

**INTERNAL AUDIT REPORT**

**2021**

# **SCDOT CORONAVIRUS RELIEF FUNDS EXPENSE ACTIVITY**

An Assessment of:

- Risks
- Control Design Adequacy
- Control Operating Effectiveness



SOUTH CAROLINA OFFICE OF THE STATE AUDITOR

**INTERNAL AUDIT  
SERVICES**

**February 26, 2021**

# 1 EXECUTIVE SUMMARY

## RISK AND CONTROL ASSESSMENT - CARES ACT EXPENSE ACTIVITY

### OBJECTIVE:

- To provide assurance that internal controls are adequately designed and operating effectively for preventing and/or detecting errors in the use of Coronavirus Relief Funds (CRF) under the Coronavirus Aid, Relief, and Emergency Services (CARES) Act.

### BACKGROUND:

- In response to the COVID-19 pandemic, the Federal Transit Administration (FTA) allocated \$25 billion through the CARES Act to transit agencies that receive urbanized and rural area formula funds.
- FTA authorized funding at a 100 percent federal share with no match requirement for eligible capital, operating, and other expenses to prevent, prepare for, and respond to COVID-19 beginning with expenses as of January 20, 2020.
- SCDOT's Office of Public Transit (OPT) was authorized \$44.8 million CRF funding and functions as a pass-through entity to provide reimbursements of qualified expenditures to its subrecipient local transit agencies throughout the state.
- OPT began reimbursing its subrecipients for eligible expenses on invoices submitted on or after March 1, 2020.

Continued on the next page

# EXECUTIVE SUMMARY continued

## CONCLUSION:

OPT has a number of internal controls to prevent and/or detect unallowable expenses. Some of these controls are applied to transactions prior to payment of CRF funds. Others, like triennial reviews, are in place to detect errors months or years after payment. In our opinion, the internal controls in place to prevent and/or detect unallowable expenses *prior to* reimbursing subrecipients with CRF funds are neither adequately designed nor operating effectively resulting in the reimbursement of unallowable costs. We identified \$1,312,257 of total unallowable costs.

## INTERNAL CONTROL OBSERVATIONS:

1. Revenue Shortfall	Risk Exposure:	Medium-High
<i>Observation:</i> SCDOT reimbursed six subrecipients for “revenue shortfall” that we determined is not an allowable use of the Coronavirus Relief Fund (CRF). Revenue shortfall is an account OPT instructed its subrecipients use to make up for revenues lost because of the pandemic. We determined the total unallowable costs for the six subrecipients to be \$951,843.		
(See detailed Observation 5.1 on page 9)		

2. Invoice Review	Risk Exposure:	Medium-High
<i>Observation:</i> We tested a sample of 50 expense line items from 20 subrecipient invoices and found five (25%) invoices included seven errors. Two invoices included errors in which the subrecipient undercharged SCDOT. The amounts were immaterial and no adjustments were requested by the subrecipients. The remaining three invoices from three subrecipients included overcharges to the CRF for unallowable expenses of \$360,414.		
(See detailed Observation 5.2 on page 13)		

Management Action Plans are included in Section 5 following each detailed Observation as referenced above.

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## 2 FOREWORD

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### **AUTHORIZATION**

The South Carolina Office of the State Auditor established the Internal Audit Services division (IAS) pursuant to SC Code Section 57-1-360 as revised by Act 275 of the 2016 legislative session. IAS is an independent, objective assurance and consulting function designed to add value and improve the operations of the South Carolina Department of Transportation (SCDOT). IAS helps SCDOT to achieve its objectives by bringing a systematic, disciplined approach to evaluating the effectiveness of risk management, internal control, and governance processes and by advising on best practices.

### **STATEMENT OF INDEPENDENCE**

To ensure independence, IAS reports administratively and functionally to the State Auditor while working collaboratively with SCDOT leadership in developing an audit plan that appropriately aligns with SCDOT's mission and business objectives and reflects business risks and other priorities.

### **REPORT DISTRIBUTION**

This report is intended for the information and use of the SCDOT Commission, SCDOT leadership, the Chairman of the Senate Transportation Committee, the Chairman of the Senate Finance Committee, the Chairman of the House of Representatives Education and Public Works Committee, and the Chairman of the House of Representatives Ways and Means Committee. However, this report is a matter of public record and its distribution is not limited.

### **PERFORMED BY**

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### **ACKNOWLEDGEMENT**

We wish to thank members of management and staff in the Office of Public Transit for their cooperation in sharing their knowledge and experience and developing actions to improve internal controls.



## 3 INTERNAL AUDITOR'S REPORT

February 26, 2021

Ms. Christy A. Hall, Secretary of Transportation  
and  
Members of the Commission  
South Carolina Department of Transportation  
Columbia, South Carolina

We have completed a risk and control assessment of the South Carolina Department of Transportation's (SCDOT's) Coronavirus Relief Funds (CRF) Expense Activity under the Coronavirus Aid, Relief, and Emergency Services (CARES) Act. The objective of this assessment was to contribute to the improvement of risk management by evaluating SCDOT's exposure to risks and the controls designed by Management to manage those risks. Our engagement included two aspects:

- Facilitation of Management's assessment of risks of non-compliance in the use of CRF funds
- Independent assessment of the design and effectiveness of internal controls to determine whether those controls effectively manage the identified risks to an acceptable level.

We planned and performed the engagement with due professional care in order to obtain sufficient, appropriate evidence to provide a reasonable basis for our observations and conclusions. Observations are described in Section 5 beginning on page 9 of this report.

George L. Kennedy, III, CPA  
State Auditor

# 4 ENGAGEMENT OVERVIEW

## 4.1 BACKGROUND

In response to the COVID-19 pandemic, the Federal Transit Administration (FTA) allocated \$25 billion through the Coronavirus Aid, Relief, and Emergency Services (CARES) Act to transit agencies that receive urbanized and rural area formula funds. The Act was signed into law on March 27, 2020. FTA authorized funding at a 100 percent federal share with no match requirement for eligible capital, operating, and other expenses to prevent, prepare for, and respond to COVID-19 beginning with expenses as of January 20, 2020.

The SCDOT's Office of Public Transit (OPT) was authorized \$44.8 million in Coronavirus Relief Fund (CRF) funding (CFDA No. 21.019) and functions as a pass-through entity to provide reimbursements of qualified expenditures to its subrecipient local transit agencies throughout the state. OPT began reimbursing its subrecipients for eligible expenses on invoices submitted on or after March 1, 2020.

## 4.2 OBJECTIVES

Management's objectives are:

- To ensure that OPT operates in compliance with grantor requirements and
- To provide accurate and timely information for the Secretary of Transportation's communication with the legislature.

Our objective is to provide assurance that internal controls are adequately designed and operating effectively for preventing and/or detecting errors in the use of CRF funds.

## 4.3 SCOPE

In its initial allocation of CRF funds, OPT established contracts with its subrecipients for one-third (\$14.8 million) of the funds provided to SCDOT for rural transit services. Allocations were based on the SCDOT Commission's 2017 approved formula for allocation of regular 5311 rural area formula grants to these same subrecipients. Our review focused on the period of the grant's inception (January 20, 2020) through July 15, 2020.

OPT is divided into the following functional groups (Appendix A describes these groups' roles):

- Grants Management
- Program Management
- Compliance and Oversight

We determined our scope should focus on Grants Management and Program Management, as these groups are responsible for preventing or detecting subrecipient expenses ineligible for CRF reimbursement.

## 4.4 METHODOLOGY

For the significant processes included in the engagement scope, we performed the following procedures:

1. We discussed with Management their processes and the respective individuals responsible.
2. We facilitated Management's completion of a risk and control matrix used to:
  - a. Identify risks which threaten process objectives;
  - b. Score the risks as to their consequence and likelihood of occurrence using the risk scoring matrix in Appendix B;
  - c. Determine if controls are adequately designed to manage the risks to within the Agency's risk appetite; and
  - d. Propose design improvements to controls when risks are not managed to within the Agency's risk appetite.

As shown on the Risk Scoring Matrix in Appendix B, risk significance is rated on a scale of 1 (lowest) to 25 (highest) and is the product of the risk consequence score (1 to 5) multiplied by the risk likelihood score (1 to 5). Risk appetite is the amount of risk exposure Management is willing to accept in pursuit of its objectives. Executive Management has set various risk appetites by risk type as shown in Appendix C. Risks scoring below Management's risk appetite require no further risk management. Controls determined to be inadequate in design result in risk exposure to the Agency if risk scores exceed risk appetite.

3. We observed the discussion by key process owners and other subject matter experts performing the steps in procedure two above.
4. We evaluated Management's assessment to determine if it was reasonable and comprehensive.
5. We tested key controls intended to manage risks with inherent risk scores of 9 and above [scale of 1 (low) to 25 (high)] to determine if controls are designed adequately and operating effectively. Our testing included inquiry, observation, inspection of documentation, and re-performance of process steps to determine if key controls are operating effectively. We tested controls for risks with inherent scores of 9 and above.
6. We developed observations for controls determined to be inadequate in design and/or ineffective in operation.
7. We collaborated with management to develop action plans to improve control design and/or operating effectiveness.

## 4.5 CONCLUSION

OPT has a number of internal controls to prevent and/or detect unallowable expenses. Some of these controls are applied to transactions prior to payment of CRF funds. Others, like triennial reviews, are in place to detect errors months or years after payment. In our opinion, the internal controls in place to prevent and/or detect unallowable expenses *prior to* reimbursing subrecipients with CRF funds are neither adequately designed nor operating effectively resulting in the reimbursement of unallowable costs. We identified \$1,312,257 of total unallowable costs.

Risk exposure is determined to be Medium-High. Our observations and recommendations in combination with Management's action plans as shown in Section 5 are expected to improve those internal controls and reduce risk exposures to within the Agency's risk appetite.

## 4.6 DEVELOPMENT OF MANAGEMENT ACTION PLANS

We facilitated Management's development of action plans for each observation to improve control design with practical, cost-effective solutions. These improvements, if effectively implemented, are expected to reduce the overall risk exposure to an acceptable level (i.e. within the Agency's risk appetite).

We will follow up with Management on the implementation of the proposed actions on an ongoing basis and provide SCDOT leadership with periodic reports on the status of management action plans and whether those actions are effectively and timely implemented to reduce risk exposure to an acceptable level.

# 5 OBSERVATIONS

<b>Observation 5.1</b> <b>Revenue Shortfall</b>	<b>Risk Exposure</b> <b>Medium - High</b>
<b>Division:</b> Office of Public Transit – Program Management	
<b>Controls Assessed:</b> Control 1 - Subrecipients Submit Supporting Documentation with Invoices Control 2 - Program Manager Review Control 3 - Grant Management Review	
<b>Control Descriptions:</b> Control 1 – OPT requires subrecipients to submit supporting documentation with invoices for reimbursement requests of capital expenses but not any other expenses. Control 2 – OPT has program managers in place to provide programmatic support to subrecipients. That support entails the program manager’s review of each invoice received from subrecipients assigned to him/her to ensure charges to the active grant are appropriate and within the budgeted and authorized funding. Control 3 – OPT has a grant manager who reviews each invoice received from subrecipients to ensure charges are within the budgeted and authorized funding and charged to the proper grant/contract number. The purpose of the review is to ensure that the following aspects of the invoice are appropriate, including but not limited to: <ul style="list-style-type: none"> <li>- Grant Contract number is correct</li> <li>- Accounts included are the same as those budgeted</li> <li>- Budget for the expense existed.</li> </ul>	
<b>Processes Affected:</b> (See process descriptions in Appendix A on page referenced below) Process 1 – Program Management Review (page 17)	
<p><b>Observation:</b> SCDOT reimbursed six subrecipients for “revenue shortfall” that we determined is not an allowable use of the Coronavirus Relief Fund (CRF). Revenue shortfall is an account OPT instructed its subrecipients use to make up for revenues lost because of the pandemic.</p> <p>When the pandemic crises began in early 2020, both private and public entities were experiencing reductions in earned revenue due to work-from-home orders, mandatory closures, and decreased consumer demand. There was an intent by the federal government to provide relief to private and public entities for the “lost” revenues (i.e. revenues that would normally have been expected but for the pandemic, less actual revenues). However, FTA initially provided no specific guidance regarding lost revenue. There appears to have been a desire by CRF recipients for clarification of the concept of lost revenue as the FTA provided subsequent non-authoritative guidance through its website as “frequently asked questions” (FAQs) and an April 2020 webinar.</p> <p>OPT, absent any initial FTA guidance, interpreted lost revenue as “revenue shortfall”, an account it instructed subrecipients to include on monthly invoices. OPT had no formal written definition of revenue shortfall until it developed a policy dated November 30, 2020. That policy defines shortfall as:</p> <p><i>“A decrease in revenue earned or an increase in expenses that is outside normal transit operations, related to CARES (COVID-19) funding, that results in expenses exceeding revenues. Interchangeable with net loss.”</i></p>	

Based on its interpretation, OPT instructed subrecipients to calculate revenue shortfall in the following manner:

- |   |
|---|
| <p>1. <b>Historical Revenues</b> (revenues received in a pre-COVID claim month a year prior to the current claim month, e.g. Oct 2019)</p> <p style="padding-left: 40px;"><b>Less</b></p> <p>2. <b>Current Revenues</b> (revenues received in the current claim month, e.g. Oct 2020)</p> |
|---|

Given the lack of a formal federal definition of lost revenue, OPT's interpretation might be considered reasonable. However, additional research might have led OPT to a different interpretation. For example, the Federal Register for the Coronavirus Relief Fund for States, Tribal Governments, and Certain Eligible Local Governments states:

*“The CARES Act requires that the payments from the Coronavirus Relief Fund only be used to cover expenses that—*

- 1. are necessary expenditures incurred due to the public health emergency with respect to the Coronavirus Disease 2019 (COVID–19).”*

Additionally, the Act, under the heading “Federal Transit Administration transit infrastructure grants”, states:

*“...funds provided under this heading are available for the operating expenses of transit agencies related to the response to a coronavirus public health emergency as described in section 319 of the Public Health Service Act, including, beginning on January 20, 2020, reimbursement for operating costs to maintain service and lost revenue due to the coronavirus public health emergency...”*

Pursuant to OPT's revenue shortfall definition, subrecipients were reimbursed for net eligible expenditures (eligible expenditures less earned revenues) *plus* the new account “revenue shortfall.” This resulted in payments of CRF funds to subrecipients in an amount greater than the net eligible expenditures incurred. Both the Federal Register and the Act limit the use of funds to cover “necessary expenditures” and “operating expenses” as noted above.

Further, subsequent guidance in the form of FTA FAQs and April 2020 webinar interpret lost revenues (i.e. revenue shortfall) consistent with the Federal Register and the Act. Excerpts include:

- From the FAQ:

**CA1** *“FTA will generally consider all expenses normally eligible under the Section 5307, 5310 and 5311 programs that are incurred on or after January 20, 2020 to be in response to economic or other conditions caused by COVID-19 and thus eligible under the CARES Act and CRRSAA.”*

**CA2** *“Funds available under the CARES Act and CRRSAA are available for all operating activities (net fare revenues) that occur on or after January 20, 2020.” And “In general, operating expenses are those costs necessary to operate, maintain, and manage a public transportation system. Operating expenses usually include such costs as driver salaries, fuel, and items having a useful life of less than one year, including personal protective equipment and cleaning supplies.”*

**CA13** *“In the case of fare-free service, FTA would fund the total operating costs, as there are no fare revenues to deduct to get to net operating cost.”*

**CA15** *“FTA will reimburse any eligible expenses incurred on or after January 20, 2020, including eligible expenses that would have otherwise been paid for by the lost revenue” and “Operating costs are those costs necessary to operate, maintain, and manage a public transportation system. Operating expenses usually include such costs as driver salaries, fuel, and items having a useful life of less than one year, including personal protective equipment and cleaning supplies.”*

- From the April 2020 webinar transcript on FTA’s website (the speaker is John Bodnar, FTA’s acting director of transit programs):

*“John Bodnar: So at this point, I need to point out and provide some additional context to the phrase “lost revenue” as it appears in the CARES Act. The CARES Act does specify that lost revenue is eligible for reimbursement with CARES Acts funds. FTA is implementing this provision of the CARES Act by reimbursing any eligible expense that occurred on or after January 20th, 2020. That includes eligible expenses that would have otherwise been paid for by lost revenue. So one example of that is if your fare revenue is down by \$100,000 and that \$100,000 in fares would have gone to pay for operations expenses, FTA can provide that \$100,000 for operations to make up for the lost revenue.*

*“Speaker: We have several questions related to lost revenues, the basic question is will lost revenues will [sic] able to be claimed by agencies?”*

*John Bodnar: John again. With the (pause) FTA cannot fund a project that doesn't have a specific eligible expense associated with it. So, by CARES Act funding being available to fund any projects that would normally be eligible under 5307 or 5311 funding, regardless of the amount of revenue that a recipient receives, that is in effect replacing the lost revenue with CARES Act funds.”*

Thus, both the FTA FAQ and the webinar clarify that lost revenue (i.e. revenue shortfall) may be used for normal eligible operating expenses of a subrecipient transit provider inclusive of the eligible expenses that typically would have been covered by the subrecipient’s revenues but weren’t because of COVID. That is, “lost revenue” is equivalent to the increase in eligible expenses that occurred because of the decline of revenues due to COVID. FTA’s use of the FAQ and webinar are not traditional communications of guidance and are not as clear and forthright as formal published regulations such as circulars. This may have contributed to OPT’s misinterpretation. In any event, SCDOT’s inclusion of revenue shortfall as an additional reimbursable account inflates the total expenses beyond actual operating costs resulting in a profit to the subrecipient. We do not believe this was the intent of the Act nor a proper interpretation of the Act, the Federal Register and FTA guidance.

We discussed these regulations and guidance with OPT during the audit. OPT agreed with our interpretation and immediately ended reimbursement payments to subrecipients for revenue shortfall. We determined the total unallowable costs for the six subrecipients to be \$951,843.

**Recommendations:**

**1a.** We recommend that OPT update its revenue shortfall policy to reflect the intent of federal guidance that lost revenue is an allowable use of Coronavirus Relief Funds up to net eligible costs. OPT should notify its subrecipients of the updated policy so that future invoice submissions by the subrecipients comply with the updated policy.

**1b.** OPT should implement procedures to improve its research of laws, regulations, and guidance connected to its grants – especially in new grants that are rushed out during a crisis – to ensure that interpretation is based on the collective body of authoritative and non-authoritative guidance. Such guidance should be continuously monitored through websites, newsletters, and correspondence with grantors and other state departments of transportation to ensure any changes or clarifications are properly interpreted and incorporated into operations.

**Management Action Plan (MAP) 5.1a**

Revenue shortfall was first considered an allowable expense by the FTA with the CARES Act. Given the confusion surrounding this new position by FTA and the delayed distribution of clear guidance at the federal level, OPT therefore had no formal written definition nor policy of revenue shortfall until developed by OPT and reviewed by the internal auditors in late 2020. Subsequently based on the determination by the internal auditors that the manner in which revenue shortfall policy was applied in South Carolina was incorrect, OPT provided notification to subrecipients that previous policy regarding revenue shortfall was voided and revenue shortfall would no longer be considered for reimbursement. As revenue shortfall was a one-time consideration in response to the COVID-19 pandemic, and as subrecipients were notified that it is not considered as an eligible expense moving forward, no additional policy action is required. OPT undertook formal efforts for affected subrecipients to return previous invoice payments for revenue shortfall. As of the completion of this report, all affected subrecipients have taken this step and fully satisfied their outstanding obligation either by way of adjustments to subsequent invoices for public transit subrecipients, or by way of a check for the single private subrecipient. Because FTA has not identified any compliance or oversight concerns in the manner in which OPT is managing CARES Act funding, there is no repayment required to FTA. All repayment is returned to the statewide CARES Act grant to satisfy future eligible expenses.

MAP Owner:	Director of Intermodal and Freight Programs
Division:	Office of Public Transit, Program Management
Scheduled Date:	Implemented during the audit

**Management Action Plan (MAP) 5.1b**

OPT will continue to defer to FTA for interpretation of relevant federal laws and regulations, recognizing FTA as the cognizant federal agency. FTA publishes formal, programmatic Circulars that govern the implementation of all funding programs under their oversight. Through these Circulars and other formal policy announcements, FTA instructs its subrecipients how to interpret the relevant Federal laws and regulations to satisfy FTA compliance and oversight expectations. In the absence of formal Circulars, such as when funding is rushed out under a new program during a time of national crisis, FTA also publishes specific guidance by way of their website as well as through webinars. OPT will continue to defer to FTA in the same manner. OPT also accesses and reviews guidance by way of FTA websites and email, direct state DOT peer information exchange, and through national associations such as AASHTO, the American Public Transportation Association (APTA) and the Community Transportation Association of America (CTAA). OPT also regularly sponsors staff and subrecipient training opportunities through our Rural Transportation Assistance Program.

MAP Owner:	Director of Intermodal and Freight Programs
Division:	Office of Public Transit, Program Management
Scheduled Date:	Implemented during the audit

<b>Observation 5.2</b> <b>Invoice Review</b>	<b>Risk Exposure</b>
	<b>Medium-High</b>
<b>Division:</b> Office of Public Transit – Program Management	
<b>Controls Assessed:</b> Control 1 - Subrecipients Submit Supporting Documentation with Invoices Control 2 - Program Manager Review Control 3 - Grant Management Review	
<b>Control Descriptions:</b> Control 1 – OPT requires subrecipients to submit supporting documentation with invoices for reimbursement requests of capital expenses but not any other expenses. Control 2 – OPT has program managers in place to provide programmatic support to subrecipients. That support entails the program manager’s review of each invoice received from subrecipients assigned to him/her to ensure charges to the active grant are appropriate and within the budgeted and authorized funding. Control 3 – OPT has a grant manager who reviews each invoice received from subrecipients to ensure charges are within the budgeted and authorized funding and charged to the proper grant/contract number. The purpose of the review is to ensure that the following aspects of the invoice are appropriate, including but not limited to: <ul style="list-style-type: none"> <li>- Grant Contract number is correct</li> <li>- Accounts included are the same as those budgeted</li> <li>- Budget for the expense existed.</li> </ul>	
<b>Processes Affected:</b> (See process descriptions in Appendix A on page referenced below) Process 2 – Program Management (page 17)	
<p><b>Observation:</b> We tested a sample of 50 expense line items from 20 subrecipient invoices and found five (25%) invoices included seven errors. Two invoices included errors in which the subrecipient undercharged SCDOT. The amounts were immaterial and no adjustments were requested by the subrecipients. The remaining three invoices from three subrecipients included overcharges to the CRF for unallowable expenses as described below.</p> <ul style="list-style-type: none"> <li>• <u>Subrecipient A:</u> This subrecipient is an intercity transit provider that operates transportation services across multiple states. SCDOT has an agreement with the subrecipient to reimburse its indirect expenses at a rate of 56% based on South Carolina's portion of 2019 total miles. We noted the invoice included costs attributable to another state and charged indirect expenses at above the approved rate as follows: <ul style="list-style-type: none"> <li>• Attributable to the state of Georgia for prepaid insurance of \$1,988</li> <li>• Indirect expense for employee insurance of \$18,018</li> <li>• Indirect expense for internet ticketing services of \$2,902</li> </ul> </li> </ul> <p>We informed OPT that this issue extended beyond this invoice and required a full detailed review of all invoices submitted by the subrecipient since the inception of the CARES Act to identify all unallowable costs. After review by OPT and the subrecipient, total unallowable costs paid to the subrecipient are \$321,089. In addition to costs attributable to another state and indirect expenses at above the approved rate, this amount includes the omission of contra expense. Contra expense is revenue earned by the subrecipient (e.g. fare revenue) that must be deducted from allowable expense.</p>	

We determined that no other funding sources in place prior to the CARES Act were affected, as CRF is the only funding source from SCDOT for this subrecipient.

- Subrecipient B: The subrecipient submitted an invoice that included \$3,369 in payroll expenses for work performed prior to CARES Act eligibility. The subrecipient subsequently transferred the identified amount out of the CARES Act subrecipient agreement and into the existing annual Section 5311 agreement. We determined that this was an isolated occurrence and did not appear in subsequent invoices.
- Subrecipient C: The subrecipient submitted an invoice with \$35,956 in costs incurred prior to the CARES Act eligible period beginning January 20, 2020. The subrecipient had identified costs in its general ledger that it failed to invoice previously. While such an adjustment is usually proper, the timeframe of those costs make them ineligible for CRF reimbursement. We discussed the error with OPT which notified the subrecipient of the error. In its January 2021 invoice submission, the subrecipient included an adjustment of \$35,956 to correct this error.

These exceptions occurred due to inadequately designed controls. A key limitation to the invoice review performed by both program managers and grant managers is that the reviews are at the account level shown on the invoice and not at the transactional level (underlying detail records). OPT requires subrecipients to submit underlying detail records for capital expenses only. Pre-reimbursement reviews of all other expenses (i.e. operating and administrative) do not include subrecipient records supporting the accuracy, validity, and allowability of those expenses. Thus, reimbursements could be made for unallowable costs. OPT has internal controls subsequent to payment. For example, certain subrecipients are placed in federally designated high-risk status requiring more scrutiny by OPT. As another example, OPT's Compliance and Oversight team conducts triennial audits of subrecipient records designed to detect unallowable costs that have already been paid; this control is not sufficient because it is performed on a sample of subrecipients months or even years after invoice payment.

OPT provided us with its 2019 FTA State Management Review report which noted that no deficiencies were found in 18 areas inclusive of a sample of invoices for ineligible expenses. The opening letter to the report states:

*“Although not an audit, the State Management Review is the FTA’s assessment of SCDOT’s compliance with Federal requirements, determined by examining a sample of award management and program implementation practices. As such, the State Management Review is not intended as, nor does it constitute, a comprehensive and final review of compliance with award requirements.”*

While the FTA review did not cover CARES Act funding, it assessed compliance with other FTA grants' requirements. With regard to the sample, the FTA review focused on compliance with FTA guidelines for reimbursed expense line items.

Total unallowable expenses are \$360,414.

**Recommendation:**

We recommend that OPT improve the design of invoice reviews for detecting unallowable costs prior to reimbursing subrecipients. We recognize that the volume of transactions and underlying subrecipient detail records is high which can make detail reviews cost-prohibitive. Hence, OPT should consider implementing risk-based reviews of certain accounts and transaction-level detail based on appropriate risk factors. Example risk factors include but are not limited to:

- Subrecipient's history of invoice errors
- Materiality of accounts
- Account complexity
- Turnover of staff
- System changes
- New subrecipients
- Unusual activity that may be identified by:
  - Significant changes from prior invoice amounts
  - Ratio analysis
  - Trend analysis

### **Management Action Plan (MAP) 5.2**

As of the completion of this report, all affected subrecipients have fully satisfied their outstanding obligation by way of adjustments to subsequent invoices or by way of check.

OPT's processes mirrored FTA processes, combining front-end grant agreement and ongoing invoice reviews with back-end compliance and oversight reviews. OPT's invoicing follows the same categorization, nomenclature and coding as FTA's, and FTA has concurred with OPT processes by way of their most recent triennial State Management Review. Therefore, in order to ensure continued consistency with FTA's own oversight and compliance processes, OPT has explored opportunities to enhance rather than significantly alter internal oversight and compliance processes in a manner that more proactively addresses and mitigates risk on the front-end.

OPT will continue to conduct scheduled compliance and oversight reviews during which subrecipient agreements and invoices are further scrutinized, with a protocol for payback of ineligible expenses established. When deemed appropriate, OPT will continue to place certain agencies on federally designated High Risk status based on the identified example risk factors.

Backup documentation and risk-based review has been required for all regular capital items such as vehicles, third party preventive maintenance, procurement of office equipment, and any other capital acquisitions. OPT has recently implemented additional risk-mitigation enhancements to the invoice review process by requiring detailed monthly payroll reports. OPT also implemented an additional layer to the invoice reviews process through the identification of subrecipients prone to submitting erroneous invoices, and requiring the submission of supplemental backup documentation for Administrative, Operating and Preventive Maintenance items. OPT periodically conducts oversight and risk-mitigation focused training for subrecipient accounting staff, to ensure that they have a clear understanding of the invoicing processes, including where there is staff turnover, system changes, new subrecipients, etc.

Prior to approving new subrecipients, with a focus on front-end risk mitigation, OPT will continue to fund new subrecipients for a three-year introductory period with State Mass Transit Funding only, as has been the practice, while providing ongoing training and ensuring the financial, administrative and technical capacity before being deemed eligible to become a full FTA funding subrecipient.

To further enhance risk-based oversight practices, OPT Program Managers will institute a 25% invoice variance rule for more detailed documentation and review, deemed appropriate since over 70% of subrecipients are very small agencies with less than \$400,000 annual budget. In such a case, OPT Program Managers will request additional documentation for line items identified as potentially having a greater risk, to include salaries and wages, miscellaneous, indirect cost, insurance, preventive maintenance, management services and contracts.

These additional steps will enhance our invoice review process by mitigating potential risks on the front end. These additional enhancements will be incorporated in the internal OPT staff Policies and Procedures and State Management Plan, where appropriate.

MAP Owner:	Director of Intermodal and Freight Programs
Division:	Office of Public Transit
Scheduled Date:	July 1, 2021

# APPENDIX A **PROCESS DESCRIPTIONS**

## Process 1 **Grants Management**

Grants management is responsible for the administration of federally funded contracts with subrecipients. The function determines eligibility and authorization amounts based on formula-driven criteria. Funding allocations are authorized and approved by the Commission. Federal grants and contracts are developed and then approved through the Federal Transit Administration.

## Process 2 **Program Management**

Program Management's role in administering the reimbursement process for subrecipient payment requests include the monitoring of subrecipient budgets and the review of invoices from subrecipients. Additionally, program management provides oversight to determine if funds are being expended in accordance with program requirements.

## Process 3 **Compliance and Oversight**

The Compliance and Oversight audit is performed annually with subrecipients on a rotating three-year cycle. The audit entails a desk review, as well as on-site review of files considered too large or sensitive for subrecipients to submit along with monthly invoices.

# APPENDIX B

## RISK SCORING MATRIX

Risk significance is rated on a scale of 1 (lowest) to 25 (highest) and is the product of the risk consequence score (1 to 5) multiplied by the risk likelihood score (1 to 5). The following matrix provides a color scale corresponding to risk significance scores.

Likelihood	Frequent or Almost Certain	3-4 Low	9-13 Medium	14-17 Med-High	18-21 High	22-25 Extreme
	Likely	3-4 Low	5-8 Med-Low	9-13 Medium	14-17 Med-High	18-21 High
	Possible	3-4 Low	5-8 Med-Low	5-8 Med-Low	9-13 Medium	14-17 Med-High
	Unlikely	1-2 Minimal	3-4 Low	5-8 Med-Low	5-8 Med-Low	9-13 Medium
	Rare	1-2 Minimal	1-2 Minimal	3-4 Low	3-4 Low	3-4 Low
		Incidental	Minor	Moderate	Major	Extreme
		Consequence				

# APPENDIX C

## RISK APPETITE

Risk appetite is defined as the amount of risk the Agency is willing to accept in the pursuit of its objectives. Management’s goal is to manage risks to within the appetite where mitigation is cost-beneficial and practical. Management has set the Agency’s risk appetite by risk type using scoring methodology consistent with the Risk Scoring Matrix shown in Appendix B. Risk appetites by risk type are as follows:

RISK TYPE	EXAMPLES	RISK APPETITE SCORE 1 = Minimal Risk 25 = Extreme Risk (See Scoring Matrix in Appendix B)
Safety	Employee and Public Well-Being	2
Ethical	Fraud, Abuse, Mismanagement, Conflict of Interest	2
Financial	Funding, Liquidity, Credit, Reporting	4
Strategic	Resources not Aligned, Unclear Objectives	4
Reputational	Unintentional Unwanted Headlines	4
Operational	Delays, Cost Overruns, Waste, Inefficiency	6
Regulatory	Non-Compliance	6
Legal	Lawsuits	10