

FINAL REPORT FOR
CITY OF STOCKTON
INTERNAL AUDIT OF GRANTS MANAGEMENT

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I. EXECUTIVE SUMMARY

As the contracted internal auditor for the City of Stockton (the City), Moss Adams performed a review of the design of existing internal control activities and the internal control environment relevant to the grants management process. The review took place between August 2014 and January 2015 and focused on assessing the internal controls over the grants management process. This review included the internal control activities performed by relevant personnel and the environment in which these internal control activities were performed.

The review of internal controls was completed under the consultancy standards of the American Institute of Certified Public Accountants (AICPA). As such, this work was not an audit of internal controls that resulted in a formal opinion or other form of assurance. Moss Adams reviewed the City's internal controls for design, but did not test those controls for operating effectiveness. Testing is expected to be a forthcoming activity that will be performed once the current findings within this report have been corrected.

The overall conclusion of this review is that, while management has made progress in the improvement of grants management throughout the City, some work remains in order to create a strong internal control environment for its departmental and city-wide grants management processes. Such work should be considered a priority and completed in phases over the next 6 to 12 months, as City resources are made available.



II. SCOPE AND METHODOLOGY

The scope of our review included the City's grants management processes and internal control environment as administered by the Public Works Department (Public Works), Police Department (Police), Economic Development Department (EDD), Financial and Accounting Operations (Accounting Division) of the Administrative Services Department (ASD), and Grants Manager in the City Manager's Office.

The methodology that Moss Adams followed to address the scope of work included interviews with personnel involved in managing grants within Public Works, Police, EDD, and ASD. We also reviewed various grant-related documents received, processed, created, maintained, and used by these departments to manage grants.

To further address the scope of this review, our methodology also included:

- Review of relevant City Administrative Directives, policies, and standard operating procedures;
- Examination of relevant documentation in support of the performance of key internal controls, such as departmental grants management policies and procedures, examples of grant documentation, timekeeping documentation to support time and effort compliance requirements, quarterly and annual reports, and examples of sub-recipient monitoring;
- Review of prior year findings from the Single Audit (OMB Circular A-133 organization-wide audit of Federal grant assistance);
- Assessment of the effectiveness of the design of these internal controls;
- Review of examples of communication between ASD and the Accounting Division with departmental grants management staff;
- Research of grants management standards; and
- Development of recommendations to improve the design of existing controls or create new, well-designed internal controls necessary to address unmitigated risks to the grants management process.

III. FINDINGS AND RECOMMENDATIONS

1. Finding: Grants management communication within the City is disjointed, and, as a result, policy and procedural changes are not consistently or proactively communicated.

In fiscal year 2013-14, the City received \$26.4 million in grant revenue from the federal government and \$28.5 million in grant revenue from the State of California for a total of \$54.9 million. To manage its grants, the City employs a largely decentralized process that relies heavily on grants management at the departmental level. Although decentralized, departmental grants management staff must communicate grant-related information to the Grants Manager in the City Manager's Office and the Accounting Division of ASD.

Prior to pursuing a grant, departments are required to provide written notification to the Grants Manager and the Accounting Division. According to City policy, the Grants Manager must be notified for appropriate coordination and to ensure that the objectives of the grant are consistent with city-wide goals and priorities, and the Accounting Division must be notified to ensure the account numbers are assigned and funds are budgeted appropriately and placed in the proper accounts.

Upon award, departmental grants managers are responsible for compliance with grant requirements, including implementation, monitoring, and reporting. The Accounting Division continues to receive grant-related accounting data and requests for grant-related journal entries from departments for financial oversight and reporting purposes. As further detailed within Finding 3, the Accounting Division and grants management staff for some departments continue to work together to submit required quarterly financial reports.

Despite the amount of information being transmitted between the Accounting Division and departmental grants managers, communication is largely informal and inconsistent. Opportunities exist for more proactive and regular two-way communication between the Accounting Division/ASD and departmental grants management staff to address challenges such as procedure changes that affect grant management.

For example, in fiscal year 2014-15, the City changed the way it recorded payroll from accrual to cash, resulting in grant expenditures being recorded differently. ASD did not communicate this shift to departmental grants management staff prior to the change occurring, so grants management staff were not able to anticipate how it would impact their processes. When the Police Department became aware of the change they informed EDD and Public Works.

Recommendation: To facilitate more effective communication, ASD, the Grants Manager in the City Manager's Office, and departmental grants managers should meet at least quarterly to discuss changes to policies and procedures, reporting requirements, and information needs, as well as to facilitate knowledge transfer and dissemination of best practices.



ASD has the authority and responsibility to make accounting decisions for the entire City based on the City's overall needs, standards, and best practices. These decisions may require changes in how individual departments manage their business processes, including the management of grants. Because each department has slightly different processes for how it administers grants and complies with reporting requirements, it is imperative to communicate as proactively as possible policy and procedural changes that could affect those activities. With prior notice, departmental staff can determine how these changes will affect internal processes and reports to grantors and grantees. For this reason, ASD should communicate in writing prior to implementation any changes to policies or procedures that may affect other departments. More proactive, two-way communication will allow departmental grants management staff to be more aware of the reasons for changes, prepare for them more effectively, and communicate potential impacts of policy changes to management in a timely manner.

Departmental personnel also need a vehicle to more effectively communicate with each other. Departmental grants management staff, grants-related ASD management and staff, and the Grants Manager should meet at least quarterly to discuss how policy changes under consideration may affect overall grants management, ask questions of one another, receive guidance from one another, coordinate training, and identify and evaluate suggestions to improve processes. The Grants Manager should coordinate these Grants Management meetings among ASD and departmental grants management staff. Departmental grants management staff should also explore setting up a share site on the City's Intranet or a group e-mail list to disseminate information in the most productive manner in between meetings with ASD and the Grants Manager.

2. Finding: Staff is not always fully aware of what changes need to be implemented to comply with updated federal requirements for grants management.

On December 26, 2014, a joint interim final rule implementing the Office of Management and Budget (OMB) Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards at 2 CFR 200 (Uniform Guidance for Federal Awards) was issued in the Federal Register. This joint interim final rule incorporates the implementation regulations of all the federal awarding agencies and brings into effect the new Uniform Guidance for Federal Awards under 2 CFR 200. The final rule was effective on December 26, 2014, and information about the rule was published in late 2013 for grantees to begin implementing changes.

Despite this updated guidance recently becoming effective, only one of the grants management staff members within Police and EDD had attended any related training as of November 2014¹. In fact, most staff within these departments have not attended any grants-related training in the last year. The majority of departmental grants management staff were unaware of changes to federal requirements, and all were unsure of exactly how those changes could affect their

¹ Grants management personnel within Public Works receive frequent training, which incorporates federal guidelines, from the California Department of Transportation.



respective internal grant processes and procedures. Additionally, despite the Uniform Guidance having been published a year prior and becoming effective in December 2014, none of the departmental grants management staff reported having received any guidance on the new standards from the City.

Without careful review and implementation of changes in requirements, the City could risk losing its current grant funding due to non-compliance. Additionally, important information that may need to be collected to adhere to new requirements may not be collected at the onset of the requirements becoming effective. Retroactively retrieving this information to comply with a requirement can be costly and time consuming. Proactively reviewing new grant requirements as they are released, determining which changes are applicable, disseminating that information to grants management staff throughout City departments, and developing a plan to implement any necessary process changes to achieve compliance with the new requirements prior to their effective date, is an important role of the City's grants management process.

Recommendation: The City's Grants Manager, in conjunction with ASD management, should coordinate the City's assessment and implementation of changes in grant requirements; the City Manager's Office should finalize its update to Administrative Directive MAN-12 to incorporate the full scope of the Grants Manager's role; and departmental grants management staff should attend grant-related training regularly to ensure that they are aware of new requirements and best practices.

While City policy assigns departments the responsibility of complying with all grant requirements, individual departments do not possess the expertise and/or resources to review new requirements and determine which ones will affect the City. The Grants Manager in the City Manager's Office should be the City's subject matter expert in this area. The Grants Manager should monitor grants requirements for changes and determine which apply to the City. If an upcoming change is applicable to the City, the Grants Manager should notify those departments with grants that will be impacted as soon as possible. If the change in requirements affects the Accounting Division, the Grants Manager should also work with ASD to provide departments with information about how the Accounting Division will implement changes and how those changes will affect departmental grants management.

The City Manager's office is in the process of updating the Grants Application Procedures and Administration policy, Administrative Directive MAN-12 since August 2013. While it is not yet approved and remains in draft form, this updated procedure does include more detailed information about the role of the City's Grants Manager. While the current draft policy is more robust, it does not define responsibility for the central coordination of monitoring changes in grant management requirements, disseminating information about how these changes will affect the City, providing information about training opportunities, or acting in an advisory role to departmental grants management staff throughout the life of a grant. The Grants Manager has been performing some of these tasks already; however, the lack of formal definition and assignment of these responsibilities to the position has led to departmental grants management



staff being unsure of whom to contact when they are in need of information and resources. As such, the City Manager's Office should ensure the final version of the Administrative Directive for grants management includes detailed information about the role of the Grants Manager.

While the Grants Manager should have centralized responsibility for monitoring changes in grant requirements, departmental personnel should also be responsible for remaining current on standards and best practices, especially those specific to their grants, by regularly attending grants-related training. The majority of the departmental staff interviewed within Police and EDD had not attended training in at least three years as of November 2014². The Grants Management group meetings recommended within Finding 1 would be a useful forum for coordinating grants-related training for a larger number of staff members, likely at a more economical cost to the City.

3. Finding: The process for creating, reviewing, and submitting quarterly financial reports (SF-425) for grants is not consistent across the City, which increases the risk of inaccurate information being submitted.

According to Administrative Directive MAN-12, departments are responsible for all grant requirements, including implementation, monitoring, and reporting. Departments must complete required quarterly financial reports, otherwise known as SF-425 reports, to comply with requirements. The amount of involvement that the Accounting Division has in assisting departments in completing these quarterly financial reports varies by department. For instance, the Accounting Division assists EDD in completing all of its quarterly financial reports, while Public Works and the Police Department complete their own reports with little to no assistance from ASD.

For the quarterly financial reports within EDD, departmental grants management staff provide to the Accounting Division information needed to complete the reports. The grants contact (Accountant) within the Accounting Division fills in the SF-425 each quarter. EDD grants management staff review the report. Accounting Division and ASD management must then sign off on the report. If time allows, the Accounting Division provides the report to EDD for final review prior to submitting it on behalf of EDD. However, this department-level review does not always occur as the report may not receive the required signatures from Accounting Division and ASD management until the day it is due, leaving little time to circulate the report back to EDD prior to submission.

Additionally, there is not a consistent process for documenting that departmental review and approval of the quarterly financial reports is occurring. Departmental grants management staff are responsible for the day-to-day management of their respective grants and, therefore, should be accountable for these reports being complete and accurate. Without record of formal approval by departmental grants management staff, this accountability is lacking.

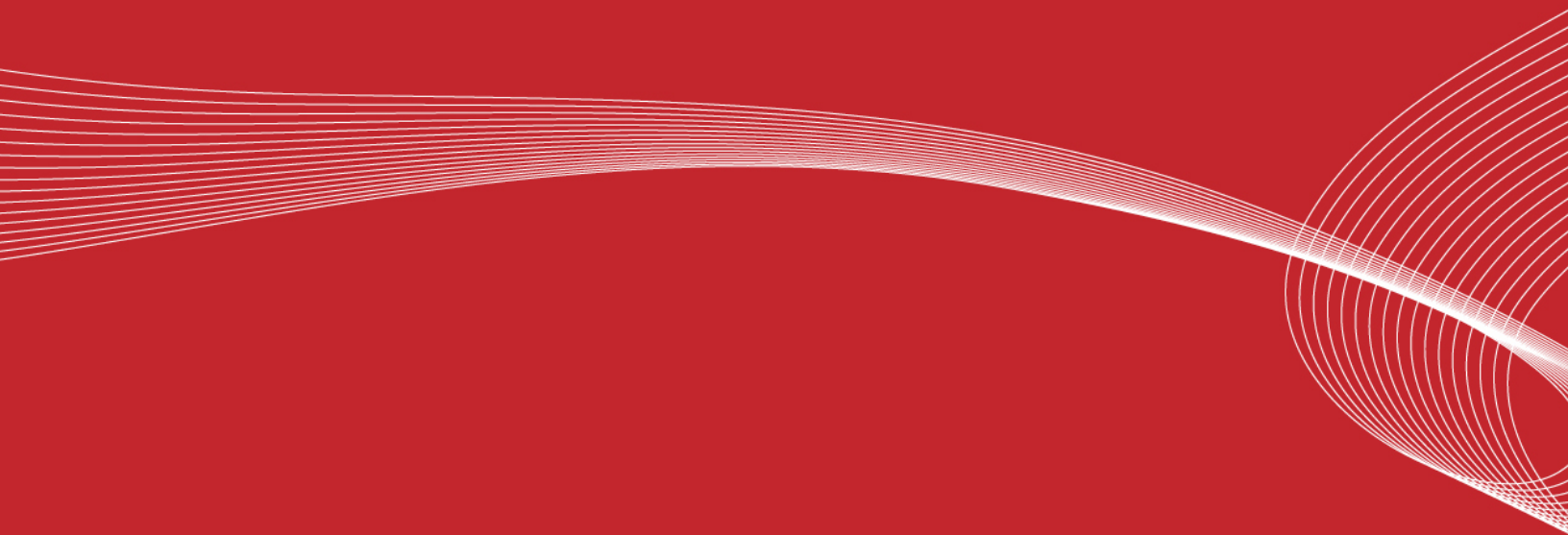
² In December 2014, following our initial fieldwork, many of the grants management staff within Police and EDD did attend a training related to current grant requirements.



Inconsistent grant reporting processes increase the risk of inaccurate information being submitted, resulting in missed cost recovery opportunities, the inclusion of unallowable costs, and possible non-compliance with grant requirements. Ultimately, non-compliance can result in the City having a more difficult time securing grants in the future. For these reasons, clearly defining the process for creating, reviewing, and submitting quarterly financial reports is important.

Recommendation: ASD should finalize its policy and procedure for the Accounting Division's assistance in creating and submitting quarterly financial reports, with input from affected departments, and ensure that ample time is provided for departmental grant management staff to review and formally approve grant reports prior to the Accounting Division submitting them.

Centralized submission of quarterly financial reports can ensure timely and uniform submission by departments receiving grants. While it is important that the Accounting Division be involved in the quarterly financial reporting for accounting purposes, departmental grants management staff must review and approve reports prior to submission in order to be responsible and accountable for their completeness and accuracy. To meet these interrelated needs and submit the quarterly financial reports on time, ASD and departmental grants management staff should determine a process and timeline for report completion that allows for ASD to receive and review grants-related accounting information, prepare documentation, and ensure departmental grants management staff review and approve the final quarterly financial report prior to submittal by ASD. Departmental staff should formally document their approval of any Accounting Division-prepared quarterly financial reports by signing and dating them or completing a template form. Departmental approvals should be documented through hard copy or electronic means and maintained as a record within ASD.



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