Test Internal Controls

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If preliminary control risk is:

LOW: Test the key internal controls to determine whether they are effective in preventing and detecting noncompliance with the requirement.

HIGH: Do not test the controls, report the issue in a finding as a “significant deficiency” or “material weakness” as appropriate.

About tests of controls: To determine whether the key controls are effective, the auditor should obtain evidence about how controls were applied at relevant times during the period under audit, the consistency with which they were applied, and by whom or by what means they were applied.

Provide Details: When documenting your testing in the ROWD, you should provide enough details so that an experienced auditor could re-perform the same test and reach the same conclusion. See *Inherent and Internal Control Risk Guidance* for what tests of controls generally include.

Remember, for a non-automated control, a “walk through” of the grantee’s process is not considered sufficient testing. A walk-through only provides an understanding of the design of a system – it does not provide evidence that the controls are effective.

-Dual purpose testing – consider whether the control can be tested in conjunction with a test of compliance to increase audit efficiency. If dual-purpose testing is performed, you must clearly document the results of control tests and compliance tests.

-If a key control is automated, control testing must include testing of both the automated control and related general controls. See additional information in the planning guide.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must**:

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 6: Assess Final Control Risk (CR)

After testing the key controls, assess final control risk. This assessment must be either low or high. If you conclude that final control risk is high, this should be reported in a finding as a “significant deficiency” or “material weakness” as appropriate.

Note: Reassessment of final control risk is required under Step 5 when noncompliance is found.

Step 7: Assess the Risk of Material Non-Compliance (combined IR and CR)

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Assess the risk of material noncompliance for this compliance requirement to help determine the nature and extent of compliance testing necessary to give an opinion on this program. The risk is based on auditor judgment in consideration of the inherent risk and control risk. Assess risk as Low, Moderate or High.

High does not result in a finding, but the auditor should consider the risk when designing the nature and extent of compliance testing.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5
24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

Record of Work Done:

Internal Control Testing
Step 5

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Key Control #1: The Capital Accountant or Fiscal Analyst for either respective program, Washington State Ferries (WSF) or Public Transportation Division (PTD), reconcile Cognos-generated expenditure data to TRAINS invoices to ensure expenditure information for the reimbursement period is accurate and complete. (Control Activities).

Key Control #2: The Expenditures Manager reviews and approves the invoice by signing the cover-sheet, authorizing the reimbursement request. (Control Activities).

Key Control #3: The Fiscal Analyst accesses ECHO to create the draw down request from the federal government. The Fiscal Analyst takes a screenshot of the request and copies the invoice/cover-sheet approval, then compiles those together in a draw folder for review by the Project Support & Receivables Manager. (Control Activities).

Key Control #4: The Project Support & Receivables Manager reviews, verifies, and signs each draw request prior to the request submission in ECHO. (Control Activities).

To test the identified key internal controls we used the testing spreadsheet located at [[SWSA Sampling Spreadsheet - Cash Management](#)] to determine the required sample size. We requested and received a list of 55 cash draws that included 20,509 expenditures that occurred during SFY '22 from Emily Overman, Project Support & Receivables Assistant Manager. We then consulted the *SWSA Small Population Spreadsheet* and identified our population of 12 cash draws.

We received and reviewed a copy of each draw, the creation of the draw request and its approval in ECHO, the relevant approved expenditure analysis, and the signed invoice along with its coversheet.

No Exceptions Identified.

Evaluation of Results: We did not identify any control deficiencies

Final Control Risk Assessment

Step 6

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will place reliance on the controls, based on our control testing above.

Risk of Material Noncompliance

Step 7

LOW – By combining our inherent risk assessment and internal control testing we have determined the risk of material noncompliance to be low. We will design our compliance testing based on this assessment.

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C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: C. Cash Management - Compliance
Prepared By: BZH, 1/10/2023
Reviewed By: ACS, 2/2/2023

Purpose/Conclusion.

Purpose:

To determine if the agency was in compliance with Cash Management requirements.

Source:

Emily Overman, Project Support & Receivables Assistant Manager

Jesse Daniels, External Audit Liaison

Conclusion:

The agency was in material compliance with federal requirements for Cash Management.
We did not identify any noncompliance.

Testing Strategy.

Test Compliance

Design the nature and extent of compliance testing based on the risk of material noncompliance. The extent of our testing must be sufficient to support our conclusion about whether the grantee has materially complied with the requirement being tested. If the nature of the transactions or records for this requirement are conducive to sampling, it is recommended the auditor select a sample (the Excel sampling template for the single audit is located in the TeamStore). Otherwise, perform a judgmental selection based on risk.

Compliance Testing - CMIA Programs

Step 1

Select cash draws and verify that the agency (1) minimized the time elapsing between the drawdown and disbursement of funds in accordance with CMIA guidelines and (2) accounted for and expended program income, rebates, refunds, and other receipts before requesting additional cash draws. (A copy of the CMIA agreement can be seen at B.1.4)

Step 2

For payments to subrecipients - Select a sample of cash requests and confirm that the amount requested by the subrecipient was not in excess of its immediate

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needs and timing of the request was reasonable.

Step 3

Determine whether the agency has prepared its annual report to OFM showing interest owed (or due from) to Federal government and whether calculation is reasonable and supported.

Compliance Testing - Non CMIA Programs

Cash Advances

Step 1

Select cash draws occurring during the audit period and verify that the auditee (1) minimized the time elapsing between the drawdown and disbursement of funds in accordance with program guidelines, (2) limited the amount of its cash request to its immediate needs, and (3) accounted for and expended program income, rebates, refunds, and other receipts before requesting additional cash draws. Advances could also take the form of payments to the entity that exceed the grant-related costs incurred.

Step 2

Review records to determine if interest was earned by the auditee on federal cash advances. If so, review evidence to ascertain whether the interest was returned to the granting agency (grantees are permitted to retain up to \$500 per year under 2 CFR section 200.305(b)(9) for administrative expenses).

Cost Reimbursement Basis

Step 1

For those reimbursement programs that received advances of Federal funds (either at the time of the award or when costs are incurred but not paid before federal funds are received), select a sample of draws of federal funds and verify that established procedures to minimize the time elapsing between drawdown and disbursement were followed. Look to the award/guidance; when the award/guidance is silent, use auditor judgement to determine if the amount of time between receipt of funds and disbursement is reasonable and consistent with the entity's disbursement policies and procedures, including voucher approval, payment preparation and disbursement.

Review records to determine if interest was earned on Federal cash draws. If so, review evidence to ascertain whether the amount in excess of \$500 per year was returned to the appropriate agency.

Step 2

When awards are funded on a true reimbursement basis, (when costs are incurred and paid before federal funds are received) select an appropriate number of reimbursement requests for testing based on the small populations matrix found in Audit Policy 3240 (in Policy/Standards tab) and trace to supporting documentation. Determine if the transactions of the request were paid by the auditee before the date they were submitted for reimbursement.

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Step 3

For payments to subrecipients

Select a sample of cash requests and confirm that the amount requested by the subrecipient was not in excess of its immediate needs and timing of the request was reasonable.

Step 4

Review records to determine if interest was earned by the auditee on federal cash advances. If so, review evidence to ascertain whether the interest (less a \$500 allowance) was returned to the granting agency.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

Step 5

Evaluation of Results: Did you identify any noncompliance? If so, **you must:**

1. Determine and document the magnitude of the noncompliance on the program as a whole or for this compliance area (5% materiality threshold).
2. Document the reason for the noncompliance.
3. Consider whether additional testing is needed to provide reasonable assurance of detecting material noncompliance (e.g. is the risk of material noncompliance increased for the activities or costs that you did not test?).
4. Reassess the final control risk. Generally, noncompliance is the result of a control deficiency; therefore, it is necessary to reconsider the effectiveness of the internal controls.] (Include this wording) After compliance testing we consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**. This **did/did not** change our final control risk, see final control risk at ([link to controls](#)).

Guidance/Criteria.

SMALL POPULATION – SELECTION SIZE

Policy 3240 contains the following table for determining sample sizes for small populations:

a. For populations of 365 or less, auditors may use the following table:

Population Size	Assurance Needed and/or Expected Deviations		
	Low	Moderate	High
<i>Formula (rounded up) where N = population size</i>	$N * 1 / \text{SQRT}(N) * 0.68$	$N * 1 / \text{SQRT}(N)$	$N * 1 / \text{SQRT}(N) / 0.68$
4 (quarterly)	2	2	do not sample
12 (monthly)	3	4	5

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24 (semi-monthly)	4	5	8
52 (weekly)	5	8	11
260 (business days)	11	17	24
365 (daily)	13	20	28

Use of this table is considered non-statistical sampling. This table should only be used for small populations and not for small strata of larger populations.

Record of Work Done:

Compliance Testing - Non CMIA Programs

To test compliance we used the testing spreadsheet located at [[SWSA Sampling Spreadsheet - Cash Management](#)] to determine the required sample size. We requested and received a list of 55 cash draws and 5 Individually Significant cash draws that included 20,509 expenditures that occurred during SFY '22 from Emily Overman, Project Support & Receivables Assistant Manager. We then consulted the *SWSA Small Population Spreadsheet* and identified our required sample size of 12 cash draws.

This program is **not subject** to the CMIA, and is not included in the OFM Treasury-State Agreement. Therefore, we reviewed Part 4 of Compliance Supplement for any program-specific requirements. We found no such requirements, however we did note there are specific requirements pertaining to reimbursement requests outlined in the FTA Master Agreement [[FTA-Master-Agreement-v29-2022-02-07](#)]:

(f) *Payment Procedures Using ECHO* - The Recipient agrees that if payment is made through ECHO-Web using an ECHO Control Number, it will comply with the “FTA ECHO-Web User Manual,” April 2016, and it will withdraw federal assistance only to pay the eligible costs of implementing the Award.

1. Major Withdrawals. When a single withdrawal will exceed \$50,000,000, the Recipient agrees to notify the appropriate FTA Regional or Program Office at least three (3) days before the withdrawal is anticipated.
2. Immediate Use. The Recipient agrees that it will not withdraw federal assistance until needed for immediate payment of those expenses and will use that federal assistance to pay for expenses that implement the Award no later than three (3) days after receipt, except as an authorized official of the Federal Government permits otherwise in writing.
3. Limits. The Recipient agrees that it will not withdraw more than the sum of federal assistance the Federal Government has awarded or the current available balance for its Award, the accompanying Underlying Agreement, and any Amendments thereto, whichever is less.
4. Control. The Recipient agrees to provide for the control and accountability of all federal assistance for its Award, the accompanying Underlying Agreement, and any Amendments thereto.

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5. Reporting. Unless an authorized FTA official determines otherwise in writing, the Recipient agrees to report its cash payments and balances promptly.
6. Penalties. If the Recipient fails to comply with this section of this Master Agreement, it agrees that it may incur or be subjected to penalties, including, but not limited to, the following:
 1. Access to ECHO-Web. The Federal Government may revoke or suspend the Recipient's ECHO Control Number and access to the ECHO-Web if the Federal Government determines that:
 - i. Fraud, waste, mismanagement, or abuse exists in the Recipient's use and application of federal assistance;
 - ii. The Recipient has failed to use federal assistance it withdrew to pay costs incurred that implement the Underlying Agreement within three (3) days of withdrawing that federal assistance;
 - iii. The Recipient has failed to return withdrawn but unspent federal assistance to the Federal Government within a reasonable time;
 - iv. The Recipient has failed to establish procedures to minimize the time between advances of federal assistance and payments of costs incurred that implement the Underlying Agreement;
 - v. The Recipient has been awarded Federal assistance through a Cooperative Agreement with FTA and will use the eInvoicing or DELPHI Mark View System as its payment method instead of the ECHO-Web System (see section 7(g)); or
 - vi. For Grants requiring a more detailed review of supporting documentation before receiving federal assistance, and as determined by the FTA Manager for the Award, the Recipient will use eInvoicing (see section 7(g)).
 2. Interest. The Recipient agrees to pay interest to the Federal Government on any federal assistance withdrawn prematurely, irrespective of whether the federal assistance has been deposited in an interest-bearing account.
 - i. *A State or State Instrumentality.*
 1. If the Recipient is a state or state instrumentality, it agrees to pay interest calculated as provided in section 5(b) of the Cash Management Improvement Act of 1990, as amended, 31 U.S.C. § 6503(b), and U.S. Department of Treasury (U.S. Treasury) regulations, "Rules and Procedures for Efficient Federal-State Funds Transfers," 31 CFR Part 205.
 - ii. *Other than a State or State Instrumentality.*
 1. If the Recipient is not a state or state instrumentality, it agrees to pay prejudgment common law interest determined by the Federal Government, as authorized by joint U.S. Treasury and U.S. Department of Justice (joint U.S. Treasury and U.S. DOJ) regulations, "Standards for the Administrative Collection of Claims," 31

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C.F.R. § 901.9(i). The Federal Government may determine the amount of interest due, based on the amount of interest the Recipient demonstrates it earned on its premature withdrawals of federal assistance, the amount of interest based on the “Treasury tax and loan account” rate prescribed under 31 U.S.C. § 3717 for debts owed to the United States, or an amount of interest as the Federal Government otherwise determines.

7. ECHO System. If the Recipient is authorized to receive payments provided through ECHO-Web, FTA does not generally review the drawdown when made; however, FTA may review the drawdown at a later time, and subject that drawdown to an audit under a financial oversight review, a triennial review, or another audit.

Emily Overman, Project Support & Receivables Assistant Manager, provided us with expenditure summary reports, TRAINS accounting invoices by work order # for the billing period, and FTA reimbursement request documentation. We noted the ECHO PO #, the Message Number, and the associated TrAMS grant the draw is pulling expenditures from, which are all created in WSDOT's Transportation Award Management System (TRAMS) each time a request is initiated. WSDOT tracks each of its reimbursement requests by these reimbursement #'s in a unique FTA Billing Log (excel spreadsheet) for record-keeping purposes, maintained by Emily Overman.

Testing

Step 1

This program cluster does not receive cash advances from the federal government, and this is reflected in the Treasury-State Agreement. ***Not Applicable.***

Step 2

The Department does not receive cash advances, as the Federal Transit Administration (FTA) awards funds on a cost reimbursement basis. The Department is reimbursed on a monthly basis and retains documentation supporting each cash draw. All cash draws pertaining to SFY '22 expenditures were performed between 7/21/2021 and 6/23/2022 (since this occurs on a reimbursement basis). Suzi Freeland, Financial Analyst (WSDOT Accounting & Financial Services) provided us with Revenue and Expenditure activity from TRAINS.

We reviewed each TRAINS accounting invoice to note the total charged to the ECHO PO# prior to submitting the FTA reimbursement request to confirm that WSDOT used its own funds to pay for expenditures for vendor services before the request for reimbursement. Additionally, we found there was adequate documentation on-file to justify the amount of each draw, as totals requested directly tie to TRAINS expenditure figures by FTA project ID. We noted the project applicable to each draw.

No exceptions identified.

The compliance supplement instructs auditors to ensure that the State minimizes the time elapsing between the draw-down and disbursement of funds in accordance with CMIA or grant guidelines. However, since the Formula Grants for Rural Areas program is a cost reimbursement program, this requirement is

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determined not applicable to the program cluster. We verified the draw request was initiated based on expenditures already incurred and paid by the Department.

No exceptions identified.

We reviewed that the documentation support the date of the draw, and the amount calculated. We found there was adequate supporting documentation on-file to justify the amount of each draw, as the totals requested directly tie to TRAINS expenditure figures by *FTA Project Number and FHWA Number*.

No exceptions identified.

Step 3

For payments to subrecipients

We were able to verify payments to subrecipients was not in excess of their immediate needs and the request timing was reasonable during our Activities Allowed compliance testing. We selected a sample of payment vouchers and performed testing here:[\[A-B. Activities Allowed/Cost Principles - Compliance\]](#).

No exceptions identified.

Step 4

We confirmed through our review of reimbursements received from FTA through TRAMS [federal draw-down system], and inquiry with WSDOT staff that no cash advances were made to the Department during the audit period. *Not Applicable.*

Evaluation of Results: We did not identify any noncompliance.

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: I. Procurement/Suspension and Debarment - Controls

Prepared By: BZH, 12/8/2022

Reviewed By: ACS, 1/5/2023

Purpose/Conclusion.

Purpose:

To gain an understanding of the internal controls the agency has established that provide reasonable assurance that procurement of goods and services are made in compliance with state law and the Common Rule and that covered transactions are not made with a debarred or suspended party.

To identify key internal controls the agency has established to prevent or detect noncompliance with procurement, suspension and debarment requirements.

To provide a preliminary control risk assessment based upon our understanding of the internal controls.

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Source:

Jesse Daniels, External Audit Liaison.
Steven Meyeroff, FTA Compliance Administrator
Doyle Dilley, Administrative Contracts Division Manager
Schatzie Harvey, Consultant Services Manager
Nina Stocker, Rural Community Liaison
Ron Westman, IT Projects Manager

Conclusion:

Based on our understanding of internal controls over Procurement, we assessed preliminary control risk as **LOW**.

Based on our understanding of internal controls over Suspension and Debarment, we assessed preliminary control risk as **LOW**.

Testing Strategy:

Procurement/Suspension and Debarment - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

Written Procurement Policies and Procedures

When procuring property and services under a Federal award, a state must follow the same policies and procedures it uses for procurements from its non-Federal funds. The state will comply with § 200.322 Procurement of recovered materials and ensure that every purchase order or other contract includes any clauses required by section § 200.326 Contract provisions.

Aggregate vs. Per-unit Cost to Determine Threshold

Note that the cost thresholds are not limited to each individual item purchased. The cost threshold will also apply to many like-kind items. For instance, an entity may purchase 500 tablets over 70 transactions during the year. Each tablet or transaction may be less than the lowest competitive threshold, but the aggregate purchase of tablets should be the dollar value used to determine which threshold applies. For example, if the 500 tablets cost \$200,000, the grantee should complete the procurement procedures required by this aggregate amount.

Contracts Must Include All Required Provisions

In addition to other provisions required by the Federal agency or non-Federal entity, all contracts made by the non-Federal entity under the Federal award must

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contain provisions as applicable (see Policies/Standards tab for list of required provisions).

Interlocal Agreements: Transactions between governments are exempt

When one government uses federal grant funds to pay for professional services provided by another government, it is not expected to obtain quotes or seek competition. If the grantee purchases equipment or other goods directly from another local government, these transactions are exempt from competitive procurement (does not apply to piggy-backing purchases). This is because federal procurement standards (2 CFR section 200.318(e)) encourages governmental entities to enter into interlocal agreements to maximize economy and efficiency. It assumes the economic benefit and efficiency has or will be achieved. RCW 39.34.030 sets forth the standards for interlocal agreements – the form of the agreement or contract may vary so long as it contains the necessary information. This exemption does not include purchases made from a third party vendor, such as a purchasing co-op, or piggy-backing off another government's bid for equipment, materials or services.

Purchasing from a Master Contract - DES has performed the procurement process

State agencies make purchases from contracts that are procured by the WA Dept. of Enterprise Services (DES). In this situation, the DES performs all the bidding requirements and the participating agency can rely on the bid process and make purchases from the contract. The DES retains all the bid documentation. If the master contract(s) is material to the grant, the procurement process may need to be tested at DES. For controls, the auditor should document how the auditee uses the DES contracts. They should ensure they are paying the same rates as in the DES contract. **Note: DES does not check for suspension or debarment.**

SUSPENSION AND DEBARMENT (S&D)

Applies To: The entity must complete the requirement for:

All *new* subrecipient contracts (no threshold)

All *new* contracts (purchases) of \$25,000 or more.

Requirement: The entity must complete at least one of the following to verify the other party is not prohibited (excluded) from receiving federal funds during the procurement process or at the time the contract is made:

1. Check their status on the online search engine SAM.gov (and print support)
2. Put a clause in the contract, whereby the signer attests they are not suspended or debarred.
3. Obtain a signed certificate, whereby the signer attests they are not suspended or debarred.

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant*

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deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the grantee's internal controls and identify the key controls to ensure:

(1) The agency followed State law and procedures and that the policies and procedures were the same as for non-Federal funds.

(2) Suspension & Debarment: vendors with contracts exceeding \$25,000 and all subrecipients are not suspended or debarred from participating in federal programs. *NOTE TO AUDITOR: When identifying internal controls for suspension and debarment, focus on the auditee's awareness of the requirement and the process it follows to ensure compliance. If a certificate or clause is in the contract or bid document, the control should focus on a person putting it in the documents or reviewing the documents to ensure it is included. Avoid a control that relies on the fact that "the clause is included in the contract."*

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as "LOW" when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee's internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

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Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Procurement

States shall use the same State policies and procedures used for procurements from non-Federal funds (2 CFR section 200.317). The policies are established in RCW 39 and also the Department of Enterprise Services and located on their website at <https://des.wa.gov/about/projects-initiatives/procurement-reform/current-policies>

Grantees and subgrantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

AGGREGATE VS. PER-UNIT COST TO DETERMINE THRESHOLD

Note that the cost thresholds are not limited to each individual item purchased. The cost threshold will also apply to many like-kind items. For instance, an entity may purchase 500 tablets over 70 transactions during the year. Each tablet or transaction may be less than the lowest competitive threshold, but the aggregate purchase of tablets should be the dollar value used to determine which threshold applies. For example, if the 500 tablets cost \$200,000, the grantee should complete the procurement procedures required by this aggregate amount.

Contracts Must Include All Required Provisions

In addition to other provisions required by the Federal agency or non-Federal entity, all contracts made by the non-Federal entity under the Federal award must contain provisions covering the following, as applicable.

(A) Contracts for more than the simplified acquisition threshold currently set at \$150,000, which is the inflation adjusted amount determined by the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) as authorized by 41 U.S.C. 1908, must address administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and provide for such sanctions and penalties as appropriate.

(B) All contracts in excess of \$10,000 must address termination for cause and for convenience by the non-Federal entity including the manner by which it will be effected and the basis for settlement.

(C) Equal Employment Opportunity. Except as otherwise provided under 41 CFR Part 60, all contracts that meet the definition of “federally assisted construction contract” in 41 CFR Part 60-1.3 must include the equal opportunity clause provided under 41 CFR 60-1.4(b), in accordance with Executive Order 11246, “Equal Employment Opportunity” (30 FR 12319, 12935, 3 CFR Part, 1964-1965 Comp., p. 339), as amended by Executive Order 11375, “Amending Executive Order 11246 Relating to Equal Employment Opportunity,” and implementing regulations at 41 CFR part 60, “Office of Federal Contract Compliance Programs, Equal Employment Opportunity, Department of Labor.”

(D) Davis-Bacon Act, as amended (40 U.S.C. 3141-3148). When required by Federal program legislation, all prime construction contracts in excess of \$2,000

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awarded by non-Federal entities must include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 3141-3144, and 3146-3148) as supplemented by Department of Labor regulations (29 CFR Part 5, “Labor Standards Provisions Applicable to Contracts Covering Federally Financed and Assisted Construction”). In accordance with the statute, contractors must be required to pay wages to laborers and mechanics at a rate not less than the prevailing wages specified in a wage determination made by the Secretary of Labor. In addition, contractors must be required to pay wages not less than once a week. The non-Federal entity must place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation. The decision to award a contract or subcontract must be conditioned upon the acceptance of the wage determination. The non-Federal entity must report all suspected or reported violations to the Federal awarding agency. The contracts must also include a provision for compliance with the Copeland “Anti-Kickback” Act (40 U.S.C. 3145), as supplemented by Department of Labor regulations (29 CFR Part 3, “Contractors and Subcontractors on Public Building or Public Work Financed in Whole or in Part by Loans or Grants from the United States”). The Act provides that each contractor or subrecipient must be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he or she is otherwise entitled. The non-Federal entity must report all suspected or reported violations to the Federal awarding agency.

(E) Contract Work Hours and Safety Standards Act (40 U.S.C. 3701-3708). Where applicable, all contracts awarded by the non-Federal entity in excess of \$100,000 that involve the employment of mechanics or laborers must include a provision for compliance with 40 U.S.C. 3702 and 3704, as supplemented by Department of Labor regulations (29 CFR Part 5). Under 40 U.S.C. 3702 of the Act, each contractor must be required to compute the wages of every mechanic and laborer on the basis of a standard work week of 40 hours. Work in excess of the standard work week is permissible provided that the worker is compensated at a rate of not less than one and a half times the basic rate of pay for all hours worked in excess of 40 hours in the work week. The requirements of 40 U.S.C. 3704 are applicable to construction work and provide that no laborer or mechanic must be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

(F) Rights to Inventions Made Under a Contract or Agreement. If the Federal award meets the definition of “funding agreement” under 37 CFR §401.2 (a) and the recipient or subrecipient wishes to enter into a contract with a small business firm or nonprofit organization regarding the substitution of parties, assignment or performance of experimental, developmental, or research work under that “funding agreement,” the recipient or subrecipient must comply with the requirements of 37 CFR Part 401, “Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements,” and any implementing regulations issued by the awarding agency.

(G) Clean Air Act (42 U.S.C. 7401-7671q.) and the Federal Water Pollution Control Act (33 U.S.C. 1251-1387), as amended—Contracts and subgrants of amounts in excess of \$150,000 must contain a provision that requires the non-Federal award to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act (42 U.S.C. 7401-7671q) and the Federal Water Pollution Control Act as amended (33 U.S.C. 1251-1387). Violations must be reported to the Federal awarding agency and the Regional Office of the Environmental Protection Agency (EPA).

(H) Debarment and Suspension (Executive Orders 12549 and 12689)—A contract award (see 2 CFR 180.220) must not be made to parties listed on the governmentwide exclusions in the System for Award Management (SAM), in accordance with the OMB guidelines at 2 CFR 180 that implement Executive Orders 12549 (3 CFR part 1986 Comp., p. 189) and 12689 (3 CFR part 1989 Comp., p. 235), “Debarment and Suspension.” SAM Exclusions contains the names of parties debarred, suspended, or otherwise excluded by agencies, as well as parties declared ineligible under statutory or regulatory authority other than Executive Order 12549.

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(I) Byrd Anti-Lobbying Amendment (31 U.S.C. 1352)—Contractors that apply or bid for an award exceeding \$100,000 must file the required certification. Each tier certifies to the tier above that it will not and has not used Federal appropriated funds to pay any person or organization for influencing or attempting to influence an officer or employee of any agency, a member of Congress, officer or employee of Congress, or an employee of a member of Congress in connection with obtaining any Federal contract, grant or any other award covered by 31 U.S.C. 1352. Each tier must also disclose any lobbying with non-Federal funds that takes place in connection with obtaining any Federal award. Such disclosures are forwarded from tier to tier up to the non-Federal award.

(J) See §200.322 Procurement of recovered materials.

Suspension and Debarment

Entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. “Covered transactions” include contracts for goods and services equal to or in excess of \$25,000 and all non-procurement transactions (e.g., awards to subrecipients), irrespective of award amount unless exempt as provided in 2 CFR section 180.215..

Record of Work Done.

Inherent Risk of Noncompliance

Step 1

We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

Review the scope of work per the grant agreement, Part 4 of the Compliance Supplement (if applicable), and any available program guidelines to determine specific requirements for Procurement / Suspension and Debarment.

We noted there is no guidance specific to the Formula Grants program in Part 4 of the Compliance Supplement. Therefore, we will refer to the requirements in Part 3 - Procurement, Suspension and Debarment.

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

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We requested and reviewed all of the Department's written policies and procedures related to Procurement [see: [CSO Manual - Part 1 \(Professional Services Contracting\)](#); [CSO Manual - Part 2 \(Professional Services\)](#)] / Suspension and Debarment as part of gaining an understanding of internal controls [see: [August 2019 - PTD Grants Guidebook](#)].

We documented the Department's response to our request for their Understanding of Controls [see: [ICRL - Suspension & Debarment \(subrecipients\) - WSDOT](#)].

Procurement

We met with the following staff from the Department of Transportation on back to back days October 19th and 20th, 2022 to discuss the Department's internal controls to ensure compliance with requirements for Procurement for contractors:

- Jesse Daniels, External Audit Liaison.
- Steven Meyeroff, FTA Compliance Administrator
- Doyle Dilley, Administrative Contracts Division Manager
- Schatzie Harvey, Consultant Services Manager
- Nina Stocker, Rural Community Liaison
- Ron Westman, IT Projects Manager

We identified 3 procured contracts that had 5311 formula grant federal funding:

- K1160
- K1174
- K993

K1160 and K1174 were contracted out to Central Washington Airporth, while K993 was contracted out to Critical Logic. We were able to gain an understanding over how the Department ensures it complies with Procurement Standards §200.318.

Part 2 of the WSDOT Consultant Services Manual states that: "The state will comply with §200.323 Procurement of recovered materials and ensure that every purchase order or other contract includes any clauses required by Appenix II to Part 200 - Contract Provisions."

The Department informed us they follow all of the guidance in their Consultant Services Manual (Key Control #1) (Control Environment) regarding initiation for solicitation, advertisement, scoring, interviewing, selection of an interview panel, agreement execution [see: [CSO Manual - Part 2 \(Professional Services\)](#) 210.01 - 240.05], and further requirements for any Sole Source Contracts. The Department utilizes its Consultant Services Office (CSO) to solicit work for:

- Financial and economic analysis
- Environmental planning and surveying
- Legal services
- Management consultant fees (not related to architectural/engineering design)
- Media and public relations, including marketing services
- Scientific studies and research

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- Expert witness services during litigation

Solicitation, Proposal, and Approval

The methods of solicitation most commonly used for project-specific Professional Services agreements are the Request for Proposal (RFP) or the Request for Qualifications (RFQ). The CSO is ultimately responsible for determining and developing the most appropriate solicitation method.

The CSO drafts a Request for Qualifications (RFQ) wherein the project scope and work elements are narrowly defined and the goal is to select the most qualified firm at the most competitive price. Selection is based on the qualifications of the firm, ability to perform the requested service(s), expertise and proposed costs.

The RFP, in contrast, provides: background on the project; the scope of work; the project schedule; funding information; a description of the consultant services needed and the minimum qualifications required; and directions for preparing a proposal in response to the solicitation.

Solicitations are determined and managed by the CSO. Solicitations require the proposer to complete the Consultant Information Form for the prime consultant, and any subconsultants that are to be used on the project. This form contains information about the consultants' business structure; Tax ID; Statewide Vendor Codes; business licenses and certifications; annual gross receipts; NAICS codes; DUNS numbers; Fiscal Year End date; and areas of expertise. The formal written contract accurately documents all terms and conditions and records the intent and agreement of the parties. The contract is the culmination of the entire procurement process and formalizes the agreement between the parties.

At a minimum, the following criteria must be used for all Professional Services solicitations:

- Consultant firm's experience, ability, and capacity.
- Staff qualifications and experience.
- Fees or costs.
- Responsiveness to schedule.
- Quality of previous performance and reputation.
- Compliance with statutes and rules related to contracts or services.
- System for Award Management Excluded Parties Records notice.

For solicitations using an RFP format, the additional following criteria are also mandatory:

- Consultant firm's understanding of the project and the proposed methodology.
- Project management, internal controls, and team structure (for multiple staff).
- Proposed work plan and description of deliverables

A time period ranging from four to eight weeks after publication of the solicitation advertisement is given to ensure a reasonable amount of time is given for responses. Proposals, requested in Adobe PDF format, are submitted via email to CSOSubmittals@wsdot.wa.gov. After proposals have been screened for appropriate responsiveness, the proposals are transmitted to an independent evaluation team. **All members of the evaluation team are selected by the CSO manager, and all scoring team members must fill out and submit a Confidentiality/Conflict of Interest statement prior to being on the panel (Key Control #1)** for scoring. Sometimes, after scoring is completed, the CSO or their designee will have several top-ranked applicants to choose from. In those

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cases, they will conduct final interviews to determine who receives the contract.

When interviews are completed, the CSO or their designee will work with the Area Consultant Liaison (ACL) to compile the evaluation panel teams score with the interview score, and will submit them to the CSO manager. **After the CSO manager has approved the selected consultant, the CSO will report the outcome, in writing, to all participating firms. (Key Control #2)**

Negotiation and Execution

Proposed fees/costs are included in the proposal and solicitation process. Therefore, they are part of the scoring/selection criteria. Negotiations are focused on refining the proposed deliverables, scope of the work, work plan, and total estimated cost (including overhead, fixed fees, etc). Payment types and cost factors can be found in the Consultant Services Manual [CSO Manual - Part 2 (Professional Services)] appendices H and L. The ACL and WSDOT Project Manager work together to prepare a summary of the final negotiations that they forward to the CSO. This documentation is retained in an official agreement file maintained by the CSO.

After the agreement has been negotiated with the consultant, the CSO will obtain consultant signatures for two original documents, including the certification exhibits, which are included in the agreement boilerplate package. The consultant will return both signed originals, including the certification exhibits, to the CSO.

Sole Source Contracts

A sole source agreement is one that is awarded without competition because the consultant providing the professional or technical service has expertise, knowledge, and abilities of such a unique and significant nature that the sole source selection is clearly and completely justifiable. When a new Professional Services agreement is needed using the sole source selection process, a "Request for Consultant Services – Sole Source" memo must be completed and submitted to the CSO.

This sole source memo must include specific justification and criteria to ensure the Department is selecting the most feasible source to provide the service. Sole source Professional Services agreements are considered an exception to competitive procurement, as outlined in 36.26 RCW and in DES policies. As in the case of competitive solicitation for Professional Services, this request memo serves as the initial planning and request document for procurement. Prior to being awarded, sole source professional service agreements of \$10,000 or greater are required to be posted onto the Washington State Electronic Business Solution (WEBS) resource center, operated by the Department of Enterprise Services DES for at least (5) business days. WSDOT will typically advertise in the Seattle daily journal of commerce, or on the CSO public website (www.wsdot.wa.gov/business/consulting). This process provides a public announcement of the potential sole source agreement and helps ensure no other firms are available or interested in providing the service. If no other consultant challenges the sole source agreement, WSDOT has adequately demonstrated that the proposed sole source consultant is the only qualified candidate, and can negotiate the final agreement.

The final negotiated agreement will be filed with the Department of Enterprise Services (DES), with an explanation about how the sole source decision was made. The filing must allow for at least ten (10) business days for the DES approval process, and the contract cannot be executed or begin until DES issues an approval. All sole source contract amendments must be filed with DES and receive prior approval except where changes are minor or technical in nature.

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Nina Stocker, Community Liaison, let us know contracts K1160 and K1174 were to help support more accessible public, rural transportation routes. The contracts were procured to help pay contracted workers. Since these are administrative costs, the proposed contracts were first be reviewed by the Assistant Attorney General (AAG) and, once approved by the AAG, a cover memo was drafted for each contract. **Before the contract can be executed, the contract will be reviewed and cover memo initialed by Bonnie Lindstrom, Chief of Staff, for final approval. (Key Control #3) (Control Activities)**

Ron Westman, IT Project Manager, informed us contract K993 was an IT contract to procure software developer talent in order to help design the new Grants Management System WSDOT is currently transitioning over to. **Before an IT contract can be executed, the contract must be reviewed and signed by Matt Modaerlli, Director of Information Technology Division.** (see **Key Control #3, combined with that noted above**). The one exception is regarding procurements under \$100,000. In those situations there is an agreement in place between the CIO and ACO that allows the signature authority to remain with the ACO's, Technical Services Director.

Note: This is also a key internal control to ensure compliance with Suspension and Debarment requirements for vendors.

Subawards - Suspension and Debarment

We met with the following staff from the Department of Transportation on September 16th, 2022:

- Jesse Daniels, External Audit Liaison.
- Steven Meyeroff, FTA Compliance Administrator
- Cheryl Steben, Transportation Planning Specialist 5

to discuss the Department's internal controls to ensure compliance with requirements for Suspension & Debarment of subrecipients.

The Department utilizes a standard Operating Agreement template for all of its 20.509 subawards, which contains a standard clause regarding subrecipient suspension and debarment. The Division Director reviews each agreement to ensure appropriateness prior to execution. (Key Control #3) (Control Activities, Information and Communication)

Once the grantee agreement has been executed, Business Services staff send an annual email to the administrative contact for each subrecipient informing them of the requirement to attest to the Department that they continue to meet all necessary federal requirements in administering their local transportation projects funded by the subaward(s).

Business Services maintains a tracking spreadsheet to monitor responses, and follows up with community liaisons to ensure each subrecipient responds. This is achieved through completion of a Certifications and Assurances document. (Key Control #4) (Control Activities, Monitoring)

Summary of Key Controls

Contracts:

Key Control #1 - All members of the evaluation team are selected by the CSO manager, and all scoring team members must fill out and submit a Confidentiality/Conflict of Interest statement prior to being on the panel. (Control Activities)

Key Control #2 - After the CSO manager has approved the selected consultant, the CSO will report the outcome, in writing, to all participating firms. (Control Activities).

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Key Control #3 - Before a contract can be executed, the correct approval authority must review and sign the contract for final approval. (Control Activities)

Subawards:

Key Control #3 - The Department utilizes a standard Operating Agreement template for all of its 20.509 subawards, which contains a standard clause regarding subrecipient suspension and debarment. The Division Director reviews each agreement to ensure appropriateness prior to execution. (Control Activities, Information and Communication)

Key Control #4 - Business Services ensures grantees attest to following federal compliance requirements through completion of a Certifications and Assurances document. Responses are tracked using a spreadsheet. (Control Activities, Monitoring)

Evaluation of Results: We did not identify any control deficiencies

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: I. Procurement/Suspension and Debarment - Tests of Controls

Prepared By: BZH, 3/28/2023

Reviewed By: ACS, 4/26/2023

Purpose/Conclusion.*

Purpose:

To test the key internal controls to determine if the controls are in place and operating as intended.

To provide a final control risk assessment based upon our testing of the key internal controls.

Source:

Jesse Daniels, External Audit Liaison.

Steven Meyeroff, FTA Compliance Administrator

Doyle Dilley, Administrative Contracts Division Manager

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Schatzie Harvey, Consultant Services Manager
Nina Stocker, Rural Community Liaison
Ron Westman, IT Projects Manager

Conclusion:

Based on our understanding of internal controls over Procurement/Suspension and Debarment, we tested the key controls. Based on our testing, we identified a control deficiency related to Suspension & Debarment for contract K993:

Through conversation and testing, we identified this check was performed when the Department first inherited this contract from OFM; however, at this point in time the contract was still a state contract and not a Federal one. The Department would need to re-perform this check since Amendment 20 was a new obligation that occurred during SFY22 and it obligated Federal funds. Due to the unique nature of this contract and this being the only exception amongst all of our testing, we have judged this to be a unique, one-time error with minimal risk. **Final risk assessment is low. We will issue an exit recommendation [EI_S1Washington_SA22_WSDOT_Formula Grants_Suspension and Debarment].**

Testing Strategy:

Procurement/Suspension and Debarment - Post Uniform Guidance Awards

Step 5: Test Internal Controls

If preliminary control risk is:

LOW: Test the key internal controls to determine whether they are effective in preventing and detecting noncompliance with the requirement.

HIGH: Do not test the controls, report the issue in a finding as a “significant deficiency” or “material weakness” as appropriate.

About tests of controls: To determine whether the key controls are effective, the auditor should obtain evidence about how controls were applied at relevant times during the period under audit, the consistency with which they were applied, and by whom or by what means they were applied.

Provide Details: When documenting your testing in the ROWD, you should provide enough details so that an experienced auditor could re-perform the same test and reach the same conclusion. See **Inherent and Internal Control Risk Guidance** for what tests of controls generally include.

Remember, for a non-automated control, a “walk through” of the grantee’s process is not considered sufficient testing. A walk-through only provides an understanding of the design of a system – it does not provide evidence that the controls are effective.

-Dual purpose testing – consider whether the control can be tested in conjunction with a test of compliance to increase audit efficiency. If dual-purpose testing is performed, you must clearly document the results of control tests and compliance tests.

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-If a key control is automated, control testing must include testing of both the automated control and related general controls. See additional information in the planning guide.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 6: Assess Final Control Risk (CR)

After testing the key controls, assess final control risk. This assessment must be either low or high. If you conclude that final control risk is high, this should be reported in a finding as a “significant deficiency” or “material weakness” as appropriate.

Note: Reassessment of final control risk is required under Step 5 when noncompliance is found.

Step 7: Assess the Risk of Material Non-Compliance (combined IR and CR)

Assess the risk of material noncompliance for this compliance requirement to help determine the nature and extent of compliance testing necessary to give an opinion on this program. The risk is based on auditor judgment in consideration of the inherent risk and control risk. Assess risk as Low, Moderate or High.

High does not result in a finding, but the auditor should consider the risk when designing the nature and extent of compliance testing.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

Procurement

States shall use the same State policies and procedures used for procurements from non-Federal funds (2 CFR section 200.317). The policies are established in RCW 39 and also the Department of Enterprise Services and located on their website at <https://des.wa.gov/about/projects-initiatives/procurement-reform/current-policies>

Grantees and subgrantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

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AGGREGATE VS. PER-UNIT COST TO DETERMINE THRESHOLD

Note that the cost thresholds are not limited to each individual item purchased. The cost threshold will also apply to many like-kind items. For instance, an entity may purchase 500 tablets over 70 transactions during the year. Each tablet or transaction may be less than the lowest competitive threshold, but the aggregate purchase of tablets should be the dollar value used to determine which threshold applies. For example, if the 500 tablets cost \$200,000, the grantee should complete the procurement procedures required by this aggregate amount.

Contracts Must Include All Required Provisions

In addition to other provisions required by the Federal agency or non-Federal entity, all contracts made by the non-Federal entity under the Federal award must contain provisions covering the following, as applicable.

- (A) Contracts for more than the simplified acquisition threshold currently set at \$150,000, which is the inflation adjusted amount determined by the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) as authorized by 41 U.S.C. 1908, must address administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and provide for such sanctions and penalties as appropriate.
- (B) All contracts in excess of \$10,000 must address termination for cause and for convenience by the non-Federal entity including the manner by which it will be effected and the basis for settlement.
- (C) Equal Employment Opportunity. Except as otherwise provided under 41 CFR Part 60, all contracts that meet the definition of “federally assisted construction contract” in 41 CFR Part 60-1.3 must include the equal opportunity clause provided under 41 CFR 60-1.4(b), in accordance with Executive Order 11246, “Equal Employment Opportunity” (30 FR 12319, 12935, 3 CFR Part, 1964-1965 Comp., p. 339), as amended by Executive Order 11375, “Amending Executive Order 11246 Relating to Equal Employment Opportunity,” and implementing regulations at 41 CFR part 60, “Office of Federal Contract Compliance Programs, Equal Employment Opportunity, Department of Labor.”
- (D) Davis-Bacon Act, as amended (40 U.S.C. 3141-3148). When required by Federal program legislation, all prime construction contracts in excess of \$2,000 awarded by non-Federal entities must include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 3141-3144, and 3146-3148) as supplemented by Department of Labor regulations (29 CFR Part 5, “Labor Standards Provisions Applicable to Contracts Covering Federally Financed and Assisted Construction”). In accordance with the statute, contractors must be required to pay wages to laborers and mechanics at a rate not less than the prevailing wages specified in a wage determination made by the Secretary of Labor. In addition, contractors must be required to pay wages not less than once a week. The non-Federal entity must place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation. The decision to award a contract or subcontract must be conditioned upon the acceptance of the wage determination. The non-Federal entity must report all suspected or reported violations to the Federal awarding agency. The contracts must also include a provision for compliance with the Copeland “Anti-Kickback” Act (40 U.S.C. 3145), as supplemented by Department of Labor regulations (29 CFR Part 3, “Contractors and Subcontractors on Public Building or Public Work Financed in Whole or in Part by Loans or Grants from the United States”). The Act provides that each contractor or subrecipient must be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he or she is otherwise entitled. The non-Federal entity must report all suspected or reported violations to the Federal awarding agency.
- (E) Contract Work Hours and Safety Standards Act (40 U.S.C. 3701-3708). Where applicable, all contracts awarded by the non-Federal entity in excess of

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\$100,000 that involve the employment of mechanics or laborers must include a provision for compliance with 40 U.S.C. 3702 and 3704, as supplemented by Department of Labor regulations (29 CFR Part 5). Under 40 U.S.C. 3702 of the Act, each contractor must be required to compute the wages of every mechanic and laborer on the basis of a standard work week of 40 hours. Work in excess of the standard work week is permissible provided that the worker is compensated at a rate of not less than one and a half times the basic rate of pay for all hours worked in excess of 40 hours in the work week. The requirements of 40 U.S.C. 3704 are applicable to construction work and provide that no laborer or mechanic must be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

(F) Rights to Inventions Made Under a Contract or Agreement. If the Federal award meets the definition of “funding agreement” under 37 CFR §401.2 (a) and the recipient or subrecipient wishes to enter into a contract with a small business firm or nonprofit organization regarding the substitution of parties, assignment or performance of experimental, developmental, or research work under that “funding agreement,” the recipient or subrecipient must comply with the requirements of 37 CFR Part 401, “Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements,” and any implementing regulations issued by the awarding agency.

(G) Clean Air Act (42 U.S.C. 7401-7671q.) and the Federal Water Pollution Control Act (33 U.S.C. 1251-1387), as amended—Contracts and subgrants of amounts in excess of \$150,000 must contain a provision that requires the non-Federal award to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act (42 U.S.C. 7401-7671q) and the Federal Water Pollution Control Act as amended (33 U.S.C. 1251-1387). Violations must be reported to the Federal awarding agency and the Regional Office of the Environmental Protection Agency (EPA).

(H) Debarment and Suspension (Executive Orders 12549 and 12689)—A contract award (see 2 CFR 180.220) must not be made to parties listed on the governmentwide exclusions in the System for Award Management (SAM), in accordance with the OMB guidelines at 2 CFR 180 that implement Executive Orders 12549 (3 CFR part 1986 Comp., p. 189) and 12689 (3 CFR part 1989 Comp., p. 235), “Debarment and Suspension.” SAM Exclusions contains the names of parties debarred, suspended, or otherwise excluded by agencies, as well as parties declared ineligible under statutory or regulatory authority other than Executive Order 12549.

(I) Byrd Anti-Lobbying Amendment (31 U.S.C. 1352)—Contractors that apply or bid for an award exceeding \$100,000 must file the required certification. Each tier certifies to the tier above that it will not and has not used Federal appropriated funds to pay any person or organization for influencing or attempting to influence an officer or employee of any agency, a member of Congress, officer or employee of Congress, or an employee of a member of Congress in connection with obtaining any Federal contract, grant or any other award covered by 31 U.S.C. 1352. Each tier must also disclose any lobbying with non-Federal funds that takes place in connection with obtaining any Federal award. Such disclosures are forwarded from tier to tier up to the non-Federal award.

(J) See §200.322 Procurement of recovered materials.

Suspension and Debarment

Entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. “Covered transactions” include contracts for goods and services equal to or in excess of \$25,000 and all non-procurement transactions (e.g., awards to subrecipients), irrespective of award amount unless exempt as provided in 2 CFR section 180.215..

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Record of Work Done.

Internal Control Testing

Step 5

Contracts [see: SWSA Sampling - Procurement Suspension and Debarment Testing (Contracts and Amendments procured)]

We identified that there were three procured contracts during SFY '22; therefore, we tested our entire population.

Key Control #1 - All members of the evaluation team are selected by the CSO manager, and all scoring team members must fill out and submit a Confidentiality/Conflict of Interest statement prior to being on the panel. (Control Activities)

We reviewed the documentation sent to us by the Department. We identified the scoring committee, the score evaluation for the approved consultant, and each conflict of interest statement for each committee member. We were able to identify this information for contracts K1160 and K1174, but not for contract K993. After discussion with WSDOT and SAO's Felicia DenAdel, Single Audit Specialist, we determined that since this contract was originally procured as a sole source contract prior to our audit period, there is nothing to verify as it relates to Procurement for the SWSA.

No Exceptions Identified.

Key Control #2 - After the CSO manager has approved the selected consultant, the CSO will report the outcome, in writing, to all participating firms. (Control Activities).

We reviewed the documentation sent to us by the Department. We identified communication from Rick Naten, Contracts Administrator, to each participating firm for the decision regarding solicitation of the contract.

We were able to identify this information for contracts K1160 and K1174, but not for contract K993. Similarly to Key Control #1, we determined there is nothing we can verify within the scope of our audit as it relates to Procurement.

No Exceptions Identified.

Key Control #3 - Before a contract can be executed, the correct approval authority must review and sign the contract for final approval. (Control Activities)

We reviewed each contract and identified an authorized signature. We were able to identify this information for all three contracts in our population.

No Exceptions Identified.

Subawards

Key Control #3 - The Department follows all of the guidance in their Consultant Services Manual (Control Activities, Information and Communication).

- To test this key control we reviewed the Consolidated Grant Guidebook, as well as the previous Biennium issue to ensure it is being updated timely. We verified this key control to be working as intended.

No Exceptions Identified.

Key Control #4 - Business Services ensures grantees attest to following federal compliance requirements through completion of a Certifications and Assurances

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document. (Control Activities, Monitoring)

- To test this key control we identified and confirmed with the Department a list of 27 total subrecipients for SFY '22. We consulted the *Small Population SWSA Sampling Spreadsheet* and determined our sample population of 8. We requested all of the Certifications and Assurances documents for our sample population. [see: SWSA Sampling - Suspension and Debarment Testing (subrecipients)].
- We reviewed and verified each Certifications and Assurances document was signed by the grantee.
- We also received and reviewed the email communication from the FTA Compliance Administrator to the grantee regarding the Certs and Assurances document and its due date.

However, Amendment 20 of the K993 contract initially procured as a sole-source state contract, awarded K993 with Federal funding. We learned through discussion the IT company, Critical Logic, was performing cybersecurity tests on the new Grants Management System during the Covid-19 pandemic. As a result of this awarding of Federal funds, the Department had to ensure the vendor, Critical Logic, was not suspended or debarred prior to awarding these funds. We inquired with the Department about this requirement. The Department's Administrative Contracts Manager responded with the following:

"I do not find any thing in this contract file meeting the requirements [listed in Uniform Guidance]. I have spent significant time searching the entirety of the contract files looking for such documentation. There is no specific item related to Amendment 20. However, I know the administrator that was handling the procurements and this particular contract would certainly be aware of the status of this vendor by reference. He was responsible for another contract with the same vendor (K1150) for similar personnel support.

We do not have a note, memo or other verification that is specific to this amendment, or any of the contract files for K993."

Exception Identified.

Evaluation of Results: After reassessing final control risk, we identified a control deficiency related to Suspension & Debarment:

1. We used the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. We consulted the Decision Matrix for Single Audit Internal Control Deficiencies located in the SWSA Major Program attachment. The likelihood of noncompliance is **remote** and the magnitude of potential noncompliance is **less than material**.
2. We noted that the Department did not have adequate controls to ensure contractors had their suspension and debarment status verified prior to obligating federal funding. Through conversation and testing, we identified this check was performed when the Department first inherited this contract from OFM; however, at this point in time the contract was still a state contract and not a Federal one. The Department would need to re-perform this check since Amendment 20 was a new obligation that occurred during SFY22 and it obligated Federal funds. Due to the unique nature of this contract and this being the only exception amongst all of our testing, we have judged this to be a unique, one-time error with minimal risk. We will assess risk as **LOW and issue an exit recommendation** [EI_S1Washington_SA22_WSDOT_Formula Grants_Suspension and Debarment].

Final Control Risk Assessment

Step 6

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will place reliance on the controls, based on our control testing above.

Risk of Material Noncompliance

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Step 7

LOW – By combining our inherent risk assessment and internal control testing we have determined the risk of material noncompliance to be low. We will design our compliance testing based on this assessment.

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: I. Procurement/Suspension and Debarment - Compliance

Prepared By: BZH, 3/28/2023

Reviewed By: ACS, 4/26/2023

Purpose/Conclusion.

Purpose:

To determine if the agency is in compliance with Procurement/Suspension & Debarment requirements.

Source:

Jesse Daniels, External Audit Liaison.
Steven Meyeroff, FTA Compliance Administrator
Doyle Dilley, Administrative Contracts Division Manager
Schatzie Harvey, Consultant Services Manager
Nina Stocker, Rural Community Liaison
Ron Westman, IT Projects Manager

Conclusion:

The agency was in material compliance with federal requirements for Procurement/Suspension and Debarment. We identified the following exceptions:

For contract K993 (Critical Logic), we were unable to verify the Department confirmed the contractor was not suspended or debarred as a result of receiving federal funds during the audit period. We considered the dollar value of the entire population, including subawards executed, and determined and documented the magnitude of the noncompliance on the program as a whole or for this compliance area. (3.3 percent). The Department communicated their reasoning for the noncompliance here: [\[RE EXTERNAL RE SWSA - SA22 - Formula Grants for Rural Areas - Procurement key internal control verification\]](#). A longstanding contract had been in place with the contractor, however an amendment was executed during the audit period wherein federal funding was obligated to the contractor for the first time. The Department did not verify the contractor's suspension and debarment status at the time of the

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amendment. This was last verified in 2017 when the contract was originally amended by WSDOT.

We will report the noncompliance as an exit item at EI S1Washington SA22 WSDOT Formula Grants Suspension and Debarment

Testing Strategy:

Test Compliance

Design the nature and extent of compliance testing based on the risk of material noncompliance. The extent of our testing must be sufficient to support our conclusion about whether the grantee has materially complied with the requirement being tested. If the nature of the transactions or records for this requirement are conducive to sampling, it is recommended the auditor select a sample (the Excel sampling template for the single audit is located in the TeamStore). Otherwise, perform a judgmental selection based on risk.

Note: population of contracts for procurement/suspension and debarment should be based off of contracts **executed** during the audit period.

Procurement:

Select procurement transactions and test to determine if the entity complied with the state procurement laws and policies.

Suspension and Debarment:

1. Select new vendor contracts that exceed \$25,000 and subrecipient agreements (no dollar minimum) and verify the entity performed one of the following during the procurement process or when the contract was made:

1. Checked their status on the online search engine SAM.gov (and have support)
2. Put a clause in the contract, whereby the signer attests they are not suspended or debarred.
3. Obtained a signed certificate, whereby the signer attests they are not suspended or debarred.

Note: If the entity did not check S&D during the procurement process or when the contract was made, there is non-compliance. In evaluating the non-compliance, consider whether the entity checked S&D before or after the first payment to the contractor/subrecipient (did their controls catch it?). Include this information with the Level of Reporting request.

2. The grantee is responsible only for determining the status of the primary contractor or primary subrecipients. Accordingly, the primary contractor or subrecipients must check the status of any covered transactions they enter into at the next lower level. The grantee must inform the primary contractor or subrecipient of this responsibility. Ascertain whether the grantee informed the lower tier participant (e.g. primary contractor or subrecipient) of the requirement to check the suspension and debarment status of any covered transactions they enter into with subcontractors or subrecipients.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

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Evaluation of Results: Did you identify any noncompliance? If so, **you must:**

1. Determine and document the magnitude of the noncompliance on the program as a whole or for this compliance area (5% materiality threshold).
2. Document the reason for the noncompliance.
3. Consider whether additional testing is needed to provide reasonable assurance of detecting material noncompliance (e.g. is the risk of material noncompliance increased for the activities or costs that you did not test?).
4. Reassess the final control risk. Generally, noncompliance is the result of a control deficiency; therefore, it is necessary to reconsider the effectiveness of the internal controls.] (Include this wording) After compliance testing we consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**. This **did/did not** change our final control risk, see final control risk at ([link to controls](#)).

Guidance/Criteria:

Procurement

States shall use the same State policies and procedures used for procurements from non-Federal funds (2 CFR section 200.317). The policies are established in RCW 39 and also the Department of Enterprise Services and located on their website at <https://des.wa.gov/about/projects-initiatives/procurement-reform/current-policies>

Grantees and subgrantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

AGGREGATE VS. PER-UNIT COST TO DETERMINE THRESHOLD

Note that the cost thresholds are not limited to each individual item purchased. The cost threshold will also apply to many like-kind items. For instance, an entity may purchase 500 tablets over 70 transactions during the year. Each tablet or transaction may be less than the lowest competitive threshold, but the aggregate purchase of tablets should be the dollar value used to determine which threshold applies. For example, if the 500 tablets cost \$200,000, the grantee should complete the procurement procedures required by this aggregate amount.

Suspension and Debarment

Entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. "Covered transactions" include contracts for goods and services equal to or in excess of \$25,000 and all non-procurement transactions (e.g., awards to subrecipients), irrespective of award amount unless exempt as provided in 2 CFR section 180.215..

Record of Work Done:

Procurement:

Select procurement transactions and test to determine if the entity complied with the state procurement laws and policies.

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We reviewed Title 39 Chapter 26 RCW Procurement of Goods and Services [here: [RCW 39.26 - requirements for procurement of goods/services](#)].

To test compliance we used the testing spreadsheet located at [[SWSA Sampling - Procurement Suspension and Debarment Testing \(Contracts and Amendments procured\)](#)] to determine the required sample size. We identified that there were three procured contracts during SFY '22; therefore, we tested our entire population.

We were able to verify all requirements listed in 39.26 RCW for contracts K1160 and K1174, but not for contract K993. After discussion with WSDOT and SAO's Felicia DenAdel, Single Audit Specialist, we determined that since the K993 contract was originally procured as a sole source contract prior to our audit period, there is nothing to verify as it relates to Procurement for the SWSA.

No Exceptions Identified.

Suspension and Debarment:

- *Select new vendor contracts that exceed \$25,000 and subrecipient agreements (no dollar minimum) and verify the entity performed one of the following during the procurement process or when the contract was made:*
 - *Checked their status on the online search engine SAM.gov (and have support)*
 - *Put a clause in the contract, whereby the signer attests they are not suspended or debarred.*
 - *Obtained a signed certificate, whereby the signer attests they are not suspended or debarred.*

To test compliance we used the testing spreadsheets [located at [SWSA Sampling - Procurement Suspension and Debarment Testing \(Contracts and Amendments procured\)](#) for contracts and amendments procured ; located at [SWSA Sampling - Suspension and Debarment Testing \(subrecipients\)](#) for subawards executed].

Contracts and Amendments procured

We reviewed and verified in contracts K1160 and K1174 language that asserts the awarded party must comply with 49 CFR part 29, Executive Orders 12549, 12689, and 31 U.S.C.6101 Debarment and Suspension.

For contract K993 - We spoke with Felicia DenAdel, Single Audit Specialist for SAO, and have documented her understanding below:

- They must verify a party is not suspended or debarred before they *enter into* a contract that is expected to equal or exceed \$25k, paid all or in part with federal award funds. There is no requirement to perform a verification for amendments to contracts already in place and I have not heard of an amendment being considered a new covered transaction. It is not uncommon for an auditee or contractor to need more time or money to get a project done under an existing contract. I wouldn't consider amending the contract to be a new covered transaction. The covered transaction is the initial contract. However, if the initial contract included an option to extend it/renew it (e.g., to continue to purchase goods/services), that is a different story. **At the time they decide to extend/renew an existing contract (assuming that was an option in the original contract/procurement action), that has been interpreted as a new covered transaction.**

Amendment 20, the amendment that obligated federal funding to this contract, there was a provision that stated the "original terms and conditions of the contract remain intact"; however, the original contract was a state funded contract. When WSDOT obligated federal funds in Amendment 20, the contract then became a federal contract with a new obligating action, and as such, a provision that specifically asserts the contractor was not suspended or debarred is required.

One Exception noted.

Subawards executed

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- To test this key control we identified and confirmed with the Department a list of 27 total subrecipients for SFY '22. We consulted the *Small Population SWSA Sampling Spreadsheet* and determined our sample population of 8. We requested all of the Certifications and Assurances documents for our sample population.
- We reviewed and verified each Certifications and Assurances document was signed by the grantee.
- We also received and reviewed the email communication from the FTA Compliance Administrator to the grantee regarding the Certs and Assurances document and its due date.

No Exceptions Identified.

Evaluation of Results: We identified the following noncompliance:

1. For contract K993, we were unable to verify the Department confirmed the contractor was not suspended or debarred as a result of receiving federal funds during the audit period. We considered the dollar value of the entire population, including subawards executed, and determined and documented the magnitude of the noncompliance on the program as a whole or for this compliance area. (3.3 percent).
2. The Department communicated their reasoning for the noncompliance here:[RE EXTERNAL RE SWSA - SA22 - Formula Grants for Rural Areas - Procurement key internal control verification]. A longstanding contract had been in place with the contractor, however an amendment was executed during the audit period wherein federal funding was obligated to the contractor for the first time. The Department did not verify the contractor's suspension and debarment status at the time of the amendment. This was last verified in 2017 when the contract was originally amended by WSDOT.
3. No additional testing is needed. Our testing included all contracts and amendments issued during the audit period.
4. We assessed the final control risk. Generally, noncompliance is the result of a control deficiency; therefore, it is necessary to reconsider the effectiveness of the internal controls. After compliance testing we consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **remote** and the magnitude of potential noncompliance is **less than material**. This **did not** change our final control risk. We consulted with audit management and determined the required level of reporting for the issue is an exit recommendation. We will issue an exit item for the noncompliance at EI_S1Washington_SA22_WSDOT_Formula Grants_Suspension and Debarment

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: M. Subrecipient Monitoring - Controls

Prepared By: BZH, 10/12/2022

Reviewed By: ACS, 10/17/2022

Purpose/Conclusion.*

Purpose:

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To gain an understanding of the internal controls the agency has established that provide reasonable assurance that Federal award information and compliance requirements are identified to subrecipients, subrecipient activities are monitored, subrecipient audit findings are resolved, the impact of any subrecipient noncompliance on the pass-through entity is evaluated, and subrecipients obtained required audits and took appropriate corrective action on audit findings.
To identify key internal controls the agency has established to prevent or detect noncompliance with subrecipient monitoring requirements.
To provide a preliminary control risk assessment based upon our understanding of the internal controls.

Source:

Jesse Daniels, External Audit Liaison
Steven Meyeroff, FTA Compliance Administrator

Conclusion:

Based on our understanding of internal controls over Subrecipient Monitoring, we assessed preliminary control risk as **LOW**.

Testing Strategy:

Subrecipient Monitoring - Post Uniform Guidance Awards

Step 1: Assess Inherent Risk (IR)

Inherent Risk of Noncompliance

See steps to assess risk and risk factor considerations are listed in the ***Inherent and Internal Control Risk Guidance*** that could apply to the compliance requirement you are reviewing. For any inherent risks you identify, determine whether the agency has established internal controls to mitigate the risk. Document this analysis in the Record of Work Done.

Step 2: Gather Information

The general subrecipient monitoring requirements are described below. In addition to this information, review Part 4 of the Compliance Supplement, the grant agreement, and any available program guidelines to determine any unique requirements over Subrecipient Monitoring for the federal award you are auditing.

(a) Subrecipient Contracts – Identification Elements: The pass-through entity (PTE) must clearly identify the contract as a federal subaward when the subaward is made (or subsequent subaward modification). The contracts must include:

1. Specific federal identification elements per 2 CFR section 200.332(a)(1) – find a list of the 13 requirements in the Policy/Standards tab
2. All program requirements imposed on the PTE that are passed through to the subrecipient (federal statutes, regulations, and the terms and conditions of the PTE's award).
3. Any additional program requirements imposed by the PTE on the subrecipient.

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Note: The auditor may be able to test suspension and debarment requirements while testing contracts for the other required elements. See testing strategy for Procurement/Suspension and Debarment.

(b) Risk Evaluations: PTEs must perform a risk assessment for every subrecipient to determine and support their level of monitoring. It is a best practice - but not required - to complete risk assessments before the subaward is made (unless specifically required by the grantor). Example considerations are in the Policy/Standards tab.

(c) Monitoring Activities: Monitoring activities must be reasonable based on the inherent risk of the program and subrecipient non-compliance. Auditors will need to use their judgement and consider any monitoring steps identified by the entity in the subrecipient risk evaluation or required by the award contract. At a minimum, subaward monitoring **must** include:

1. Reviewing financial, performance and special reports required by the PTE.
2. Ensuring the subrecipient receives a single audit (if required) and the subrecipient takes timely and appropriate action on all deficiencies from audits, on-site reviews, etc.
3. Issuing a management decision when their subrecipient receives audit findings for their program.

Subrecipient's Reimbursement Requests: When the PTE receives claims for reimbursement, they should either:

1. request copies of supporting documentation for costs included on the requests; or
2. ask the subrecipient retain supporting documentation for review for on-site visits (if part of the monitoring plan).

Note: The pass-through agency is not expected to perform an extensive audit of the fiscal records, but it should have a process in place so that it can reasonably detect unallowable or unsupported costs.

Case-by-case Information: There is additional information for the auditor when the following situations occur. Find this information in the Policy/Standards tab as needed:

- A. For-Profit Subrecipients
- B. PTE Agreed-Upon Procedure Engagements
- C. Fixed-amount Subawards

Step 3: Gain an Understanding of Internal Controls

*Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Implementation means the control exists and the grantee is using it. The key controls you identify should be those that are **effective** in providing reasonable assurance that material noncompliance will be prevented or detected and corrected timely. The identification of key controls should include reviewing all of the Department's written policies and procedures related to the compliance area. If there is not a key control designed to address the compliance requirement, a significant*

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deficiency or material weakness likely exists. When identifying key controls, consider whether inherent risks identified above are reasonably addressed and if automated controls affect the manner in which grant related transactions are initiated, authorized, recorded, processed and reported.

Submit an internal control request to the agency liaison using the applicable template(s) from the TeamStore, and document the date you sent the document(s) to the agency. Attach the agency's response (if applicable) in TeamMate.

Gain an understanding of the internal control process and identify the key internal controls that are effective in ensuring:

(a) Subrecipient Contracts: The entity includes all necessary information in the subrecipient contract per 2 CFR section 200.332(a)(1).

NOTE: The control may be someone writes the contract to include all of the elements, someone reviews the contracts to specifically confirm all elements are included, or someone ensures they use an established contract template that includes the elements and periodically makes sure that template is up to date with the federal requirements (since elements may change over time).

(b) Risk Assessments: The auditee performs a risk assessment of each subrecipient to determine the appropriate level of monitoring.

(c) Monitoring: Subrecipients are monitored to ensure that federal awards are used for authorized purposes and in accordance with Federal statutes, regulations, and the terms and conditions of the Federal award. This includes monitoring the subrecipient to ensure they are performing eligibility determinations appropriately and accurately (as applicable). The auditee must have a process in place to provide reasonable assurance that they can prevent or detect non-compliance or unallowable costs.

(d) Subrecipients' Audits:

- Subrecipients receive a single audit if necessary.
- Management decisions are issued on audit findings within 6 months after receipt of the subrecipient's audit report
- Subrecipients took timely and appropriate corrective action on all audit findings.
- Sanctions are taken (or other appropriate action) in cases of continued inability or unwillingness of a subrecipient to have the required audits.

NOTE: The control may be that someone checks with SAO, on the SAO website or with the subrecipient to determine if an audit was completed and the results. The auditee should make or retain documentation of this process.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.

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2. Document the rationale for a LOW or HIGH risk assessment.]

Step 4: Assess Preliminary Control Risk (CR)

Based on your understanding of key internal controls, assess preliminary control risk. This assessment must be either low or high. Control Risk should be assessed as “LOW” when:

1. There is only a remote likelihood that noncompliance that is material could occur and not be prevented or detected on a timely basis, or
2. The auditee’s internal controls are considered sufficient to limit noncompliance to amounts that are less than material and would not merit the attention of the grantor or those charged with governance.

Otherwise, assess control risk as "high." **If preliminary control risk is "HIGH" a finding must be issued.**

Once you've signed off on this procedure step, wait for supervisor review before proceeding with control/compliance testing. If necessary, schedule a meeting with Supervisor to discuss the identified internal controls, and ask questions about how to conduct testing including necessary data, sampling methodology, and coordination with IT Audit. If work from the IT audit is expected, please inform the SWSA AIC.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

The requirements for subrecipient monitoring for the subaward are contained in 31 USC 7502(f)(2) (Single Audit Act Amendments of 1996 (Pub. L. No. 104-156)), 2 CFR sections 200.331, .332, and .501(h); Federal awarding agency regulations; and the terms and conditions of the award.

Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. State agencies cannot be subrecipients of another state agency. (Note: there are a few very rare exceptions, such as some FEMA awards, where a federal grantor may specify state agencies be treated as subrecipients). Please keep in mind, however, that if the managing state agency gives federal funds to a second state agency, we may need to test subrecipient monitoring at the second agency.

DEFINITION OF “FIRST TIER” SUBRECIPIENT

First tier subrecipients are those that receive federal awards from direct (prime) recipients. For example, state agencies are often direct (prime) recipients of grant funds. If a state agency passes the funding through to a local government, the local government is the first tier subrecipient. Similarly, some local governments receive federal awards directly from a federal agency. In this case, the local government is the direct (prime) recipient. Then, if the local government passes

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funding through to another local government or non-profit, the receiving local government/non-profit is the first tier subrecipient.

SUBRECIPIENT CONTRACTS – IDENTIFICATION ELEMENTS

Subaward contracts must include the following elements per federal requirements per 2 CFR section 200.331(a)(1):

<i>Subaward Contract Checklist</i>	
Element	Element
(i) Subrecipient name (which must match the name associated with its unique entity identifier);	(viii) Total Amount of Federal Funds Obligated to the subrecipient by the pass-through entity including the current obligation;
(ii) Subrecipient's unique entity identifier;	(ix) Total Amount of the Federal Award committed to the subrecipient by the pass-through entity;
(iii) Federal Award Identification Number (FAIN);	(x) Federal award project description, as required to be responsive to the Federal Funding Accountability and Transparency Act (FFATA);
(iv) Federal Award Date (see §200.39 Federal award date) of award to the recipient by the Federal agency;	(xi) Name of Federal awarding agency, pass-through entity, and contact information for awarding official of the Pass-through entity;
(v) Subaward Period of Performance Start and End Date;	(xii) Assistance Listings number and Title; the pass-through entity must identify the dollar amount made available under each Federal award and the Assistance Listings Number at time of disbursement;
(vi) Subaward Budget Period Start and End Date;	(xiii) Identification of whether the award is R&D; and
(vii) Amount of Federal Funds Obligated by this action by the pass-through entity to the subrecipient;	(xiv) Indirect cost rate for the Federal award (including if the de minimis rate is charged per §200.414 Indirect (F&A) costs).

SUBRECIPIENT RISK EVALUATIONS

PTEs must perform a risk assessment for every subrecipient to determine and support their level of monitoring (2 CFR section 200.331(b)). This evaluation may include consideration of:

1. The subrecipient's prior experience with the same or similar subawards;

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2. The results of previous audits including whether or not the subrecipient receives a single audit as mandated, and the extent to which the same or similar subaward has been audited as a major program at the subrecipient;
3. Whether the subrecipient has new personnel or new or substantially changed systems
4. The extent and results of Federal awarding agency monitoring (e.g., if the subrecipient also receives Federal awards directly from a Federal awarding agency).

IS THE LEVEL OF MONITORING REASONABLE?

The auditor may need to consider whether the amount of oversight is reasonable. Factors such as the size of awards, percentage of the total program's funds awarded to subrecipients, and the complexity of the compliance requirements may influence the extent of monitoring procedures. See additional monitoring considerations below. If there are significant concerns regarding monitoring, contact the Single Audit Specialist.

A. FOR-PROFIT SUBRECIPIENTS

Some Federal awards may be passed through to for-profit entities. For-profit subrecipients are accountable to the PTE for the use of the Federal funds provided. Because the single audit is not applicable to for-profit subrecipients, the PTE is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients for the subaward. The agreement with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the agreement, and post-award audits (2 CFR section 200.501(h)).

B. PTE AGREED-UPON PROCEDURES ENGAGEMENTS

A pass-through entity may arrange for agreed-upon procedures engagements for certain aspects of subrecipient activities, such as eligibility determinations. Since the pass-through entity determines the procedures to be used and compliance areas to be tested, these agreed-upon procedures engagements enable the pass-through entity to target the coverage to areas of greatest risk. The pass-through entity's costs of agreed-upon procedures engagements is allocable to the federal award if the agreed-upon procedures are performed for subrecipients below the single audit threshold for audit (currently at \$750,000 for fiscal years ending on or after December 31, 2015) **AND** the AUP is limited in scope to one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; and reporting (Uniform Guidance 2 CFR §200.425 Audit services).

C. FIXED AMOUNT SUBAWARDS

Per 2 CFR 200.332, with prior written approval from the Federal awarding agency, a pass-through entity may provide subawards based on fixed amounts up to \$150,000, provided that the subawards meet the requirements for fixed amount awards in 2 CFR 200.201. Except in the case of termination before completion, there is no governmental review of the actual costs incurred by the awardee in performance of these fixed amount subawards.

Record of Work Done:

Inherent Risk of Noncompliance

Step 1

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We do not believe there are any inherent risks that increase the risk of material noncompliance.

In accordance with AU-C Sec. 935, we have considered inherent risk factors that apply to this compliance requirement and assess the inherent risk of noncompliance at LOW.

Gather Information

Step 2

We reviewed the scope of work per the grant agreement, Part 4 of the Compliance Supplement, and did not identify any specific requirements for Subrecipient Monitoring.

Understanding of Internal Controls

Step 3

In obtaining our understanding of internal controls over compliance, we considered the five components of internal control per AU-C sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring) as documented in our Overall COSO Evaluation step.

We requested and reviewed all of the Department's written policies and procedures related to Subrecipient Monitoring as part of gaining an understanding of internal controls [see: [WSDOT Consolidated Grant Guidebook \(March 2022 update\)](#) p.105].

We documented the Department's response to our request for their Understanding of Controls [see: [ICRL - Subrecipient Monitoring - WSDOT](#)].

We met with the following staff from the Department of Transportation on September 16th, 2022:

- Jesse Daniels, External Audit Liaison.
- Steven Meyeroff, FTA Compliance Administrator
- Cheryl Steben, Transportation Planning Specialist 5

to discuss the Department's internal controls to ensure compliance with requirements for Subrecipient Monitoring.

WSDOT provides general terms and conditions to subrecipient agreements (awards) outlined in its “Consolidated Grant Guidebook”. This guide is issued each biennium (when new subrecipient agreements are awarded) via WSDOT’s website to all subrecipients receiving funding under the Section 5311. (Key Control #1) (Information/Communication)

Subaward Information

WSDOT uses a standardized template based on what kind of project the grant agreement is funding. This template includes required language to ensure DOT makes subrecipients aware of all required subaward information per 2 CFR 200.332(a) including, but not limited to, terms and conditions of the project, Federal Award Identification Number (FAIN), CFDA #, and duration (term) of the award. **The agreements with subrecipients are drafted by the Fiscal Unit, and signed into effect by Brian Lagerberg, Director for Public Transportation, before the agreements are executed (Key Control #2) (Control Activities/Monitoring).**

(Note: Due to closure of offices agreements may not contain wet signatures. Furthermore, some agreements have pre-award authority, which allowed worked to

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begin prior to signing).

Risk Assessments

Steven Meyeroff, FTA Compliance Administrator, maintains a tracking spreadsheet of all subrecipients, which includes a risk assessment due date, regardless of whether the subrecipient is applying for additional award funding for the impending biennium (Key Control #3) (Monitoring).

If an entity has an existing subaward under the Section 5311 Program, then WSDOT requires annual written certifications and assurances from the recipient indicating their continued adherence to federal requirements, including receiving a Single Audit, if necessary. The Transportation Planning Specialist submits annual requests to each grantee requesting these certifications and assurances be provided to the Department in writing before the beginning of the new SFY (June of prior SFY). **The FTA Compliance Administrator monitors the timeliness of responses using a Certifications and Assurances tracking spreadsheet (Key Control #4) (Monitoring).**

Site Visits

Once a Biennium ('21-'23 current Biennium) Marlo Binkley, Capital Programs Planner, runs a report in the Grants Management System to identify what kind of monitoring each subrecipient needs. She maintains this data in a 'Calendar' with the types of oversight required for each subrecipient, including the level of monitoring, as well as different kind of reviews needed. A group of staff perform a comprehensive on-site monitoring visit of each subrecipient. This group includes the following staff:

- Steven Meyeroff, FTA Compliance Administrator
- Cherryl Steben, Transportation Planning Specialist 5
- Nhan Nguyen, Transportation Planning Specialist 5
- Michelle Cowan, Transportation Planning Specialist 4

For the '21-'23 biennium, there is an administrative review, a financial review, a capital review, and a Drug and Alcohol review included as part of grantee monitoring visits. Each staff member performs a different review. Each review has an associated "Site visit form" that covers monitoring oversight in totality.

For Section 5311 grantees, PTD requires monitoring staff to utilize Department-approved checklists in completing reviews (Key Control #5)

(Information/Communication). The site visit process is being implemented into the Grants Management System during this biennium (21-23); therefore, due to that change in IT systems, current monitoring visits are performed using a hybrid approach of an Excel spreadsheet (population of who needs what type of visit) and the Grants Management System (performance, tracking, and monitoring).

Before any on-site visit, an assigned WSDOT contact or a WSDOT subject matter expert will review the policies and other documents WSDOT has on file for each subrecipient. The staff member conducting the visit will ask the subrecipient for updates made since WSDOT last collected policies, or the staff member may require an amendment to the subrecipient policies to comply with requirements.

To ensure site visits are completed, the Capital Programs Planner (Marlo Binkley) tracks all completed site visits for each subrecipient in the Grants Database. The Grants Database includes the scheduled completion date for the next visit due. Marlo monitors the status of each grantee's site visits to ensure a visit is completed each biennium, as required under Department policy (Key Control #6) (Monitoring).

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Progress ("status") reports are due within 30 days after of the end of each fiscal quarter (October, January, April, and July), and the Contract Managers track progress reports due from each recipient in the Grants Management System, following up with Program Managers for recipients who do not provide the information timely (Key Control #7) (Monitoring Activities).

Single Audits for Subrecipients

At the end of each recipient's fiscal year, the FTA Compliance Administrator sends a written request for information on federal award expenditures and a written attestation from the subrecipient that it did not expend \$750,000 or more in annual federal financial assistance that would require a Single Audit. (Key Control #8) (Control Activities).

The FTA Compliance Administrator and Transportation Planning Specialist 3 (Tina Rea) are both responsible for review of attestations submitted by all subrecipients of federal funds, and of inputting and monitoring each subrecipient's Single Audit Due Date into both a tracking spreadsheet and also into the Grants Management System (GMS) (Information/Communication, Monitoring) (Key Control #9). The reason as to why both are currently in use is because the grants management system is new to DoT, and they are in the process of transitioning over to GMS completely. Since they have not completely transitioned over yet, they have both the old tracking spreadsheet as well as GMS to ensure compliance does not slip during this time.

The Compliance Administrator and Tina Rea both monitor these spreadsheets to ensure an audit report is received no later than the Audit Due Date, and any subrecipients who fail to produce an audit report to PTD after their due date are contacted via phone to provide justification. If applicable, the Compliance Administrator reviews audits and follows up with subrecipients who have findings reported to ensure corrective actions are documented and implemented. **The Compliance Administrator is responsible for ensuring any subrecipients who fail to produce an audit report to PTD after their due date are contacted via phone to provide justification. If applicable, the Compliance Administrator reviews audits and follows up with subrecipients who have findings reported to ensure corrective actions are documented and implemented (Monitoring) (Key Control #10).**

Summary of Key Controls

Key Control #1 - WSDOT provides general terms and conditions to subrecipient agreements (awards) outlined in its "Consolidated Grant Guidebook". This guide is issued each biennium (when new subrecipient agreements are awarded) via WSDOT's website to all subrecipients receiving funding under the Section 5311 **(Information/Communication).**

Key Control #2 - The agreements with subrecipients are drafted by the Fiscal Unit, and signed into effect by Brian Lagerberg, Director for Public Transportation, before the agreements are executed **(Control Activities).**

Key Control #3 - The FTA Compliance Administrator, maintains a tracking spreadsheet of all subrecipients, which includes a risk assessment due date, regardless of whether the subrecipient is applying for additional award funding for the impending biennium **(Monitoring).**

Key Control #4 - The FTA Compliance Administrator monitors the timeliness of responses using a Certifications and Assurances tracking spreadsheet **(Monitoring).**

Key Control #5 - For Section 5311 grantees, PTD requires monitoring staff to utilize Department-approved checklists in completing reviews

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(Information/Communication).

Key Control #6 - To ensure site visits are completed, the Capital Programs Planner (Marlo Binkley) tracks all completed site visits for each subrecipient in the Grants Database. The Grants Database includes the scheduled completion date for the next visit due. Marlo monitors the status of each grantee's site visits to ensure a visit is completed each biennium, as required under Department policy **(Monitoring)**.

Key Control #7 - Progress ("status") reports are due within 30 days after of the end of each fiscal quarter (October), and the Contract Managers track progress reports due from each recipient in the Grants Management System, following up with Program Managers for recipients who do not provide the information timely **(Monitoring)**.

Key Control #8 - At the end of each recipient's fiscal year, the Compliance Administrator sends a written request for information on federal award expenditures and a written attestation from the subrecipient that it did not expend \$750,000 or more in annual federal financial assistance that would require a Single Audit. **(Control Activities)**.

Key Control #9 - The FTA Compliance Administrator and Transportation Planning Specialist 3 (Tina Rea) are both responsible for review of attestations submitted by all subrecipients of federal funds, and of inputting and monitoring each subrecipient's Single Audit Due Date into both a tracking spreadsheet and also into the Grants Management System (GMS) **(Information/Communication, Monitoring)**.

Key Control #10 - The Compliance Administrator monitors these subrecipients to ensure any subrecipients who fail to produce an audit report to PTD after their due date are contacted via phone to provide justification. If applicable, the Compliance Administrator reviews audits and follows up with subrecipients who have findings reported to ensure corrective actions are documented and implemented **(Monitoring)**.

Evaluation of Results: We did not identify any control deficiencies.

Preliminary Control Risk Assessment

Step 4

LOW - Internal control design is likely to be effective to prevent or detect non-compliance with grant requirements. We will perform testing to determine if we can place reliance on the controls.

C.13.PR.G - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: M. Subrecipient Monitoring - Tests of Controls

Prepared By: BZH, 1/25/2023

Reviewed By: ACS, 2/2/2023

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Purpose/Conclusion.*

Purpose:

To identify the key internal controls and test these controls to determine if the controls are in place and operating as intended.
To provide a final control risk assessment based upon our testing of the key internal controls.

Source:

Jesse Daniels, External Audit Liaison
Steven Meyeroff, FTA Compliance Administrator

Conclusion:

Based on our understanding of internal controls over Subrecipient Monitoring, we tested the key controls. Based on our testing, we found that the internal controls related to risk assessments are not in place and operating as intended to prevent material noncompliance with federal requirements. **Final risk assessment is high and we will report a finding for a material weakness at: [2022-012 The Washington State Department of Transportation did not have adequate controls over and did not comply with requirements to perform risk assessments for subrecipients of the Formula Grants for Rural Areas program.]**

Testing Strategy.*

Subrecipient Monitoring - Post Uniform Guidance Awards

Step 5: Test Internal Controls

If preliminary control risk is:

LOW: Test the key internal controls to determine whether they are effective in preventing and detecting noncompliance with the requirement.

HIGH: Do not test the controls, report the issue in a finding as a “significant deficiency” or “material weakness” as appropriate.

About tests of controls: To determine whether the key controls are effective, the auditor should obtain evidence about how controls were applied at relevant times during the period under audit, the consistency with which they were applied, and by whom or by what means they were applied.

Provide Details: When documenting your testing in the ROWD, you should provide enough details so that an experienced auditor could re-perform the same test and reach the same conclusion. See **Inherent and Internal Control Risk Guidance** for what tests of controls generally include.

Remember, for a non-automated control, a “walk through” of the grantee’s process is not considered sufficient testing. A walk-through only provides an understanding of the design of a system – it does not provide evidence that the controls are effective.

-Dual purpose testing – consider whether the control can be tested in conjunction with a test of compliance to increase audit efficiency. If dual-purpose

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testing is performed, you must clearly document the results of control tests and compliance tests.

-If a key control is automated, control testing must include testing of both the automated control and related general controls. See additional information in the planning guide.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

Evaluation of Results: Did you identify any control deficiencies? If yes, **you must:**

1. Use the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**.
2. Document the rationale for a LOW or HIGH risk assessment.]

Step 6: Assess Final Control Risk (CR)

After testing the key controls, assess final control risk. This assessment must be either low or high. If you conclude that final control risk is high, this should be reported in a finding as a “significant deficiency” or “material weakness” as appropriate.

Note: Reassessment of final control risk is required under Step 5 when noncompliance is found.

Step 7: Assess the Risk of Material Non-Compliance (combined IR and CR)

Assess the risk of material noncompliance for this compliance requirement to help determine the nature and extent of compliance testing necessary to give an opinion on this program. The risk is based on auditor judgment in consideration of the inherent risk and control risk. Assess risk as Low, Moderate or High.

High does not result in a finding, but the auditor should consider the risk when designing the nature and extent of compliance testing.

Guidance/Criteria:

INTERNAL CONTROL UNDERSTANDING

Documentation should address the five components of internal control per AU-C Sec. 315 (control environment, risk assessment, control activities, information and communication, and monitoring).

The requirements for subrecipient monitoring for the subaward are contained in 31 USC 7502(f)(2) (Single Audit Act Amendments of 1996 (Pub. L. No. 104-156)), 2 CFR sections 200.330, .331, and .501(h); Federal awarding agency regulations; and the terms and conditions of the award.

Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. State agencies cannot be subrecipients of another state agency. (Note: there are a few very rare exceptions,

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such as some FEMA awards, where a federal grantor may specify state agencies be treated as subrecipients). Please keep in mind, however, that if the managing state agency gives federal funds to a second state agency, we may need to test subrecipient monitoring at the second agency.

DEFINITION OF “FIRST TIER” SUBRECIPIENT

First tier subrecipients are those that receive federal awards from direct (prime) recipients. For example, state agencies are often direct (prime) recipients of grant funds. If a state agency passes the funding through to a local government, the local government is the first tier subrecipient. Similarly, some local governments receive federal awards directly from a federal agency. In this case, the local government is the direct (prime) recipient. Then, if the local government passes funding through to another local government or non-profit, the receiving local government/non-profit is the first tier subrecipient.

SUBRECIPIENT CONTRACTS – IDENTIFICATION ELEMENTS

Subaward contracts must include the following elements per federal requirements per 2 CFR section 200.331(a)(1):

Subaward Contract Checklist

Element	Element
(i) Subrecipient name (which must match the name associated with its unique entity identifier);	(viii) Total Amount of the Federal Award committed to the subrecipient by the pass-through entity;
(ii) Subrecipient's unique entity identifier;	(ix) Federal award project description, as required to be responsive to the Federal Funding Accountability and Transparency Act (FFATA);
(iii) Federal Award Identification Number (FAIN);	(x) Name of Federal awarding agency, pass-through entity, and contact information for awarding official of the Pass-through entity;
(iv) Federal Award Date (see §200.39 Federal award date) of award to the recipient by the Federal agency;	(xi) CFDA Number and Name; the pass-through entity must identify the dollar amount made available under each Federal award and the CFDA number at time of disbursement;
(v) Subaward Period of Performance Start and End Date;	(xii) Identification of whether the award is R&D; and
(vi) Amount of Federal Funds Obligated by this action by the pass-through entity to the subrecipient;	(xiii) Indirect cost rate for the Federal award (including if the de minimis rate is charged per §200.414 Indirect (F&A) costs).
(vii) Total Amount of Federal Funds Obligated to the subrecipient by the pass-through entity including the current obligation;	

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SUBRECIPIENT RISK EVALUATIONS

PTEs must perform a risk assessment for every subrecipient to determine and support their level of monitoring (2 CFR section 200.331(b)). This evaluation may include consideration of:

1. The subrecipient's prior experience with the same or similar subawards;
2. The results of previous audits including whether or not the subrecipient receives a single audit as mandated, and the extent to which the same or similar subaward has been audited as a major program at the subrecipient;
3. Whether the subrecipient has new personnel or new or substantially changed systems
4. The extent and results of Federal awarding agency monitoring (e.g., if the subrecipient also receives Federal awards directly from a Federal awarding agency).

IS THE LEVEL OF MONITORING REASONABLE?

The auditor may need to consider whether the amount of oversight is reasonable. Factors such as the size of awards, percentage of the total program's funds awarded to subrecipients, and the complexity of the compliance requirements may influence the extent of monitoring procedures. See additional monitoring considerations below. If there are significant concerns regarding monitoring, contact the Single Audit Specialist.

A. FOR-PROFIT SUBRECIPIENTS

Some Federal awards may be passed through to for-profit entities. For-profit subrecipients are accountable to the PTE for the use of the Federal funds provided. Because the single audit is not applicable to for-profit subrecipients, the PTE is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients for the subaward. The agreement with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the agreement, and post-award audits (2 CFR section 200.501(h)).

B. PTE AGREED-UPON PROCEDURES ENGAGEMENTS

A pass-through entity may arrange for agreed-upon procedures engagements for certain aspects of subrecipient activities, such as eligibility determinations. Since the pass-through entity determines the procedures to be used and compliance areas to be tested, these agreed-upon procedures engagements enable the pass-through entity to target the coverage to areas of greatest risk. The pass-through entity's costs of agreed-upon procedures engagements is allocable to the federal award if the agreed-upon procedures are performed for subrecipients below the single audit threshold for audit (currently at \$750,000 for fiscal years ending on or after December 31, 2015) **AND** the AUP is limited in scope to one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; and reporting (Uniform Guidance 2 CFR §200.425 Audit services).

C. FIXED AMOUNT SUBAWARDS

Per 2 CFR 200.332, with prior written approval from the Federal awarding agency, a pass-through entity may provide subawards based on fixed amounts up to \$150,000, provided that the subawards meet the requirements for fixed amount awards in 2 CFR 200.201. Except in the case of termination before completion,

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there is no governmental review of the actual costs incurred by the awardee in performance of these fixed about subawards.

Record of Work Done:

Internal Control Testing

Step 5

Key Control #1 - WSDOT provides general terms and conditions to subrecipient agreements (awards) outlined in its “Consolidated Grant Guidebook”. This guide is issued each biennium (when new subrecipient agreements are awarded) via WSDOT’s website to all subrecipients receiving funding under the Section 5311 (Information/Communication).

- To test this key control we reviewed the Consolidated Grant [Guidebook](#), as well as the previous Biennium issue to ensure it is being updated timely. We verified this key control to be working as intended.

No Exceptions Identified.

Key Control #2 - The agreements with subrecipients are drafted by the Fiscal Unit, and signed into effect by Brian Lagerberg, Director for Public Transportation, before the agreements are executed (Control Activities).

- **Selection:** To obtain our sample population we requested and received a list of 44 subawards executed during SFY '22. We consulted the *Small Population SWSA Sampling Spreadsheet*, used a 5% Tolerable Control Failure Rate and a desired assurance level of HIGH. We were able to select a sample of **10 subawards**. [See: [SWSA Sampling - Subrecipient Monitoring Controls/Compliance Testing](#)].
- **Testing:** We verified each subrecipient agreement was signed by Brian Lagerberg (Director) or Firas Makhoul (Assistant Director) on his behalf.

No Exceptions Identified.

Key Control #3 - The FTA Compliance Administrator, maintains a tracking spreadsheet of all subrecipients, which includes a risk assessment due date, regardless of whether the subrecipient is applying for additional award funding for the impending biennium (Monitoring).

- To test this key control we requested and received the subrecipient risk assessment tracking index (spreadsheet) maintained by Steven Meyeroff, FTA Compliance Administrator, from Steven himself (see [SWSA Sampling - Subrecipient Monitoring Controls/Compliance Testing](#)). We identified the spreadsheet contained appropriate fields such as "grantee", "community liaison name", "total score", "biennium risk level", "completed date" and various notes from reviewers. We noted that while the spreadsheet exists and was used to monitor risk assessments completed, 9 total subrecipients were not listed on the risk assessment tracker we obtained. Based on this observation, this internal control **is not working** as intended to prevent noncompliance with requirements for performing risk assessments.

9 Exceptions Identified.

Key Control #4 - The FTA Compliance Administrator monitors the timeliness of responses using a Certifications and Assurances tracking spreadsheet (Monitoring).

- To test this key control we requested and received the Cert and Assurance tracking spreadsheet from Steven Meyeroff, FTA Compliance Administrator. We reviewed the tracking spreadsheet and ensured it contained adequate headers with relevant information to track subrecipients.

No Exceptions Identified.

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Key Control #5 - For Section 5311 grantees, PTD requires monitoring staff to utilize Department-approved checklists in completing reviews (Information/Communication).

- **Selection:** To ensure management approved checklists were utilized, we identified and requested a list of monitoring visits that occurred during the SFY from the Department. Steven Meyeroff, FTA Compliance Administrator, provided us a list of 13 visits. We consulted the *SWSA Small population sampling spreadsheet* [[SWSA Sampling - Subrecipient Monitoring Controls/Compliance Testing](#)] and identified our sample population of six monitoring visits.
- **Testing:** To test our sample, we requested the site visits and any supporting documentation including the checklist used for the monitoring.
 - *Note: We will also use these monitoring checklists as a part of compliance testing.*

No exceptions identified.

Key Control #6 - To ensure site visits are completed, the Capital Programs Planner (Marlo Binkley) tracks all completed site visits for each subrecipient in the Grants Database. The Grants Database includes the scheduled completion date for the next visit due. Marlo monitors the status of each grantee's site visits to ensure a visit is completed each biennium, as required under Department policy (Monitoring).

- To test this key control we requested and received a GMS extract of the site visit report maintained by the Capital Programs Planner. We reviewed the tracking spreadsheet and ensured it contained adequate information about each subrecipient with relevant information in order to track site visits. We determined each active subrecipient and the type of site visits they had received during SFY '22 were documented in the tracking spreadsheet.

No Exceptions Identified.

Key Control #7 - Progress ("status") reports are due within 30 days after of the end of each fiscal quarter (October), and the Contract Managers track progress reports due from each recipient in the Grants Management System, following up with Program Managers for recipients who do not provide the information timely (Monitoring).

- To test this key control we requested and received a GMS extract from Steven Meyeroff, FTA Compliance Administrator, showcasing subrecipient status reports and due dates. We reviewed the tracking spreadsheet and ensured it contained adequate information for tracking each subrecipient status report. We verified the report documented each quarterly status report submitted by the grantee, if the status report was approved, and the respective dates of both. We also verified each subrecipient was being tracked on the spreadsheet.

No Exceptions Identified.

Key Control #8 - At the end of each recipient's fiscal year, the Compliance Administrator sends a written request for information on federal award expenditures and a written attestation from the subrecipient that it did not expend \$750,000 or more in annual federal financial assistance that would require a Single Audit. (Control Activities).

- **Selection:** To obtain our sample population we identified and confirmed with the Department a list of all 27 active subrecipients during SFY '22. We consulted the *Small Population SWSA Sampling Spreadsheet*, and we were able to identify our sample population of **8 subrecipients**. [see: [SWSA Sampling - Subrecipient Monitoring Controls/Compliance Testing](#)].

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- **Testing:** To test this key control we requested from Steven Meyeroff, FTA Compliance Administrator, the email sent to our eight samples requesting an attestation or an official response regarding their single audit status during SFY '22. We received this email from Steven and verified he communicated to the subrecipients.

No Exceptions Identified.

Key Control #9 - The FTA Compliance Administrator and Transportation Planning Specialist 3 (Tina Rea) are both responsible for review of attestations submitted by all subrecipients of federal funds, and of inputting and monitoring each subrecipient's Single Audit Due Date into both a tracking spreadsheet and also into the Grants Management System (GMS) (Information/Communication, Monitoring).

- To test key control #9 we requested and received a GMS report extract from Steven Meyeroff, FTA Compliance Administrator. We reviewed and verified data categories such as Compliance Status, Compliance Due Date, Compliance Type, and there was a field to specify if there was resolution to a missed due date. We verified the spreadsheet included each active subrecipient during SFY '22.

No Exceptions Identified

Key Control #10 - The Compliance Administrator monitors these subrecipients to ensure any subrecipients who fail to produce an audit report to PTD after their due date are contacted via phone to provide justification. If applicable, the Compliance Administrator reviews audits and follows up with subrecipients who have findings reported to ensure corrective actions are documented and implemented (Monitoring).

- To test key control #10, we reviewed the Federal Audit Clearinghouse and searched using the following criteria:
 - Fiscal Year 2020
 - Audit type: Single Audit, Program-Specific Audit
 - State: Washington
 - Assistance Listing (CFDA) Number: 20.509
 - Major Program: YES
 - Federal Award Findings: YES

We obtained our population of 2 subrecipients who received Findings related to 20.509 Formula Grants. We requested from Steven Meyeroff, FTA Compliance Administrator, the follow-up that was required for these 2 subrecipients. We were provided the management decision letter and corrective action plan for both of our requested samples.

No Exceptions Identified

Evaluation of Results: We identified a control deficiency related to Risk Assessments:

1. We used the decision matrix to determine and document the likelihood of noncompliance and the magnitude of potential noncompliance on the program as a whole. (Include this wording) We consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **more than remote** and the magnitude of potential noncompliance is **material**.
2. We noted that the Risk Assessment tracking spreadsheet is missing 9 total subrecipients. We will assess risk as HIGH.

Final Control Risk Assessment

Step 6

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HIGH - Based on our internal control testing, we identified a control weakness related to tracking risk assessments for subrecipients. This has changed our Final Control Risk Assessment.

Internal control design is **not** likely to be effective to prevent or detect non-compliance with grant requirements. We will assess Risk as High. We will report a **material weakness** in accordance with 2 CFR §200.516(1) at: [2022-012 The Washington State Department of Transportation did not have adequate controls over and did not comply with requirements to perform risk assessments for subrecipients of the Formula Grants for Rural Areas program.].

Risk of Material Noncompliance

Step 7

HIGH – By combining our inherent risk assessment and internal control testing we have determined the risk of material noncompliance to be high. We will design our compliance testing based on this assessment. Due to an elevated level of risk, compliance testing will be increased.

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

Procedure Step: M. Subrecipient Monitoring - Compliance

Prepared By: BZH, 1/3/2023

Reviewed By: ACS, 1/5/2023

Purpose/Conclusion.*

Purpose:

To determine if the agency is in compliance with Subrecipient Monitoring requirements.

Source:

Jesse Daniels, External Audit Liaison
Steven Meyeroff, FTA Compliance Administrator
Cherryl Steben, TPS 5 Business Analyst

Conclusion:

The Agency was not in material compliance with federal requirements for Subrecipient Monitoring. We identified the following exceptions:

Monitoring Compliance - Risk Assessments

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We identified during testing that 2 of our 8 samples (25 percent) did not receive a Risk Assessment prior to executing a grant award with WSDOT. The Department identified that it did not perform Risk Assessments for the two aforementioned grantees. **A finding must be issued for a control weakness that resulted in material noncompliance.** See: [2022-012 The Washington State Department of Transportation did not have adequate controls over and did not comply with requirements to perform risk assessments for subrecipients of the Formula Grants for Rural Areas program.].

Testing Strategy:

Test Compliance

Design the nature and extent of compliance testing based on the risk of material noncompliance. The extent of our testing must be sufficient to support our conclusion about whether the grantee has materially complied with the requirement being tested. If the nature of the transactions or records for this requirement are conducive to sampling, it is recommended the auditor select a sample (the Excel sampling template for the single audit is located in the TeamStore). Otherwise, perform a judgmental selection based on risk. Often times, subrecipient monitoring requires three separate samples for testing (awards, monitoring and A-133 audits).

1. Select subaward contracts/agreements to determine compliance with the following attributes:

a. Ascertain if the pass-through entity (PTE) made subrecipients aware of all required subaward information per 2 CFR 200.332(a):

1. Federal Award Identification.

- (i) Subrecipient name (which must match the name associated with its unique entity identifier);
- (ii) Subrecipient's unique entity identifier;
- (iii) Federal Award Identification Number (FAIN);
- (iv) Federal Award Date (see §200.39 Federal award date) of award to the recipient by the Federal agency;
- (v) Subaward Period of Performance Start and End Date;
- (vi) Subaward Budget Period Start and End Date; (added on November 12, 2020)
- (vii) Amount of Federal Funds Obligated by this action by the pass-through entity to the subrecipient;
- (viii) Total Amount of Federal Funds Obligated to the subrecipient by the pass-through entity including the current obligation;
- (ix) Total Amount of the Federal Award committed to the subrecipient by the pass-through entity;
- (x) Federal award project description, as required to be responsive to the Federal Funding Accountability and Transparency Act (FFATA);
- (xi) Name of Federal awarding agency, pass-through entity, and contact information for awarding official of the Pass-through entity;
- (xii) CFDA Number and Name; the pass-through entity must identify the dollar amount made available under each Federal award and the CFDA number at time of disbursement;
- (xiii) Identification of whether the award is R&D; and
- (xiv) Indirect cost rate for the Federal award (including if the de minimis rate is charged per §200.414 Indirect (F&A) costs).

Note: The auditor may be able to test suspension and debarment requirements while testing contracts for the other required elements. See testing strategy for Procurement/Suspension and Debarment.

2. All requirements imposed on the PTE that are passed through to the subrecipient (Federal statutes, regulations and the terms and conditions of the PTE's Federal award);

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3. Any additional requirements that the pass-through entity imposes on the subrecipient in order for the pass-through entity to meet its own responsibility to the Federal awarding agency including identification of any required financial and performance reports;

b. Verify that the subaward project and costs outlined in the subrecipient's contract are for allowable activities per the auditee's award agreement.

c. Verify that the pass-through entity required subrecipients expending \$750,000 or more in Federal awards during the subrecipient's fiscal year to have audits made in accordance with Uniform Guidance.

2. Review the pass-through entity's documentation of subrecipient monitoring to ascertain if the pass-through entity monitored the subrecipient to ensure that Federal funds are used for authorized purposes in compliance with Federal statutes, regulations, and the terms and conditions of the subaward, achieves performance goals, and whether the subrecipient took action in response to pass-through monitoring findings. Monitoring includes ensuring the subrecipient determines eligibility correctly (as applicable.) (NOTE: You do not have to audit the subrecipient's costs for compliance with Cost Principles – that is done in procedures A and B – rather, you are evaluating the pass-through agency's monitoring effort. Contact the Single Audit Specialist if you notice a cost being claimed for reimbursement by a subrecipient that does not appear to be allowable and/or made in accordance with Cost Principles.)

Perform testing of subrecipient monitoring activities by the pass-through entity to include the following required or optional activities (see 2 CFR 200.331):

a. Evaluating each subrecipient's risk of noncompliance (risk assessment), considering: the subrecipient's prior performance/noncompliance, results of subrecipient's prior single audits, change in subrecipient's staff or accounting systems, and results of direct Federal agency monitoring. **(Required)**

b. Reviewing subrecipient financial and performance reports **(Required)**

c. Verifies that subrecipients receive a single audit if they have total federal expenditures above the single audit threshold, \$750,000. (The amount of the subaward does not matter.) **(Required)**

d. If the subrecipient received an audit finding related to subaward, the PTE issued a management decision within six months of the audit report. **(Required)**

e. Ensuring subrecipients take timely, appropriate action on all identified deficiencies relating to the federal subaward **(Required)**

(NOTE: the subrecipient audit reports that must be tested are the ones due to the agency during the audit period. Subrecipients are required to provide copies of the report to the agency within 9 months of their fiscal year end. In order to identify this population the auditor must use expenditures that include prior audit periods. If you have any questions on how to identify the population please contact the SWSA supervisor or the SWSA AIC.)

3. Review the auditee's documentation of subrecipient monitoring to determine if it was sufficient to prevent or detect noncompliance with federal statutes, regulations, and the terms and conditions of the subaward, and whether the subrecipient took action in response to pass-through monitoring findings.

NOTE: You do not have to audit the subrecipient's costs for compliance with Cost Principles – that is done in procedures A and B – rather, you are evaluating the pass-through agency's monitoring effort.

4. If the subrecipient was not in compliance with their federal award (as identified by our office or by the pass through entity), verify that the effects of subrecipient noncompliance and/or questioned costs are properly reflected in the pass-through entity's records.

Note: Prior to completing the Evaluation of Results (below), auditors must document to whom final exceptions were sent and when they were sent.

Evaluation of Results: Did you identify any noncompliance? If so, **you must:**

1. Determine and document the magnitude of the noncompliance on the program as a whole or for this compliance area (5% materiality threshold).

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2. Document the reason for the noncompliance.
3. Consider whether additional testing is needed to provide reasonable assurance of detecting material noncompliance (e.g. is the risk of material noncompliance increased for the activities or costs that you did not test?).
4. Reassess the final control risk. Generally, noncompliance is the result of a control deficiency; therefore, it is necessary to reconsider the effectiveness of the internal controls.] (Include this wording) After compliance testing we consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. The likelihood of noncompliance is **<remote/more than remote>** and the magnitude of potential noncompliance is **<less than material/material>**. This **did/did not** change our final control risk, see final control risk at ([link to controls](#)).

Guidance/Criteria:

Record of Work Done:

Test 1 - Subaward Compliance

Select subaward contracts/agreements to determine compliance with the following attributes:

a. *Ascertain if the pass-through entity (PTE) made subrecipients aware of all required subaward information per 2 CFR 200.332(a): Federal Award Identification.*

1. *Ascertain if the pass-through entity (PTE) made subrecipients aware of all required subaward information per 2 CFR 200.332(a):*
 1. (i) *Subrecipient name (which must match the name associated with its unique entity identifier);*
 2. (ii) *Subrecipient's unique entity identifier;*
 3. (iii) *Federal Award Identification Number (FAIN);*
 4. (iv) *Federal Award Date (see §200.39 Federal award date) of award to the recipient by the Federal agency;*
 5. (v) *Subaward Period of Performance Start and End Date;*
 6. (vi) *Subaward Budget Period Start and End Date;*
 7. (vii) *Amount of Federal Funds Obligated by this action by the pass-through entity to the subrecipient;*
 8. (viii) *Total Amount of Federal Funds Obligated to the subrecipient by the pass-through entity including the current obligation;*
 9. (ix) *Total Amount of the Federal Award committed to the subrecipient by the pass-through entity;*
 10. (x) *Federal award project description, as required to be responsive to the Federal Funding Accountability and Transparency Act (FFATA);*
 11. (xi) *Name of Federal awarding agency, pass-through entity, and contact information for awarding official of the Pass-through entity;*
 12. (xii) *CFDA Number and Name; the pass-through entity must identify the dollar amount made available under each Federal award and the CFDA number at time of disbursement;*
 13. (xiii) *Identification of whether the award is R&D; and*
 14. (xiv) *Indirect cost rate for the Federal award (including if the de minimis rate is charged per §200.414 Indirect (F&A) costs).*

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2. *All requirements imposed on the PTE that are passed through to the subrecipient (Federal statutes, regulations and the terms and conditions of the PTE's Federal award);*
 3. *Any additional requirements that the pass-through entity imposes on the subrecipient in order for the pass-through entity to meet its own responsibility to the Federal awarding agency including identification of any required financial and performance reports*
- b. *Verify that the subaward project and costs outlined in the subrecipient's contract are for allowable activities per the auditee's award agreement.*
- c. *Verify that the pass-through entity required subrecipients expending \$750,000 or more in Federal awards during the subrecipient's fiscal year to have audits made in accordance with Uniform Guidance.*

To test Subaward compliance we determined we used the testing spreadsheet located at [[SWSA Sampling - Subrecipient Monitoring Controls/Compliance Testing](#)]. We determined we would use the same population we used to test key control #2. See [[M. Subrecipient Monitoring - Tests of Controls](#)] for how we obtained our sample of 10. We noted the R&D eligibility of award expenses is not applicable for this federal program. Based on our testing of subawards, we determined the Department was in compliance with ensuring subrecipients were made aware of federal requirements under the 2 CFR 200.332. ***No exceptions noted.***

Test 2 - Monitoring Compliance

Perform testing of subrecipient monitoring activities by the pass-through entity to include the following required or optional activities (see 2 CFR 200.332):

a. *Evaluating each subrecipient's risk of noncompliance (risk assessment), considering: the subrecipient's prior performance/noncompliance, results of subrecipient's prior single audits, change in subrecipient's staff or accounting systems, and results of direct Federal agency monitoring. (Required)*

- To test Risk Assessment compliance for Formula Grants we identified and verified with the Department a list of subrecipients for SFY'22. We identified a total population of twenty-seven subrecipients, and consulted the SWSA Small Population Testing Spreadsheet and identified our sample of 8.
 - We identified that 2 of our 8 samples (25%) did not receive a Risk Assessment.

2 Exceptions Noted.

2. Review the pass-through entity's documentation of subrecipient monitoring to ascertain if the pass-through entity monitored the subrecipient to ensure that Federal funds are used for authorized purposes in compliance with Federal statutes, regulations, and the terms and conditions of the subaward, achieves performance goals, and whether the subrecipient took action in response to pass-through monitoring findings.

Perform testing of subrecipient monitoring activities by the pass-through entity to include the following required or optional activities (see 2 CFR 200.332):

- To test monitoring compliance for Formula Grants we requested and received a list of monitoring visits that occurred during the State Fiscal Year from Steven Meyeroff, FTA Compliance Administrator. We received a list of 13 visits and consulted the SWSA Small Population Testing Spreadsheet and identified our sample of 6. [See: [SWSA Sampling - Subrecipient Monitoring Controls/Compliance Testing](#)].
 - We reviewed each visit that occurred and what kind of visit it was. We reviewed documentation of the visit and determined the Department adequately ensured Federal funds were used for authorized purposes in compliance with 2 CFR 200.332.

No Exceptions Identified.

Test 3 - Subrecipients' Audit Compliance

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3. Review the auditee's documentation of subrecipient monitoring to determine if it was sufficient to prevent or detect noncompliance with federal statutes, regulations, and the terms and conditions of the subaward, and whether the subrecipient took action in response to pass-through monitoring findings.
4. If the subrecipient was not in compliance with their federal award (as identified by our office or by the pass through entity), verify that the effects of subrecipient noncompliance and/or questioned costs are properly reflected in the pass-through entity's records.

To test Subrecipients' Audits we performed 2 tests:

- For Test #1, we requested, received, and verified a list of grantees that received 5311 funding during Fiscal Year End December 2020 with Cherryl Steben, TPS5 Business Analyst. We identified our total population of 21 subrecipients, consulted the *SWSA Small population spreadsheet* and determined our sample population of 7 [see: [SWSA Sampling - Subrecipient Monitoring Controls/Compliance Testing](#)].
 - We reviewed the Federal Audit Clearinghouse and ensured that each sample received a Single Audit, if required. We identified one subrecipient who was not required to receive a single audit, and we received the attestation stating so from the Department for that grantee.

No Exceptions Identified

- For Test #2, we reviewed:
 - If the subrecipient received an audit finding related to subaward, the PTE issued a management decision within six months of the audit report.
 - If the Department ensured subrecipients take timely, appropriate action on all identified deficiencies relating to the federal subaward

We first ran a report in the Federal Audit Clearinghouse filtered by the following fields:

- Fiscal Year 2020
- Audit type: Single Audit, Program-Specific Audit
- State: Washington
- CFDA 20.509
- Major Program: YES
- Federal Award Findings: YES

We obtained our population of 2 subrecipients who received Findings related to 20.509 Formula Grants. We requested from Steven Meyeroff, FTA Compliance Administrator, the follow-up that was required for these 2 subrecipients. We were provided the management decision letter and corrective action plan for both of our requested samples.

No Exceptions Identified

Evaluation of Results: We identified the following noncompliance:

Subaward Compliance

No Exceptions identified.

Monitoring Compliance - Risk Assessments

1. We identified during testing that 2 of our 8 samples (25 percent) did not receive a Risk Assessment prior to executing a grant award with WSDOT.
2. The Department identified that they did not perform Risk Assessments for the two aforementioned grantees.
3. No other testing needs to be performed

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4. After compliance testing we consulted the *Decision Matrix for Single Audit Internal Control Deficiencies* located in the SWSA Major Program attachment. **The likelihood of noncompliance is more than remote and the magnitude of potential noncompliance is material. This did change our final control risk**, see final control risk at [M. Subrecipient Monitoring - Tests of Controls]. **We will issue a finding** [see: 2022-012 The Washington State Department of Transportation did not have adequate controls over and did not comply with requirements to perform risk assessments for subrecipients of the Formula Grants for Rural Areas program.].

Subrecipients Audits' Compliance

No Exceptions identified.

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Procedure Step: Program Summary

Prepared By: BZH, 3/28/2023

Reviewed By: ACS, 4/26/2023

Purpose/Conclusion.:

Purpose:

To summarize the major program audit results.

Conclusion:

We have summarized the major program audit results.

Testing Strategy.:

Step 1. Audit Summary Always Follows Uniform Guidance: This section contains UG requirements. Despite whether the program subject to audit has pre-UG or UG awards, our planning, concluding and reporting should be performed under UG because the entity's fiscal year started after the UG effective date of 12/26/2014.

Summary: Complete the Major Federal Program spreadsheet, the same one from the Compliance Requirements step. While it summarizes the results, each compliance area with an exception should have a rationale for reporting level in the ROWD.

Questioned Costs: Known and likely questioned costs of \$25,000 or greater must be reported as a finding. Known questioned costs must be listed separately from likely/projected/estimated questioned costs on the finding. See the Audit Report Standards Manual for an example.

Don't Net Questioned Costs: If you find the entity overbilled and underbilled the program, do not net them to determine total questioned costs. Overbilled

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amounts represent unallowable costs that are used to determine the level of non-compliance. Underbilled amounts just represent the availability of other costs that are considered allowable.

Associated Questioned Costs: When you question direct costs you should consider the impact errors would have for “directly associated costs.” When an unallowable cost is incurred, directly associated costs are also unallowable. Directly associated costs are incurred solely as a result of incurring another cost and would not have been incurred if the other cost had not happened. For example:

1. Fringe benefits are directly associated with payroll costs,
2. Indirect rates multiplied against questioned direct costs results in directly associated indirect costs.

Step 2. Document and hyperlink to each exception(s) identified in the audit (i.e. 1 finding for reporting, 1 exit item for program income.)

Step 3. Determine if the status of prior audit findings has been resolved, if applicable. Update the "Worksheet for Prior Audit Findings" with the status of the findings.

Guidance/Criteria.

Record of Work Done.

Step 1

We have completed the "Audit Summary" tab of the SWSA Major Program worksheet at [[SWSA Major Program](#)].

Step 2

- Finding for Subrecipient Monitoring - Risk Assessments [[2022-012 The Washington State Department of Transportation did not have adequate controls over and did not comply with requirements to perform risk assessments for subrecipients of the Formula Grants for Rural Areas program.](#)]
- Exit item for Suspension and Debarment [[EI S1Washington SA22 WSDOT Formula Grants Suspension and Debarment](#)].

Step 3

There were no findings in the prior audit.

C.13.PRG - 20.509-Formula Grants for Rural Areas - DOT

State of Washington

Procedure Step: Exit Conference
Prepared By: BZH, 4/26/2023
Reviewed By: ACS, 4/27/2023

Purpose/Conclusion.

Purpose:

To communicate the results of our federal Single Audit work to agency management.

Conclusion:

We have communicated the results of our federal Single Audit work to agency management.

Testing Strategy.

For large programs, agencies with multiple programs, or programs with significant/multiple issues, a program exit should be held with the agency prior to the formal exit, when appropriate. These should be coordinated through the SWSA AAM and the agency's audit liaison.

1. Send the audit liaison a list of all finalized exit items for the program. Include who the list was sent to and the date. Attach the word document to this step.
2. If needed, schedule an exit conference with the appropriate staff/managers of your grant program (via the audit liaison if applicable). This "program-specific" exit will precede the final agency exit.
3. Document how the audit results were relayed- meeting, phone or written correspondence, etc. A written summary (exit document) is recommended, however may not be necessary for clean programs. Any formal exceptions should be documented and provided to the agency.
4. Document who attended the exit conference if one was held.

***NOTE:** Communication of IT security matters are highly sensitive, Washington OCIO [category 3](#) information. Please mark IT Security exceptions in TeamMate with **"This record contains information considered exempt from public disclosure under RCW 42.56.420 of the Public Records Act. As such, distribution of this record is limited."** IT security details should never be sent via Email.*

***Recommendation Review Requirement** - IT Security related information, that an external party may use to manipulate the government's system or security-related procedures, is protected by Public Request Exemption RCW 42.56.420. All IT security-related recommendations must be reviewed by [Team IT Audit](#). [IT Recommendation Procedures](#) are located in Team IT Audit's Support Workgroup folder. Template language for common IT related recommendations can also be found in the [ARS manual Part 5 Chapter 8](#).*

State of Washington

Guidance/Criteria:

SAO Audit Policy 2220 - Conducting Exit Conferences (effective 6/30/16)

BACKGROUND

Exit conferences provide a forum for communication between auditors, entity management, the governing body and any other parties with oversight responsibility or who have contracted for or requested the audit. These conferences serve to communicate the significant results of our audit and ensure that effective two-way communication has taken place regarding the engagement.

REQUIREMENTS

1. Auditors will conduct timely exit conferences for all engagements before the report is issued.

If the government declines an exit conference or it is not feasible to have the conference before report issuance, auditors must document the reasons for not holding the conference, and how, and when and to whom required information was communicated.

2. Auditors will use the applicable template(s) in preparing information for the exit conference to ensure required communications are included.

Auditors must adapt presentations to meet the needs of conference participants while effectively communicating required information. At a minimum, the following items will be addressed as applicable during exit conferences:

- Draft audit report(s), including the planned issuance date.
- Findings and management letter issues.
- Status of prior audit recommendations.
- Cost of attestation engagements and local government audits.
- Auditor's views about qualitative aspects of the government's significant accounting policies or reporting.
- Significant difficulties encountered during the audit such as considerable delays in getting information; extensive unexpected effort to obtain audit evidence; unavailability of expected information; restrictions imposed on auditors by entity management; and an unreasonably brief time within which to complete the audit. Such circumstances may represent a scope limitation.
- Disagreements with management regarding selection or application of criteria, reasonableness of management's estimates or interpretations or other matters relevant to the audit.
- Material misstatements in the audited financial statements that were corrected by management.
- Uncorrected misstatements in the audited financial statements.
- The results of any fraud investigation completed during the audit and any fraud, noncompliance or abuse identified by the audit other than matters that are clearly inconsequential.
- Any concerns about the quality of the work of other auditors.

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- Written representations provided by management pursuant to Policy 3420.
- Any other findings or issues that are significant and relevant to the governing body's responsibilities.

3. Exit conferences will be summarized in the engagement documentation.

Documentation will include the date, participants, and a summary of significant items discussed during the conference.

4. Auditors will communicate conference information to members of the governing body or audit committee who did not attend the exit conference.

Auditors should document the method of communication (for example, mailing or e-mailing the meeting handouts).

5. Exit conferences will be conducted in compliance with the Open Public Meetings Act.

If a quorum attends the exit conference, the entity is responsible for ensuring it meets requirements of the Open Public Meetings Act.

RELATED POLICIES

2130 – Inviting Officials to Entrance and Exit Conferences

REFERENCES

AU-C §260.12-20 – The Auditor's Communication with those Charged with Governance

AU-C §600.48 – Special Considerations – Audits of Group Financial Statements

Record of Work Done.*

We sent Jesse Daniels, the list of approved exit items on April 17, 2023.

Exit Conference:

We held our exit conference with the Washington State Department of Transportation on April 24, 2023. We presented the agency with the exit document, see [FY22 SWSA Exit Document - WSDOT programs].

The following SAO staff were in attendance:

- Cavan Busch, Audit Manager
- Andrew Schmitz, Audit Supervisor
- Anthony Welsh, Assistant State Auditor
- Brandon Hofman, Assistant State Auditor

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The following WSDOT staff attended the official exit conference:

- Jesse Daniels, External Audit Liaison
- Marshall Elizer, Assistant Secretary Multimodal Development & Delivery
- Stephanie Tax, Local Programs, Program Manager
- Kyle McKeon, Local Programs, Engineering Services Manager
- Kurt Williams, Deputy Construction Director - Materials Division
- Cindy Bellus, AFS, Payroll Manager
- Cindy Kay, AFS, Acting Director
- Doug Vaughn, Chief Financial Officer
- Mike Gribner, Assistant Secretary Regions/Chief Engineer
- Garrett Webster, Assistant State Material Engineer - Materials Quality
- Heidi Jensen, Transportation Technical Engineer
- Lew Bequette, WSF - Controller
- Hector Menenes, AFS, Assistant Director
- Jay Drye, Local Programs Administrator
- Suzi Freelund, AFS, Accounting & Reproting Manager
- Steve McKerney, Director Internal Audit
- Cherryl Steben, Public Transportation Planning Specialist
- Jeff Pelton, Assistant Secretary Finance and Administration