

## 2. FINANCIAL CAPACITY – ENHANCED REVIEW MODULE

### PURPOSE OF THIS REVIEW AREA

The recipient must have financial policies and procedures; an organizational structure that defines, assigns and delegates authority; and financial management systems in place to manage, match, and charge only allowable cost to the award. The recipient must conduct required Single Audits and provide financial oversight of subrecipients.

### USE OF THIS MODULE

This enhanced review module (ERM) questionnaire presents recommended questions for an enhanced review of financial capacity. Based on the scope of the approved ERM, all or a selection of the questions of this module will be conducted. The actual questions asked and the items sampled and observations made will be determined during the scoping meeting. The Federal Transit Administration (FTA) regional office and/or the Office of Transit Safety and Oversight may ask the reviewer to develop a unique scope of work for the ERM. Additional questions may be asked and additional sampling and observations may be performed as directed by FTA. The scope, questionnaire, sampling, and observations will be subject to final review and approval by the respective regional FTA office and the Office of Transit Safety and Oversight.

### QUESTIONS TO BE EXAMINED

1. Does the recipient have policies and procedures in place for managing federal awards, establishing internal controls, ensuring timely distribution of funds, and determining allowability of costs?
2. Does the recipient's organizational structure clearly define, assign, and delegate appropriate authority for all financial duties and require that those duties are 1) carried out by properly qualified personnel 2) segregated within the organization and 3) subject to review to ensure that adequate internal checks and balances exist?
3. Does the recipient's financial management system allow it to prepare reports and trace funds adequately to establish compliance with award terms and conditions?
4. [Does the recipient have financial resources to provide local share for active awards and to adequately maintain and operate FTA-funded assets?](#)

### INFORMATION NEEDED FROM RECIPIENT

#### Pre-site Visit Request

- Financial statements or comprehensive annual financial reports for the past three years
- Report of amounts and sources of local match for the current year as well as the last three years and next three years
- Financial policies and procedures that includes determining the allowability of cost and timely distribution of funds
- Cash Management Improvement Act of 1990 (CMIA) agreements (states only)
- Organizational chart for organization as a whole and the financial office(s)
- Position and job descriptions for award related personnel
- Resumes of award-related personnel with financial duties
- Sample record from financial system identifying the following elements: FTA awards with the Catalog of Federal Domestic Assistance (CFDA) title and number, FAIN (Federal Award Identification Number) and year, name of the awarding federal agency, and name of the pass-through entity, if any
- Sample financial record including Federal award information, amounts awarded, authorized, encumbered and expended; including income earned

- Most recent variance report(s) demonstrating that budget/actual comparisons are completed for awards
- Financial plan projecting revenues and expenses for the next three years (or longer), including the assumptions and notes to the financial plan
- Operating and capital budgets for the past three years
- Listing of local or state legislation, with sunset provisions, impacting transit funding
- State/Transportation Improvement Program (S/TIP)
- Annual budget to actual reconciliation reports for the review period

**Recipient Follow-up**

- Selected board resolutions
- Listing of sources of funding used for local match, along with a description
- Debt instruments (bonding prospectus, agency debt covenants, etc.)
- Total Federal (non-FTA) funds expended for the past three years by year
- Documentation of progress towards closing open Single Audit findings
- Approval notification of the Cost Allocation Plan (CAP) or Indirect Cost Rate Proposal (ICRP)
- Approval notification of the central services plan
- Approved CAP or ICRP
- Board meeting minutes for the review period

**FCERM1. Does the recipient have policies and procedures in place for managing federal awards, establishing internal controls, ensuring timely distribution of funds, and determining allowability of costs?**

**BASIC REQUIREMENT**

Recipients must have financial policies and procedures to ensure effective financial management of FTA awards and establish a system of internal controls to safeguard against waste, loss, and misuse of federal funds.

**APPLICABILITY**

All recipients

**DETAILED EXPLANATION FOR REVIEWER**

When developing financial plans/budgets, recipients should have policies and procedures in place to assess the risk that key revenue and cost assumptions will not be realized and identify appropriate sources of contingency reserves. For example, to support its entire planned capital and operating programs, a recipient assuming sales tax revenue growth must base its assumptions on historical experience, economic trends and the financial and legal constraints within which the agency must operate.

As part of the planning and periodic monitoring process, policies and procedures should reflect the recipient’s methodology for allocating matching funds to ensure that the same non-Federal funds are not committed to support multiple projects.

In addition, refer to questions F1 and F7 in the baseline review.

**INDICATORS OF COMPLIANCE**

- a. *What are the policies and procedures for developing long-term and short-term financial plans/budgets?*

Reviewer Response

- b. *What are the policies and procedures for identifying non-Federal portions of project costs?*

Reviewer Response

- c. *What policies and procedures are in place to ensure that the same non-Federal funds are not committed to meet matching requirements of multiple projects?*

Reviewer Response

- d. *What are the policies and procedures for identifying any inherent, foreseen risks that could affect the source and level of funding commitments for the transit program? Describe any such risks identified in developing the current financial plan(s)/budget(s)?*

Reviewer Response

- e. *What are the policies and procedures for identifying any significant financial challenges not reflected in the current financial plan/budget, (e.g., unanticipated cost, economic downturn, etc.)? Describe any such challenges identified for the current financial plan(s)/budget(s).*

Reviewer Response

- f. *What is the process for developing a mitigation plan when non-Federal funds are no longer available to match the Federal portion of project costs?*

Reviewer Response

- g. *What are the procedures for planning capital projects and award funding? Are they currently being followed? If not, how has the recipient deviated from the procedures?*

Reviewer Response

- h. *What procedures are in place to provide assurance that approvals and funding commitments are received from the FTA and from appropriate state/local agencies/authorities before entering into spending commitments?*

Reviewer Response

## **INSTRUCTIONS FOR REVIEWERS**

Refer to questions F1 and F7 in the baseline review.

## POTENTIAL DEFICIENCY DETERMINATIONS

Refer to questions F1 and F7 in the baseline review.

## GOVERNING DIRECTIVES

Refer to questions F1 and F7 in the baseline review.

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**FCERM2. Does the recipient's organizational structure clearly define, assign, and delegate appropriate authority for all financial duties and require that those duties are 1) carried out by properly qualified personnel 2) segregated within the organization and 3) subject to review to ensure that adequate internal checks and balances exist?**

### BASIC REQUIREMENT

Recipients must have an organizational structure that clearly defines, assigns, and delegates appropriate authority for all financial duties. Those duties must be carried out by properly qualified personnel and be segregated within the organization and reviewed to ensure that adequate internal checks and balances exist.

### APPLICABILITY

All recipients

### DETAILED EXPLANATION FOR REVIEWER

Recipients should develop annual budgets that reflect the program of projects to be implemented in the current period. The timing, content, necessary approvals, and assumptions used in developing the budget should be based on policies and/or requirements set by the agency's governing body or final authority. The policies are often guided by state or local statute, award agreement or other third party requirement, i.e. debt covenant. Most budgets are not final until approved by the head of the agency, indicating that the agency is authorized to enter into commitments, accept funds and meet obligations in order to continue operations.

Recipient financial policies and procedures should address a process for initiating, reviewing and approving budget revisions. Budget revisions should be properly authorized and justified, with supporting assumptions and real time financial information for the changes made. Budget revisions can be initiated by user departments or prompted by the recipient's financial management policies. Despite the source of the budget revisions, adjustments should be based upon variance in the results of the financial operations and projected amounts, balanced with reasonable assumptions, i.e., changes in the economy, unanticipated funding, etc. Approved revisions must be reflected in the financial management systems and FTA awards, as applicable.

Recipients must have a process to systematically compare actual expenditures or outlays with budgeted amounts for each award or subaward. The results of such comparison must be assessed to determine that actual financial and operational performance are on target to meet projections or whether adjustments must be made or contingency plans implemented.

In addition, refer to question F2 in the baseline review.

### INDICATORS OF COMPLIANCE

- a. *What department(s)/individual(s) is/are responsible for developing/preparing financial plan(s)/budget(s)?*
  - i. *Who reviews and approves/adopts the final?*
  - ii. *Are the same departments/individuals involved in the development and review and approval process?*

Reviewer Response

- b. *Which departments are involved and at what staffing level (i.e., engineering, planning, customer service, etc.) in initiating revisions?*
  - i. *Who reviews and approves/adopts the final?*
  - ii. *Are the same departments/individuals involved in the development and review and approval process?*

Reviewer Response

- c. *If revisions impact FTA award budget, how are those appropriately processed?*
  - i. *Who prepares the revision for FTA consideration?*
  - ii. *Who inputs the revision in the appropriate award in TrAMS?*
  - iii. *Who reviews and approves that the correct information has been entered in the award?*

Reviewer Response

- d. *What is the process for examining significant variances from expected results?*
  - i. *Who performs the function?*
  - ii. *What is the level of authority of the person/office performing this examination?*
  - iii. *What type of documentation is maintained as evidence of the examination?*

Reviewer Response

**INSTRUCTIONS FOR REVIEWER**

Review written financial policies and procedures that govern the budget development process. Determine whether appropriate segregation of responsibilities exists between budget preparation and approval processes and to ensure the integrity of the budgeting process and the validity of the resulting budget and subsequent revisions; and whether the budget is properly approved.

Obtain the most recently approved budget. Review evidence of approval and compare to the current budget to determine what changes have been made. Determine whether supplemental budgets or budget transfers were made. Review the authorization of the supplemental budgets or budget transfers for adequacy.

When budget revisions affect FTA awards, verify that the recipient complied with requirements. Review a sample of award budgets and determine whether the recipient has notified the FTA and sought FTA approval for revisions. Discuss with the recipient staff on site.

Obtain and review variance analyses performed for several months during the year to assess the

implementation of procedures to perform such analyses systematically and report on the results to management such that appropriate action can be taken.

In addition, refer to question F2 in the baseline review.

#### **POTENTIAL DEFICIENCY DETERMINATIONS**

The recipient is deficient if budgets are not approved. The recipient is deficient if the approved budget does not provide sufficient basis for financial operations.

DEFICIENCY CODE FCERM2-1: Insufficient budget development process

SUGGESTED CORRECTIVE ACTION: The recipient must develop and submit to the FTA regional office procedures to ensure that the budget is approved and is based on the financial operations.

The recipient is deficient if budget revisions are not adequately supported. The recipient is deficient if budget revisions are not appropriately approved. The recipient is deficient if budget revisions are not reflected in financial management systems and/or award agreements.

DEFICIENCY CODE FCERM2-2: Insufficient budget revision process

SUGGESTED CORRECTIVE ACTION: The recipient must develop and submit to the FTA regional office procedures for making budget revisions.

In addition, refer to question F2 in the baseline review.

#### **GOVERNING DIRECTIVES**

Refer to question F2 in the baseline review.

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### **FCERM3. Does the recipient's financial management system allow it to prepare reports and trace funds adequately to establish compliance with award terms and conditions?**

#### **BASIC REQUIREMENT**

Recipients must have financial management systems in place to accurately account for and report on federal funds.

#### **APPLICABILITY**

All recipients

#### **DETAILED EXPLANATION FOR REVIEWER**

Completing systematic evaluations of projected and actual financial activities provides a basis for assumptions used in short- and long-term planning. Recipient policies that require the completion of such reviews and then submission to senior management, demonstrates the agency's ability to adequately plan and adjust projections based upon known facts.

In addition, refer to question F3 in the baseline review.

#### **INDICATORS OF COMPLIANCE**

- a. *How often and in what detail is budget variance information provided to senior management?*

Reviewer Response

- b. *How are budget revisions reflected in the financial management system? Are they reflected in the Transit Award Management System (TrAMS)?*

Reviewer Response

### **INSTRUCTIONS FOR REVIEWERS**

Obtain and review variance analyses performed for several months during the year. Determine whether analyses are discovering errors or highlighting situations where the budget requires adjustment.

Review occasions when actual expenses exceeded budgeted expenses or cash outlays exceeded budgeted outlays. Review the effectiveness of procedures designed to report overruns to management and the FTA, as appropriate. Assess the adequacy of the communication and reporting process.

In addition, refer to question F3 in the baseline review.

### **POTENTIAL DEFICIENCY DETERMINATIONS**

Determination of deficiency should be made in concert with assessing the reliability of the recipient's controls over the budget development process.

In addition, refer to question F3 in the baseline review.

### **GOVERNING DIRECTIVES**

Refer to question F3 in the baseline review.

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## **FCERM4. Does the recipient have financial resources to provide local share for active awards and to adequately maintain and operate FTA-funded assets?**

### **BASIC REQUIREMENT**

Recipients must have the financial capacity to carry out their proposed program of projects.

### **APPLICABILITY**

All recipients

### **DETAILED EXPLANATION FOR REVIEWER**

A recipient's financial condition, future financial capacity, and ability to match FTA funds could be affected greatly if one or more of its sources of non-FTA funding are affected by pending legislation or "sunset" provisions in current legislation. Similarly, the agency's eligible and available non-Federal funds may be diverted from serving as match for an FTA award if there are other Federal awards which are at risk of lapsing.

When state and/or local sources of funding decrease, the recipient may be unable to meet the non-Federal match requirements for existing FTA awards. This may also result in service reductions and/or fare increases, redirecting funds to meet critical operating and maintenance needs, and/or staff reductions. Revenue sources should be stable and reliable enough to meet future annual operating and routine capital costs.

In addition, refer to question F8 in the baseline review.

Recipients may pledge debt to meet the matching requirements of Federal funds. Financial plans must detail the debt burden at a level of detail appropriate to the project being matched. While recipients may use debt to fulfill their matching requirements, debt instruments can also carry restrictive covenants that specify how and how much funds are to be used at any one time. Covenants can include debt service

ratio requirements, outstanding debt ceilings, and limits on debt expenditures.

In addition, refer to question F7 in the baseline review.

### **INDICATORS OF COMPLIANCE**

a. *How does the recipient determine the amount of non-Federal funds it will receive annually?*

- i. *Are amounts committed through legislation, budgeted through allocation from general funds, or planned and awaiting legislative/formal action?*
- ii. *What are the legal restraints or restrictions on amounts available for non-Federal match?*
- iii. *What are the projected changes in the levels and sources of non-Federal funds available for the transit program?*

Reviewer Response

a. *What proportion of matching funds is being obtained through debt?*

Reviewer Response

b. *What is the recipient's debt capacity? Has the recipient utilized all of its available credit?*

Reviewer Response

c. *Does the recipient have or foresee financial challenges that will affect its ability to satisfy its current obligations?*

Reviewer Response

### **INSTRUCTIONS FOR REVIEWER**

Review the current year's budget, including capital and operating expenses, and multi-year financial projections for financial condition and capacity. Discuss onsite with the recipient pending legislation or "sunset" provisions in current legislation and restrictions on amounts pledged as local match. Review audit reports for restrictions on assets the recipient may have pledged as match for Federal funds.

Review financial plans for evidence of matching funds in the form of debt. Obtain and review governing body resolutions authorizing the recipient to obtain and use the funds as match. Obtain documentation of the debt instruments (bonding prospectus, agency debt covenants, etc.). Review the terms of the instruments to obtain an understanding of the requirements of utilizing and repaying the proceeds. Audit reports will indicate restrictions on assets the recipient may have pledged as match for Federal funds. Perform simple financial ratios to assess the recipient's debt capacity and credit utilization.

Financial Ratios:

1. Quick Ratio:  $(\text{Current Assets} - \text{Inventories}) / \text{Current Liabilities}$
2. Current Ratio:  $\text{Current Assets} / \text{Current Liabilities}$
3. Debt-Equity Ratio:  $\text{Total Liabilities} / \text{Net Position}$



## **POTENTIAL DEFICIENCY DETERMINATIONS**

Refer to question F7 in the baseline review.

## **GOVERNING DIRECTIVES**

Refer to question F7 in the baseline review.

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## **REFERENCES**

1. 49 U.S.C. Chapter 53, Federal Transit Laws
2. 2 CFR Parts 200 and 1201, "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards"
3. FTA Circular 5010.1E, "Award Management Requirements"
4. FTA Circular 9030.1E, "Urbanized Area Formula Program: Program Guidance and Application Instructions"
5. FTA Circular 9040.1G, "Formula Grants for Rural Areas: Program Guidance and Application Instructions"
6. FTA Circular 9045.1, "New Freedom Program Guidance and Application Instructions"
7. FTA Circular 9070.1G, "Enhanced Mobility of Senior and Individuals with Disabilities Program Guidance and Application Instructions"

## **USEFUL WEBLINKS**

Flexible Funds: FHWA and FTA Programs

Revenue Bonds

Debt Service Reserve Financing

Electronic Clearing House Operation (ECHO) Web User Manual for FTA and FAA

Federal Audit Clearinghouse (FAC)