

American Recovery and Reinvestment Act
Preliminary Key Risk Factors

The National Association of State Auditors, Comptrollers and Treasurers (NASACT) has identified a number of **key risk factors** based on a preliminary review of the *American Recovery and Reinvestment Act* (ARRA). NASACT will continue to identify key risk factors as more guidance on the legislation is issued by the U.S. Office of Management and Budget and individual federal grantor agencies.

Many of these risk factors and issue areas were developed based on lessons learned from states' experiences with emergency management situations (e.g., Hurricane Katrina), where large sums of federal funding were received with an expectation of quick disbursement.

Overall/Cross-Cutting Issues

- Lack of resources/experienced personnel in state agencies – Most states have scaled back personnel in recent years and may not have adequate staff to handle this large increase in federal funding. Lack of grant experience will be a concern that must be addressed. States should consider capitalizing on retirees and other experienced government workers. However, states must be cognizant that hiring numerous employees to handle the workload in the short term with the intent to make them permanent is not sustainable once federal funds are gone.
- States must be careful not to use and budget stimulus funds as though they will be a recurring source of revenue. Funds from ARRA should be treated as “one-time” money.
- States must recognize all of the “costs” associated with these funds, including matching provisions that must come from state funds. This will require advance planning by the states.

Accountability/Transparency

- Recovery.gov – This new Web site is intended to track all expenditures of funds from ARRA. It is unclear what level of reporting will be required and how this information will be provided. It is also unclear as to whether the federal government will develop required data elements. State systems will likely have to be programmed to capture and report this information electronically. Guidance on payments to subrecipients must be developed. This has been a major problem under the Federal Funding Accountability and Transparency Act (FFATA) and its Web site, USASpending.gov. The Office of Management and Budget must issue clear guidance on recovery.gov so that all grant recipients and subrecipients can be informed of their level of responsibility.
- Oversight – Many state and local governments may not have systems in place to provide strong oversight over this influx of money. State comptrollers and auditors, along with financial management within state agencies, should review and test their internal control systems to ensure adequate accountability. Lacking proper controls, swift and massive infusions of cash like those called for in ARRA can easily produce greater opportunities for waste, inadequate accountability, and even corruption. Necessary modifications to internal control systems should be made now.

Procurement/Contracting

- Conflicts between federal and state laws – Recipients must be aware that federal and state laws can be in conflict. For example, the state may not require professional service contracts to be bid whereas the federal rules may require a competitive process. Or, state law can be more stringent than federal law. States should identify those differences now and provide that information to local governments and other subrecipients.
- Contract review – Normal internal controls and contract review procedures could be circumvented or scaled back in an effort to release funds quickly for “shovel ready” projects. This could lead to cost overruns, project mismanagement, or fraud.

- Contract scope/milestones – Contract scope and milestones should be clearly stated so that progress can be clearly measured. Contracts should be negotiated as performance based with performance measures that are measurable, time bound, and results oriented.
- Project budgets – Budgets should be sufficiently detailed so that meaningful monitoring can be performed to determine whether projects are on budget. Contractors should be required to submit periodic progress reports.
- Change orders – Contracts should contain formalized approvals and amendments for changes to the original contract terms and conditions.
- Monitoring – A designated individual should be responsible for overseeing the contract, including reviewing and approving all requests for payment.
- Nonperformance – Contracts should contain penalties for failure to complete the project or meet milestones.

Financial Management

- Disbursement of funds – In the haste to expend the funds quickly, the entities receiving/expend the funds may not have established internal controls to adequately ensure that the funds are expended properly. For example, large sums of money may be disbursed to smaller entities of local government or not-for-profit organizations that do not have adequate internal controls in place to ensure the funds are properly spent. Funds should be disbursed only to entities that demonstrate adequate controls are in place.
- Appropriateness of expenditures – Again, in an environment where funds are being spent quickly, there is a risk that entities receiving these funds will feel pressure to expend the monies even if the funds cannot be used for allowable purposes. The primary recipients (in many cases – states) should ensure that the funds are passed through only to entities that have a demonstrated need for the monies.
- Allowable costs – Federal grantor agencies must clearly communicate the allowable uses for the funds. Without clear guidance, funds might be spent on items which appear to be in conflict with the federal “intent.” Both primary recipients and subrecipients may spend the funds improperly, causing problems later for both auditors and the recipients.
- Separate accounting – Failure to separately track stimulus funds will lead to problems in calculating performance metrics (e.g., job creation). The federal government should issue clear guidance on its expectations on how these funds should be tracked. Some states have already reported setting up separate activity or “reporting categories” to separately track these funds. States need to begin this planning process upfront before any money is expended.
- Cash Management Improvement Act (CMIA) requirements – Are CMIA requirements going to be waived as part of the act, or will this vary from agency to agency, grant to grant? Primary recipients must understand these requirements and also notify all subrecipients.
- Custodial risks/collateralization – Grant recipients must be cautious to provide adequate collateralization. If large sums of cash are advanced, appropriate and timely collateralization of the deposits may not be possible. Similarly, investment of any idle funds in a manner that does not sufficiently limit interest rate, credit, and custodial risks should be addressed.
- Subrecipient education/notification/monitoring – Primary recipients must notify subrecipients of the source of funding and the related compliance issues. Subrecipients must also be informed of the need to collect, prepare, and maintain adequate documentation, including testing for items like eligibility. Experience has shown that this is a major area that causes problems later for entities. States should consider regional workshops, where appropriate, to provide education on these grant management issues.

Single Audit

- New compliance requirements – Federal grantor agencies must develop new compliance requirements (if any) quickly and must communicate those requirements to auditors promptly so that adequate audit planning can occur.

- Audit cost – Clearly, there will be increased audit responsibilities resulting from this legislation. Will there be funding for state auditors? How can state auditors adequately “ramp up” resources to cover these increased demands for the short-term?
- Grant and CFDA numbers – It is unclear how federal agencies will award the money to the grant recipients. Will there be unique grant award numbers or Catalog of Federal Domestic Assistance (CFDA) numbers that will be used to track the funds? Any expansion of the CFDA number from five numbers to six (or more) will be problematic in some states, requiring significant modifications to existing accounting systems. Furthermore, grant recipients should be permitted to charge these system-type costs directly to the stimulus funds and not be required to include them in the statewide cost allocation plan as indirect costs.
- New major programs – Auditors should be alert to new Type A programs in this audit cycle due to large increases in some grant programs (e.g., state revolving funds for clean and drinking water).