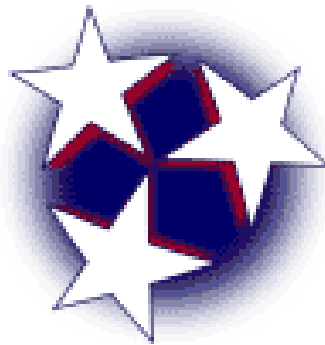

TENNESSEE SUBRECIPIENT CONTRACT MONITORING MANUAL



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Prepared by:
Resource Development and Support
Department of Finance and Administration
Nashville, Tennessee 37243

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Introduction

The Federal Office of Management and Budget (OMB) issued a revised publication of *Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations* June 2003. This circular rescinds *Circular A-128, Audits of State and Local Governments*, issued April 12, 1985, and supersedes *Circular A-133, Audits of Institutions of Higher Education and Other Non-Profit Institutions*, issued April 22, 1996. The revision raised the audit threshold of subrecipients expending Federal funds from \$300,000 to \$500,000 increasing the number of subrecipients exempt from audit when Federal expenditures are less than \$500,000 for fiscal years ending after December 31, 2003. The revision also prohibits charges to federal awards for the costs of a single audit for entities expending less than \$500,000 per year. However, the revision allows charges for subrecipient monitoring costs or the costs of agreed upon audit procedures to federal awards provided that the monitoring procedures and/or audits are of lesser scope than a single audit.

OMB Circular A-133, Section .400(d) discusses the various responsibilities of the pass-through entity, i.e., the state. The responsibility for monitoring is explained in sub paragraph (3) of this section which states that the pass-through entity is responsible for “monitoring the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved”. In order to comply with the provisions of *OMB Circular A-133*, the state:

has made appropriate changes in agreements with subrecipients to reflect that single and program specific audits are no longer required for subrecipients expending less than \$500,000 annually;

has reviewed the overall monitoring process, and is requiring uniform statewide monitoring procedures to ensure subrecipient compliance;

has taken into consideration the cost-effectiveness of monitoring procedures compared to the relative size and complexity of the federal awards administered by subrecipients in determining the appropriateness of monitoring procedures.

OMB Circular A-133 and the *Single Audit Act Amendments of 1996* require states to monitor subrecipients to assure that Federal funds are used appropriately. The State of Tennessee has chosen to treat state and Federal dollars alike in the area of monitoring. Any entity meeting the subrecipient criteria will be subject to monitoring including private non-profits, for-profits, public non-profits, state government and local governments. In response to the revision of *OMB Circular A-133* and the result of a Department of Finance and Administration 1996 survey of state monitoring activities, the state has developed an approach to monitoring which ensures uniform monitoring of subrecipients. The foundation of this approach is based on *OMB Circular A-133*. Uniformity is brought to monitoring through the development of core tests areas.

The uniform monitoring approach is aimed at targeting resources to areas of greater risk, obtaining better information, and reducing audit costs. The revised *OMB Circular A-133* and the survey results have compelled the state to examine monitoring activities of all state departments, agencies, and commissions (hereafter referred to as state agency) and to ensure that all subrecipients are adequately monitored. The Department of Finance and Administration in a collaborative effort with the Comptroller of the Treasury's Office has identified the need for a standardized system to address statewide monitoring issues.

Purpose and Applicability

The purpose of this document is to serve as a guide in monitoring state and/or federal funded programs administered by subrecipients. It is intended to identify requirements that the state, as both a grantor and pass-through entity for program funds, should monitor in order to provide reasonable assurance that subrecipients are in compliance with all applicable requirements.

This manual is structured to provide consistency in the monitoring activities across various state agencies and to ensure that core-monitoring areas are reviewed by monitoring groups. The manual provides assistance in the development of a monitoring plan. It also identifies minimum monitoring requirements along with a set of core areas common to most state and/or federal awards. The core areas are consistent with requirements of OMB Circular A-110, *Uniform Administrative Requirements for Grants and Other Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, OMB Circular A-122, *Cost Principles For Non-Profit Organizations*, and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Decentralized Monitoring Approach

The state has chosen to conduct monitoring activities in a decentralized fashion, whereby all agencies with subrecipient relationships are responsible for ensuring that their subrecipient contracts are adequately monitored. Although shifting from a centralized to a decentralized approach, the objective of maintaining a uniform monitoring approach, regardless of the state and/or federal program, remains intact. In addition to uniformity, developing a system that is auditable is also a goal. Policy 22 will assist in meeting these objectives by clearly defining monitoring requirements and by requiring each state agency to have a well-documented monitoring plan that ensures compliance with applicable state and/or federal monitoring requirements.

For the purposes of this plan, “monitoring” is defined as the review process used to determine a subrecipient’s compliance with the requirements of a state and/or federal program, applicable laws and regulations, and stated results and outcomes. Monitoring also includes the review of internal controls to determine if the financial management and the accounting system are adequate to account for program funds in accordance with state and/or federal requirements. Monitoring should result in the identification of areas of non-compliance with the expectation that corrective action will be taken to ensure compliance.

While affected agencies are individually responsible for ensuring that appropriate monitoring activities are conducted, communication between the agencies, the Comptroller of the Treasury, Division of State Audit and the Department of Finance and Administration will still be necessary to adequately carry out the requirements of Policy 22. Each entity is involved in the process at various times and to varying degrees, however, the involvement of each entity should ensure that minimum monitoring requirements are met, therefore creating a uniform and auditable process. The responsibilities of each group include, but are not limited to:

State Agency

- Develop monitoring plan in compliance with Policy 22
- Ensure subrecipient compliance via monitoring
- Review and approve corrective action plans submitted by subrecipients

State Audit

- Ensure agency compliance with Policy 22

Finance and Administration

- Review, comment on and approve monitoring plans submitted by state agencies
- May review agency compliance with approved monitoring plans

Required Monitoring Plan

All state agencies that fund subrecipients must develop and submit an annual monitoring plan, for review and approval, to the Department of Finance and Administration, Office of Audit and Consulting Services, by October 1st of each year, beginning in 2004. Any changes to the monitoring plan following approval by F&A should be documented by the agency and maintained with their approved plan. Changes to the population of contracts to be monitored should be particularly well documented with an explanation accompanying the changes made.

The monitoring plan is a summary of the agency's planned monitoring activities for the current annual monitoring cycle and must include the following components:

1. Total subrecipient contract population

The monitoring plan should identify all subrecipients in a contractual relationship with the state agency and their associated current year contracts. A subrecipient is a non-federal entity that expends state and/or federal funds received from the state to carry out a state and/or federal program. If available, the following information should be identified for each contract: vendor number, contract number, program name, risk assignment, and current year maximum liability.

A vendor is a dealer, distributor, merchant, or other seller providing goods or services that are required for the conduct of a state and/or federal program. These goods or services may be for an organization's own use or for the use of beneficiaries of the state and/or federal program. A subrecipient is not a vendor because program compliance requirements usually do not pass through to vendors. Therefore, state agencies are **not** required to include vendors in their monitoring plan.

There may be unusual circumstances or exceptions to the characteristics of subrecipients and vendors. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all subrecipient characteristics will be present. Judgment should be used in determining whether a contract represents a subrecipient or a vendor relationship. If the contractual relationship with the state meets the vendor criteria, then the state agency must ensure that the procurement, receipt, and payment for goods and services comply with laws, regulations, and the provisions of the contract.

To distinguish a subrecipient from a vendor, use the characteristics below from OMB Circular A-133, Section .210.

Subrecipient Characteristics	Vendor Characteristics
<p>Determines who is eligible to receive state and/or federal financial assistance available through the program administered</p> <p>Has its performance measured against whether the objectives of the state and /or federal program are met</p> <p>Has responsibility for programmatic decision making</p> <p>Has responsibility for adherence to applicable state and/or federal program compliance requirements</p> <p>Uses state and/or federal funds to carry out a program of the state as compared to providing goods or services for a program of the state</p>	<p>Provides the goods and services to many different purchasers</p> <p>Provides goods and services within normal business operations</p> <p>Operates in a competitive environment</p> <p>Provides goods or services that are ancillary to the operation of the state and/or federal program</p> <p>Is not subject to compliance requirements of the state and/or federal program</p>

2. Subrecipient contracts to be monitored

Following the guidelines outlined in Policy 22, all subrecipient contracts to be monitored by the agency during the current year should be identified. If available, the following contract information should also be identified: vendor number, contract number, program name, risk assignment, and current year maximum liability.

3. Monitoring cycle

Agencies should indicate if their monitoring cycle is based on the state fiscal year (July 1-June 30) or the federal fiscal year (October 1-September 30). This cycle will dictate when the new monitoring year for the agency begins and ends, thereby defining the timeframe the agency has to complete the monitoring reviews. Regardless of the cycle chosen, all monitoring plans are due no later than October 1st of each year.

4. Monitoring guide/s

A sample monitoring guide for each state and/or federal program that includes all monitoring requirements should be included in the plan. The guide/s will serve as a summary of the monitoring work performed. Each state agency should develop monitoring guides that reflect their program’s specific state and/or federal monitoring requirements, as well as the applicable core monitoring areas. The guides should meet both program and fiscal needs.

A sample guide that incorporates all core areas is presented as Attachment B of this manual. Agencies may choose to use this guide in conjunction with any program specific guides they have developed, or the two can be combined to form one comprehensive guide. Despite the

approach taken, agencies must ensure that the applicable core monitoring areas **and** the program's specific monitoring requirements are well documented in the guides used.

5. *Monitoring staff*

Full-time equivalents and personnel classifications for all staff dedicated to monitoring activities should be identified. To the extent possible, there should be a separation of duties between monitoring staff and program operations to allow for independence and objectivity. For example, monitoring personnel should have duties that are segregated from program and fiscal management, program development, technical assistance, or any other function related directly to program administration.

Possible conflicts of interest should be disclosed. It is recommended that agencies require all monitoring staff to complete a Conflict of Interest form, similar to the one in Attachment C of this manual, for each review they participate in.

6. *Program descriptions*

A brief, high-level description of each state and/or federal program being monitored should be incorporated into the monitoring plan. This description should provide information such as the purpose of the program, the program's main objectives, the population being served, etc. Its function in the monitoring plan is to provide an overview of the programs being monitored by the agency.

7. *Risk assessment and assignment*

When selecting and prioritizing contracts for monitoring each year, one of the factors that agencies should consider is the risk the subrecipient poses to the state. A risk assessment should be completed for each subrecipient on an annual basis in order to make this determination. A ranking of high, medium or low risk should be assigned to all subrecipients and their associated contracts. Because risk is being assigned to the subrecipient, it is not necessary to complete a risk assessment for every contract with that entity. The population or value of contracts a subrecipient has with an agency may affect its overall risk assignment.

8. *Criteria used to assign risk*

An explanation of the criteria used to assign risk to subrecipients, and their related contract/s, must be included in the monitoring plan. An example risk assessment form has been included as Attachment A of this manual, which agencies may choose to use as-is or can modify to fit their needs. The criteria chosen should be applicable to the agency's specific programs. Such a tool is useful in determining the priority of subrecipients to be reviewed and the level of monitoring to be performed. Also, the risk assessment can help determine how often each subrecipient should be monitored.

Attachment A involves the evaluation of several factors, such as operating systems, internal controls, experience with government contracts, financial/budget impact, and results of prior monitoring reviews or audits. When using a risk assessment, it should target areas that help identify the subrecipient's risk level, such as financial problems that could lead to diversion of program funds, loss of essential personnel, loss of license or accreditation to operate the program, rapid growth, new activities or services, organizational restructuring, and

complaints regarding program and/or fiscal operations. Other information may be used in assessing the subrecipient's risk level such as historical information; anecdotal information from employees; clients and participants; and anticipated changes.

9. *Summary of findings*

The monitoring plan should include a summary of the findings identified by the agency during the previous monitoring year. The summary should highlight those core areas and program areas in which findings were most prevalent. Over time this information can be used to identify problematic areas and decisions can be made to determine if changes in contract language, program policies, etc. are needed to address these areas. Attachment F provides a suggested template for capturing this information.

10. *Corrective action process*

Per Policy 22, subrecipients are required to submit a corrective action plan outlining the steps that will be taken to correct any findings identified in monitoring reports. Agencies must have a process in place to review and approve these corrective action plans and, if needed, provide additional support to the subrecipient to assist them in developing solutions for correcting any monitoring report findings.

A brief narrative of the agency's corrective action process should be included in the annual monitoring plan. This summary should indicate those within the agency responsible for reviewing and approving the plans and the estimated timeframes for providing feedback to the subrecipient.

State Monitoring Requirements

The primary objective of the state's monitoring approach is to ensure that a standard level of monitoring occurs regardless of the state and/or federal program and the agency conducting the review. Uniformity in the monitoring process across multiple agencies is also an important element in helping to ensure that an adequate level of monitoring is conducted.

Selecting Contracts to be Monitored (Referenced in Policy 22-Paragraph 13)

When choosing the population of contracts to be monitored each year, agencies must ensure that their population meets two main criteria:

1. They must monitor a *minimum* of 1/3 of the total number of all subrecipient contracts executed by their agency (in addition to those chosen to meet the federal monitoring frequency requirements*).
2. The current year maximum liability value of these contracts *must be equal to or greater than* 2/3 of the current year aggregate maximum liability value of the agency's entire subrecipient grant population (this value should not take into account contracts chosen to meet federal monitoring frequency requirements*).

*Note the *Federal Monitoring Frequency Requirements* section below*

It is important to recognize that the 2/3 maximum liability value discussed above should be calculated using only the current year value of the agency's contracts, not the multi-year totals.

Changes to the Subrecipient Contract Population

While agencies should have a firm grasp on their total subrecipient contract population by October 1st (the due date for the annual monitoring plan), it is very likely that an agency's contract population may change throughout the year as new contracts are added and currently executed contracts are canceled.

When choosing the population of contracts to be monitored, in order to meet the 1/3 and 2/3 monitoring requirements, agencies should use the contract population at the time of the monitoring plan's submission as the basis for their calculations. This population can, and should, include contracts that are not yet completely executed but that will, or are expected to be, executed during the monitoring year.

For purposes of determining compliance with the policy, the agency's contract population at the time of the monitoring plan submission should be used to determine whether or not an agency has met the 1/3 and 2/3 monitoring requirements.

Proper documentation should be maintained by the agency to justify any significant changes in the contract population, particularly if it affects the agency's ability to meet the 1/3 and 2/3 monitoring requirements.

Federal Monitoring Frequency Requirements (Referenced in Policy 22-Paragraph 13)

Subrecipient contracts associated with programs that have federally mandated monitoring requirements, which dictate the *frequency* of monitoring, should, at a minimum, be monitored *as often as federally required*. Therefore, these contracts should not be included in the 1/3 and 2/3 calculations used to identify the population of contracts to be monitored during a given year.

Example: An agency has 100 contracts. Thirty of these contracts are associated with programs that have federal requirements dictating how often the contracts must be monitored. Therefore, the agency in this example would monitor the 30 contracts as often as federally required and use the remaining 70 contracts in their population to meet the 1/3 and 2/3 state criteria.

The federal monitoring requirements for some programs specify that contracts must be monitored every X number of years, while some require that a certain percentage be monitored each year. Regardless of the variations in how the frequency requirements are calculated, the agency should monitor these, at a minimum, as often as federally required. More frequent reviews can be conducted, if needed, to ensure compliance.

While the state's criteria for choosing the population of contracts to be monitored each year will not apply to contracts associated with programs that have federal frequency requirements, the core monitoring areas (described on pages 14-19 of this manual) covered during these reviews should not differ. All applicable core-monitoring areas must be addressed for every review conducted.

Contracts Without a Maximum Liability

Although a majority of contracts are assigned a maximum liability value for each year of the contract term, there are some contracts for which a maximum liability value is not assigned. In order to accurately factor such contracts into the population of contracts to be monitored, while also ensuring that policy requirements are adhered to, agencies should comply with the following guidelines:

- An estimated current year value should be assigned to each contract based on historical data available for that subrecipient (i.e. past contractual expenses)
- If no historical data is available the agency should make a good faith effort to determine the approximate projected current year value of the contract

Multi-Year Contract Values with Single Maximum Liability Value

While many multi-year contracts specify a maximum liability amount for each year of the contract term, there are contracts for which this information is not available or does not apply due to the provisions of the contract. For multi-year contracts that **do not** specify a maximum liability amount for each year of the contract term, but instead have a single maximum liability amount that can be expended at any time during the life of the contract, agencies should comply with the following guidelines when choosing the population of contracts to be monitored. These guidelines will help to ensure that such contracts are accurately factored into the population of contracts to be monitored and that policy requirements are adhered to:

- For purposes of meeting the 2/3 current year maximum liability value requirement: The total contract value should be used as the current year maximum liability amount during the first year of the contract. In subsequent years the current year maximum liability amount would be the contract's remaining balance.

- If a contract is chosen for monitoring and no funds are expended during the year, or the amount expended is too insignificant to warrant a review, proper documentation indicating that a review was planned but did not ultimately occur for this reason should be maintained by the agency. Such contracts should be considered for monitoring in future years.

Frequency of Monitoring

There are no state policy requirements related to the frequency of monitoring. How frequently a subrecipient, and its related contracts, is monitored should be decided by considering the following factors:

1. Based on their state agency assigned risk assessment, do they pose a greater risk to the state (programmatically and/or financially)?
2. Have they recently been monitored?
3. Have prior review findings indicated serious deficiencies?

Scope of Monitoring

Agencies may choose to vary the scope of their reviews and the techniques used based on factors such as the risk level of the subrecipient, the value of the contract/s, the result of prior reviews and audits, etc. This variance in scope could result in, among other things, changes to the sample size, changes in the monitoring techniques used, or a decision to conduct a desk review instead of an on-site review. While the scope of a review may vary it must include, at a minimum, the program specific monitoring requirements as well as the applicable core monitoring areas.

Reporting (Referenced in Policy 22-Paragraph 15)

Following each monitoring review subrecipients should be notified of the outcome of the review. If findings and observations were identified, state agencies must issue a report that, at a minimum, summarizes the findings and observations noted. Because development of an appropriate corrective action plan during the term of the contract is critical to ensuring compliance, the issuance of reports in a timely manner is essential. For this reason, reports shall be issued within 30 business days after the completion of all fieldwork. The workpapers for any reports not issued within this timeframe should contain documentation explaining why the deadline was not met.

Reports should be shared with the subrecipient and the Comptroller of the Treasury, Division of State Audit and a copy should be retained by the state agency that conducted the monitoring review. Such a report would result in a corrective action plan, which is to be developed by the subrecipient and approved by the state agency.

If no findings or observations were noted, subrecipients should be notified in writing of this fact.

Every effort should be made to issue reports and feedback in a timely manner.

Example/Visual Representation

The example on the following page is provided to help clarify the requirements for selecting the population of contracts to be monitored each year.

Example: Selecting Subrecipient Contracts to be Monitored

Sample: Total Subrecipient Population

Contracts	Current Yr. Max. Liability	Length of Contract (years)	Total Max. Liability	Estimated Current Yr. Value	Risk	Federal Monitoring Frequency Requirements
Contract 1	50,000	3	150,000		L	Y
Contract 2	25,000	3	75,000		L	Y
Contract 3	800,000	1	800,000		M	N
Contract 4	1,000,000	1	1,000,000		H	Y
Contract 5		1		750,000	H	N
Contract 6		1		450,000	M	N
Contract 7		5		100,000	L	N
Contract 8	100,000	5	500,000		M	Y
Contract 9	250,000	3	750,000		L	N
Contract 10	500,000	1	500,000		M	N
Contract 11	75,000	5	375,000		L	Y
Contract 12	25,000	3	75,000		L	Y
Contract 13	150,000	1	150,000		L	N
Contract 14	300,000	1	300,000		M	N
Contract 15	250,000	3	750,000		H	N
Contract 16	100,000	3	300,000		L	N
Contract 17	1,000,000	1	1,000,000		H	N
Contract 18	750,000	1	750,000		M	N
Contract 19	500,000	2	1,000,000		M	N
Contract 20	100,000	3	300,000		M	Y
20	\$ 5,975,000		\$ 8,775,000	\$ 1,300,000		

These contracts do not have maximum liability amounts assigned to them. However, based on historical data, or a good faith effort to determine their likely value, the agency assigns an estimated value to each contract for the current year

Risk levels are defined by the state agency through the use of a risk assessment form (completed for each subrecipient)

Note that the calculations used to determine which contracts will be monitored during any given year are based on the current year maximum liability amount **not** on the total (multi-year) max. liability

Minimum Monitoring Requirements

Total # of contracts with federal monitoring frequency requirements: 7
 Total current year value of contracts with federal monitoring frequency requirements: \$1,375,000

1/3 total # of contracts (excluding those with fed. monitoring frequency requirements) = 4 (20 total contracts minus 7 with fed. monitoring frequency requirements = 13; 1/3 of 13 = 4.33)
 2/3 total value of contracts = \$3,894,000 (\$7,275,000 minus \$1,375,000 = \$5,900,000; 2/3 of \$5.9M = \$3,894,000)

Current year aggregate max. liability value of contracts with federal monitoring frequency requirements
 Current year aggregate max. liability value + Estimated current year value (5,975,000+1,300,000)

Agency must monitor at least 4 contracts totaling at least \$3,894,000

Sample: Contract Monitoring List for Current Year

Contract 5	750,000
Contract 15	250,000
Contract 17	1,000,000
Contract 3	800,000
Contract 18	750,000
Contract 10	500,000
6 contracts	\$ 4,050,000

- ~These are the contracts the agency has selected to monitor to meet state monitoring requirements (various options are available)
- ~6 contracts were chosen, which meets the 1/3 total # criteria
- ~The total value of the contracts chosen is \$4,050,000, which meets the 2/3 value criteria
- ~In this example all high risk contracts were included, as they pose a greater risk to the state
- ~The total # of contracts monitored by the agency could end up being greater depending on federal monitoring frequency requirements for contracts 1, 2, 4, 8, 11, 12, & 20. Example: these contracts could be in a program requiring 25% of contracts to be monitored each year. The agency would be required to monitor 2 of those contracts, in addition to the 6 they've chosen to monitor to meet state requirements.

Required Core Monitoring Areas

In addition to state and/or federal program specific monitoring requirements, all reviews must address the applicable core monitoring areas. A sample guide that incorporates all core areas is presented as Attachment B of this manual. Agencies may choose to use this guide in conjunction with any program specific guides they have developed, or the two can be combined to form one comprehensive guide.

OMB Circular A-133 Compliance Supplement defines core monitoring areas 1-13. Should the OMB Circular A-133 Compliance Supplement core areas change; agencies must ensure that the core areas covered during monitoring activities mirror the most recent OMB A-133 Compliance Supplement.

The required core monitoring areas include:

I. Activities Allowed or Unallowed

The primary compliance test to be performed on each program reviewed is whether the activities of the program are allowable under particular program regulations, laws, and provisions of the contract/grant agreement.

Tests that could be performed for this core area include, but are not limited to:

- Test to determine through telephone inquiries or in writing whether the activities of the program are consistent with the current year grant/contract
- Test to determine whether the program objectives and activities continue to be allowable
- Review grants, contracts, and all applicable program guidelines to identify the activities that are allowable
- Test to determine through inquiries, observation and review of documentation whether activities are consistent with the program objectives and are allowable
- Review contractual relationships that a subrecipient has with any other entity, employee, and/or board member
- Review the documentation which supports the activities under any subcontract and determine if program compliance requirements are being met, if program activities meet program objectives, and if activities are allowable

II. Allowable Costs/Cost Principles

Allowable costs applicable to subrecipients of program funds are described in detail in the cost principles of OMB Circular A-122 and OMB Circular A-87. These circulars describe allowable and unallowable costs and standard methods for calculating indirect cost rates. A state agency may require more stringent guidelines on allowable and unallowable costs. When the requirements of a state agency are more stringent than the federal requirements, then the monitor should apply the requirements of the state agency.

Tests that could be performed for this core area include, but are not limited to:

- Conduct desk review. Inspect current contracts and program narratives to determine any changes from prior years' program
- Perform analytical review of pertinent program and financial information including expenditure reports and program progress reports
- Perform analytical review of program and financial information for reasonableness of costs and services rendered
- Perform analytical review of program and financial information for reliability and consistency between different quarters and prior years
- Follow up desk review with telephone inquiry to resolve or clarify any questions that arose from desk review
- Request copies of supporting documentation deemed necessary to vouch existence of reported transactions
- Determine if a follow up onsite review is necessary
- Test to determine if costs charged to the program are allowable, reasonable and necessary for the performance and administration of the program
- Test to determine if costs are allocable to programs under provisions of applicable state requirements and/or applicable OMB circulars; and that costs allocated to the program are consistent with the benefit received from the program
- Test to determine if costs are applied consistently and conform to generally accepted accounting principles
- Test to determine if costs conform to the limitations of, and the exclusions set forth in, OMB Circulars A-122 and A-87 or the applicable state guidelines
- Test to determine that costs charged to any program are net of applicable credits, such as discounts, rebates or allowances, recoveries, insurance refunds or adjustments for overpayments
- Vouch to determine if costs are supported by adequate documentation (such as vendor invoices, canceled checks, time and attendance records, approved purchase orders, receiving reports, etc.) and represent actual costs, not budgeted or projected amounts

III. Cash Management

Cash management refers to the internal control procedures that minimize the time elapsing between the transfer of funds to subrecipients and the related disbursement. This is applicable only to those grants/contracts that allow advance payments and even payments. It is important to ensure that subrecipients do not have excess funds on hand beyond their immediate needs.

When funds are advanced, state agencies and subrecipients must have procedures to minimize the time elapsing between the transfer of funds to the subrecipient and disbursement. When advance payment procedures are used, the state agency must review and concur with the subrecipient's established procedures.

Tests that could be performed for this core area include, but are not limited to:

- Review expenditure reports
- Compare year to date expenditures to cash advances or drawdowns to determine if drawdowns exceed immediate cash needs

- Test to determine if cash advances or drawdowns are only for amounts necessary for immediate cash needs
- Test to determine if cash does not accumulate beyond the immediate needs of the program

IV. Davis-Bacon Act

The Davis-Bacon Act requires that laborers and mechanics paid under a federal construction contract of \$2,000 or more be paid wages not less than the prevailing wage rates for the locality. This Act will not be applicable to most subrecipients having a grant/contract with the state.

Tests that could be performed for this core area include, but are not limited to:

- Test to determine if the subrecipient has entered into a federal construction contract in the amount of \$2000 or more
- Test to determine if the subrecipient paid the required Department of Labor prevailing rates to laborers and mechanics employed under any federal construction contract

V. Eligibility

Each program has specific requirements for eligibility that are unique. These are usually dictated by the laws, regulations, and the provisions of the contract/grant agreements pertaining to the program.

Tests that could be performed for this core area include, but are not limited to:

- Test to determine if the program participant population and area served were eligible under applicable eligibility guidelines
- Test to determine if program benefit amounts provided to or on behalf of eligible participants were calculated in accordance with program requirements
- Test to determine if the program participants continued to be eligible after the initial eligibility assessment, and if program participants' benefits were discontinued when the period of eligibility expired

VI. Equipment and Real Property Management

Equipment refers to tangible non-expendable property having a useful life of more than one year and an acquisition cost of \$1,000 or more per unit. (The limit of the acquisition cost has been increased to \$5,000 or more per unit at the federal level.) Until the state agency revises its requirements regarding acquisition costs, \$1,000 will continue to be the limit. Equipment purchased with federal funds must be used in the program that acquired it or, when appropriate, in other federal programs.

Tests that could be performed for this core area include, but are not limited to:

- Conduct desk review of subrecipient's budget to determine whether there was provision of any reported equipment acquisition
- Test to determine whether the program funds used to purchase were within the amount approved for such equipment
- Test to determine if program funds were used to purchase any equipment

- Test to determine if the subrecipient's policies and procedures for equipment are adequate and consistent with the state and/or federal requirements
- Test to determine if equipment transactions are in compliance with applicable policies and procedures
- Test to determine if equipment records include the following minimal information: description of the equipment, serial number, tag number, source of funding, who holds title to the equipment, acquisition date, acquisition cost, percentage of state and/or federal participation in cost, location, condition, disposal date (if applicable) and sale price (if applicable)
- Test to determine if the state agency was reimbursed for the appropriate share of disposed equipment
- Inspect the equipment acquired and determine whether it is consistent with what was planned

VII. *Matching, Level of Effort, Earmarking*

Some funding sources have a match requirement, a level of effort requirement and/or an earmarking requirement. Matching requirements refer to contributions specified as an amount or percentage of expenditures that must be borne by the subrecipient. Level of effort refers to a specified level of service to be provided during a defined period; or a specified level of expenditures from other sources for specific activities; or the use of other state and/or federal funds to supplement, but not supplant, non-state and/or non-federal funding of services. Earmarking refers to requirements that define the minimum or maximum amount or percentage of the program's funding that must be used for specified activities provided by the subrecipient.

Tests that could be performed for this core area include, but are not limited to:

- Conduct desk review of grant reports
- Calculate and determine if required match contributions, level of effort or earmarking requirements were met
- Test to determine if matching contributions are from allowable sources
- Test to determine if values placed on in-kind are reasonable and appropriately documented
- Test to determine if state and/or federal funds were used to supplant

VIII. *Period of Availability of Funds*

This refers to verification that program funds were used only during the period that the funds were authorized to be used.

Tests that could be performed for this core area include, but are not limited to:

- Inspect grant award and contract to determine the appropriate period of availability of the funds to program
- Select a sample of transactions reported to the grant program and vouch whether the underlying obligations occurred during the period of availability
- Select a sample of transactions that were recorded during the period of availability and verify whether underlying obligations occurred during the period of availability

- Select a sample of adjustments to the grant and verify that the adjustments were for transactions that occurred during the period of availability

IX. Procurement, Suspension and Debarment

This is to verify that subrecipients use the same or more stringent policies and procedures for procurement and to ensure that non-federal entities are prohibited from contracting with, or making subawards to, parties suspended or disbarred from federal grant program.

Tests that could be performed for this core area include, but are not limited to:

- Test to determine whether procurements were made in compliance with the provisions of A-102 Common Rule and OMB Circular A-110
- Obtain subrecipient's procurement policies and determine whether they are more stringent
- Select and test a sample of procurements to determine compliance with state laws and procedures and other applicable policies
- Verify whether procurements were made through full and open competition
- Test a sample of procurements and subawards to ascertain if the contracts were entered into with any parties listed on the *List of Parties Excluded from Federal Procurement or Nonprocurement Programs*, issued by the General Services Administration

X. Program Income

Program income refers to gross income received by the subrecipient and acquired with program funds. The income is directly generated by the state and/or federally funded programs during the duration of the contract/grant. Examples of program income are fees collected for services, income from the rental of real property, and income from the rental of personal property.

Tests that could be performed for this core area include, but are not limited to:

- Test to determine program income was received, identified and recorded properly
- Test to determine program income was used in accordance with all applicable requirements

XI. Real Property Acquisition and Relocation Assistance

This relates to the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, which provides for uniform and equitable treatment of persons displaced by federally assisted programs from their homes, businesses or farms.

Tests that could be performed for this core area include, but are not limited to:

- Inquire of management whether the subrecipient administers federally assisted programs that involve the acquisition of real property and/or displacement of households or businesses
- Review records to ascertain whether the right amount of compensation was offered based on the appraisal process
- Test records to determine whether the appraisal was reviewed by a review appraiser and that the review appraiser prepared a signed statement which explains the basis of any adjustments

- Test supporting documentation of Residential Relocations to determine whether displaced persons were offered one or more comparable replacement dwellings

XII. Reporting

This test is to verify that subrecipients use the standard reporting forms as prescribed by OMB or state policy or specific program requirements. These forms may include financial, performance, and special reporting.

Tests that could be performed for this core area include, but are not limited to:

- Through a desk review, inspect forms used by subrecipient for reporting to determine whether the authorized forms were used
- Specifically review expenditure reports to determine whether they are the authorized forms for Uniform Reporting Requirements Policy 03

XIII. Special Tests and Provisions

In many cases a program specific supplement, performance standards, or specific program policies will be available to provide specific guidance to the monitor with respect to internal controls, compliance requirements, and suggested procedures. Parts 1-3 of the OMB A-133 Compliance Supplement have been included as Attachments H, I and J of this manual. When a program supplement is not available, the monitor should use, at a minimum, the core tests of the appropriate monitoring level.

XIV. Title VI

The Title VI Compliance Commission Advisory Memorandum No. 3, issued April 14, 2004 has been included as Attachment D of this manual. Refer to this memo for Title VI monitoring requirements.

Suggested Monitoring Techniques

Meeting the monitoring objectives for high, medium and low risk subrecipients can be achieved through a variety of monitoring techniques. The techniques listed below are *suggested* for testing the core monitoring areas for compliance. If the suggested techniques remain the same for high, medium and low risk subrecipients then the intensity of the testing and/or the sample size could increase as the risk level increases.

The *suggested* monitoring tests recommended are physical examination, confirmation, vouching, tracing, inquiry, observation, reperformance, reconciliation, inspection and analytical procedures.

Physical examination

Physical examination refers to gathering physical evidence and it provides the most reliable form of evidence. Therefore, observation of physical evidence may be required when testing high risk subrecipients such as counting petty cash, inspecting new equipment, observing inventory, determining staff/client ratio, or inspecting medications. However, reviewing invoices and/or other supporting documentation may satisfy the same objective when testing medium or low risk subrecipients.

Confirmation

Confirmation refers to the written requests to a particular third party to confirm assertions made by the subrecipient. It may include confirming the accounts receivable balance or confirming that an individual received service from a particular program, confirming civil rights compliance with appropriate federal/state agencies, or confirming policy waivers given by the state agency.

Vouching

Vouching is the examination of documents that support a recorded transaction, amount, or activity. Vouching helps to obtain evidence about a recorded transaction, and therefore cannot identify unrecorded transactions or activities. Vouching starts from the recorded transaction to the supporting evidence. Vouching may be used to verify the expenditure reports reported to the grantor or to the reliability of program results and achievements to supporting documentation.

Tracing

Tracing refers to verifying the recording of a document in the accounting records. Tracing is similar to vouching, except it starts with the document to the records. A monitor may use tracing to verify a transaction, such as an invoice, through the accounting system to its ultimate recording in the accounting records, journal, ledgers and to the appropriate grant program. A monitor may also use tracing to verify that incidents, runaways, or use of physical restraints was reported to the proper authorities and recorded in the client's record.

Inquiry

Inquiry is the test used to obtain management's and employees' responses to questions about the operations of the subrecipient. Monitors may use inquiries to get a better understanding of staffing patterns, levels of supervision, how services are delivered, management controls, and

how a program is intended to operate. Inquiries usually provide the basis for further testing to substantiate the responses to the inquiries.

Observation

Observation is the witnessing of physical activities by the monitor such as taking of physical inventory, touring facilities, attending client staffings, or witnessing physical restraints. Monitors may also use this test to observe how a program is operated. Observation and inquiry should be used in testing monitoring areas when the monitor cannot review a document in any other manner. When the circumstance does not allow the monitor to review or test documentation, the monitor can make inquiry and observe the process to ensure that the intended controls are adequate or being implemented as intended. Inquiry of the process to gain an understanding of how it operates may be sufficient for a low risk subrecipient; however, the process may need to be observed in a high and/or medium risk subrecipient.

Reperformance

Reperformance is the process of testing the integrity of transactions or balances by monitors to independently verify the reliability of the controls. Monitors may reperform some transactions and compare the results of the reperformance with expected results.

Reconciliation

Reconciliation is the process of matching two independent sets of records. Reconciliation serves to provide assurance of completeness and existence. Reconciliation may be necessary to confirm grant revenues and receivables in a high and/or medium risk subrecipient before closing out a program year.

Inspection

Inspection is the examination of documents other than vouching and tracing. Inspection is the critical reading of a document to compare the information therein with other information known to the monitor. This includes review of contracts, leases, insurance policies, program guidelines, minutes of board meetings and other pertinent records. Inspection may be used in all monitoring activities regardless of the risk level.

Analytical procedures

Analytical procedures encompass a number of specific tests that a monitor may use to test the reasonableness of data. A monitor may use analytical procedures, such as certain ratios and trends to determine any unusual conditions that indicate further testing is warranted. Analytical procedures may be used to provide some level of assurance of low risk subrecipients and may be used to confirm and substantiate the balances in high risk subrecipients.

In using these techniques, the monitor should exercise discretion and apply the most relevant tests to the given situation.

Attachment A: Risk Assessment Form

AGENCY INFORMATION SUMMARY

Subrecipient Name _____

Date Last Monitored _____

Street Address _____

Telephone Number _____

City, State, Zip _____

Federal ID (FEIN) _____

Contact Person _____

Contact Telephone Number _____

List Each State Department That this Agency Contracts With, Type Program(s), And The Contract Amount:

State Agency	Program	Grant/Contract Amount

RESULT OF RISK ASSESSMENT			
Assessed Risk Measure: (See last page for instructions.)			
High	=	_____	
Medium	=	_____	
Low	=	_____	
Type Review To Be Conducted: <input type="checkbox"/> Fiscal <input type="checkbox"/> Program <input type="checkbox"/> Both <input type="checkbox"/> No Review			

Risk Assessment Performed by: _____

Reviewer(s) Assigned: _____

Date: _____

RISK CATEGORIES

SCORE

1.	FEDERAL FUNDS EXPENDED DURING A FISCAL YEAR	
	• <\$50,000	= 1
	• >\$50,000 AND <\$150,000	= 2
	• >\$150,000 AND <\$300,000	= 3
	• >\$300,000 AND <\$500,000	= 4
	• >\$500,000	= 5 _____
2.	MONITORING JUDGMENT RISK	
	• Little concern; review on request or monitor's discretion	= 1
	• Low concern; review every 5 years	= 2
	• Moderate concern; review every 3-4 years	= 3
	• Fairly high concern; review every 2 years	= 4
	• High audit concern; review annually	= 5 _____
3.	INTERNAL CONTROL	
	• Very insignificant weaknesses	= 1
	• Minor weaknesses	= 2
	• Average or no prior audit	= 3
	• Some weaknesses	= 4
	• Many weaknesses	= 5 _____
4.	RESULTS OF PRIOR AUDIT	
	• No significant findings	= 1
	• Some minor findings	= 2
	• Moderate findings or no prior audit	= 3
	• Some significant findings	= 4
	• Many significant findings	= 5 _____
5.	RESULTS OF PRIOR MONITORING OR OTHER SITE VISITS	
	• No significant findings	= 1
	• Some minor findings	= 2
	• Moderate findings	= 3
	• Some significant findings	= 4
	• Many significant findings	= 5 _____
6.	NUMBER OF PROGRAMS FOR PERIOD BEING MONITORED	
	• Single	= 1
	• 2-4	= 2
	• 5	= 3
	• 6-7	= 4
	• 8 and over	= 5 _____

7. FINANCIAL/BUDGET IMPACT
- Very little or no impact = 1
 - Little impact = 2
 - Moderate impact = 3
 - High impact = 4
 - Very high impact = 5 _____
8. SIZE OF STAFF FOR PERIOD BEING MONITORED
- Very small(1-4) = 1
 - Small (5-8) = 2
 - Moderate (8-10) = 3
 - Large(11- 15) = 4
 - Very large (15 and over) = 5 _____
9. MANAGEMENT INPUT/CONCERN
- Very little = 1
 - Some = 2
 - Moderate = 3
 - Much = 4
 - High = 5 _____
10. RESULTS OF COLLATERAL CONTACTS. SELF-ASSESSMENT CUSTOMER SURVEYS, ETC.
- Zero or small indication of risk = 1
 - Some indication of risk = 2
 - Moderate indication of risk = 3
 - Large indication of risk = 4
 - Very large indication of risk = 5 _____

For 11 & 12, add one for each of the items that are applicable.

11. CHANGES IN THE AUDIT UNIT
- Change in accounting/computer system = 1
 - Change in business conditions = 1
 - Change in economic trends = 1
 - Change in Internal controls = 1
 - Change in management = 1
 - Rapid growth of organization = 1
 - Reorganizations, restructuring or downsizing = 1
 - Major changes in policy or procedures = 1 _____

12.	CURRENT OPERATING ENVIRONMENT		
	• Safety/environmental concerns	= 1	
	• Budget/deadline pressure	= 1	
	• Centralized/decentralized management	= 1	
	• Civil Liability	= 1	
	• Confidentiality of data	= 1	
	• Volatile political events or excessive political pressure	= 1	
	• Government regulations reporting	= 1	
	• Remoteness of location	= 1	
	• Number of locations	= 1	
	• Personnel turnover	= 1	
	• Volume of sections	= 1	_____
13.	TYPE OF CONTRACT FOR PERIOD BEING MONITORED		
	• This is a Fee for Service Contract	= 1	
	• This is a Spending Plan or Reimbursement Contract	= 3	_____
14.	BOARD OF DIRECTORS INVOLVEMENT		
	• Very active board (provides appropriate oversight)	= 1	
	• Active board (takes interest in financial matters/ reviews reports)	= 2	
	• Moderately effective	= 3	
	• Not very effective (not sufficiently independent of management)	= 4	
	• Inactive board (does not meet regularly)	= 5	_____
15.	EXPERIENCE WITH STATE/GOVERNMENT CONTRACTS		
	• Over ten years experience	= 1	
	• Five to ten years experience	= 2	
	• Two to five years experience	= 3	
	• Less than two years experience	= 4	
	• Completely new	= 5	_____
16.	CHANGES IN EQUIPMENT SYSTEMS & STAFF SINCE LAST REVIEW		
	• No changes	= 1	
	• Moderate changes-low turnover	= 2	
	• Equipment changes-low turnover	= 3	
	• High turnover	= 4	
	• High turnover & equipment/system change	= 5	_____
17.	EXPOSURE TO-LOSS		
	• None	= 1	
	• Physical assets	= 2	
	• Readily negotiables	= 3	
	• Cash	= 4	
	• Confidential data	= 5	_____

18. AUTOMATED SYSTEM COMPLEXITY

- Very simple = 1
- Simple = 2
- Moderately complex = 3
- Complex = 4
- Very complex = 5 _____

TOTAL RISK SCORE _____

INSTRUCTIONS

1. Determine the Assessed Risk based on the following guidelines:

<u>Score</u>	<u>Risk Level</u>
35 or Less	Low
36 to 55	Medium
Over 55	High

2. Write the Total Risk Score next to the appropriate risk level on the first page of the Risk Assessment Form.

Attachment B: Detail Review Guide

CORE MONITORING AREAS

TABLE OF CONTENTS

	<u>Reference</u>
I. Activities Allowed or Unallowed	
II. Allowable Costs / Cost Principles	
III. Cash Management	
IV. Davis-Bacon Act	
V. Eligibility	
VI. Equipment And Real Property Management	
VII. Matching, Level Of Effort, Earmarking	
VIII. Period Of Availability Of Funds	
IX. Procurement, Suspension And Debarment	
X. Program Income	
XI. Real Property Acquisition And Relocation Assistance	
XII. Reporting	
XIII. Special Tests and Provisions	
XIV. Title VI	

The objective of the test of Activities Allowed or Unallowed is to determine whether the activities of the program are allowable under the program regulations, laws, and provisions of the contract/grant agreement.

I. ACTIVITIES ALLOWED OR UNALLOWED

1. Review documentation relevant to the review of the contract(s) (program regulations, laws, contractual agreement, etc.) to identify the activities funded through the contract(s).

2. Design and perform testwork to ensure subrecipient compliance with applicable contractual and other requirements. As appropriate, program specific guides may be used to help assist in this process.

3. Document testwork performed to ensure subrecipients compliance.

NA	Initials	WP Reference

Summarize the results of the Activities Allowed and Unallowed testwork.

The objective of the test of Allowable Costs/Cost Principles is to provide assurance that costs reported under the grant program are allowable and consistent with the provisions of the state agency guidelines and OMB Circular A-122 and/or A-87.

II. ALLOWABLE COSTS / COST PRINCIPLES

1. Review documentation relevant to the contract(s) such as fiscal manuals, applicable federal circulars and other documentation regarding allowable costs.
2. Review the latest audit report as well as current internal financial statements. Document any important matters identified during the review.
3. Determine the solvency and financial viability of the subrecipient.
4. Determine methods of accounting and if bookkeeping is up to date.
5. Assess Internal controls as necessary to understand the process regarding subrecipient charges to the grant(s). Document assessment and understanding of the process. (See Attachment E for an example of Internal Control Questionnaire)
6. Test a sample of transactions for allowability of program costs. Document testing of the sample (list items tested and attributes tested) and the method used to select the sample.

NA	Initials	WP Reference

Summarize the results of Allowable Costs testwork.

The objective of this test is to determine whether the subrecipient receives funds in advance of disbursements and whether the grant funds on hand are in excess of the immediate needs of the program.

III. CASH MANAGEMENT

1. Refer to documentation relevant to the review of the contract(s) to identify if funds are restricted (the contract is other than fee for service). If funds are restricted, can excess funds be accumulated? If so, test for excess cash on hand.
2. List items and attributes tested.

NA	Initials	WP Reference

Summarize the results of the Cash Management testwork.

The objective of this test is to determine whether any laborers and mechanics working under a federal construction contract that exceeded \$2,000, were not paid less than the prevailing wage rates for the locality.

IV. DAVIS-BACON ACT

1. Refer to documentation relevant to the review of the contract(s) to identify if the program(s) funded involve any federal construction contract. If there are none, the following tests do not apply.
2. Determine if the subrecipient has entered into a federal construction contract equal to or exceeding \$2,000.
3. Determine the Department of Labor prevailing rates at the time of the construction payroll. The DOL Wage and Hour Division publishes a Register of Wage Determination. For Tennessee you will find it at the following web location.
<http://www.access.gpo.gov/davisbacon/tn.html>
4. Select a sample of contractor or subcontractor payroll submissions and certifications and determine whether laborers and mechanics were paid the prevailing rates for the locality.

NA	Initials	WP Reference

Summarize the results of Davis Bacon Act testwork.

The objective of this test is to determine whether program participants were eligible under the applicable program guidelines, remained eligible during the period, and whether the amounts of benefits provided were properly computed and adequately documented.

V. ELIGIBILITY

1. Refer to documentation relevant to the review of the contract(s) to identify Client Eligibility Requirements.
2. Test a sample of program participants to ensure that applicable eligibility guidelines were met. Document the sample and the method for choosing the sample.
3. Test to determine that contract requirements, **if any**, were met with regard to targeted program participant population and/or area served.

NA	Initials	WP Reference

Summarize results of Eligibility testwork.

The objective of this test is to determine whether the subrecipient’s policies and procedures with regard to the purchase of equipment are adequate and consistent with the state agency’s guidelines.

VI. EQUIPMENT AND REAL PROPERTY MANAGEMENT

1. Refer to documentation relevant to the review of the contract(s) to determine if equipment was budgeted and purchased.
2. Inquire of management and/or otherwise determine if state agency has paid for equipment from **prior grants**.
3. Review the accounting report(s) for the program(s) funded to determine if any equipment has been charged to the state agency. If an answer to 1, 2, or 3 is yes, do the following tests.
 - a. Obtain a copy of the equipment inventory.
 - b. Select a sample of individual items to test from the list and/or the general ledger. Develop attributes to be tested in detail.
 - c. Document testing performed (items and attributes tested).

NA	Initials	WP Reference

Summarize results of Equipment and Property testwork.

The objective of this test is to determine whether the subrecipient met the minimum requirements for local contributions to match the grant award, or whether the subrecipient incurred adequate level of expenditures borne by other sources of funds to meet the minimum requirements under the grant program. This test also verifies whether the subrecipient met the minimum or maximum amount or percentage of the program funding that must be used for specified activities provided by the subrecipient.

VII. MATCHING, LEVEL OF EFFORT, EARMARKING

1. Refer to documentation relevant to the review of the contract(s) to identify match requirements. If match is required, do the following tests.
2. Review and document the type and source of match required.
3. Additional tests are required if Donated Materials, Services, Facilities are used as match.
4. Document (items and attributes tested) the in-kind match items tested.

NA	Initials	WP Reference

Summarize the results of the Match, Level of Effort, and Earmarking testwork.

The objective of this test is to verify whether the grant funds were used during the period the funds were authorized.

VIII. PERIOD OF AVAILABILITY OF FUNDS

1. Refer to documentation relevant to the review of the contract(s) to identify the period of availability of funds. This will be the period the contract is in force.
2. Select a sample of transactions including those reported and paid by the state agency. Include some transactions from the beginning of the contract period. Vouch that the underlying obligations occurred during the period of availability. Liabilities for eligible costs incurred but not paid during the contract period are within the period of availability.
3. List items and attributes tested. *This may be a test attribute of disbursements testing covered in II.*

NA	Initials	WP Reference

Summarize the results the Period of Availability of Funds testwork.

The objective of these test is to ensure that purchases were made in compliance with provisions of A-102 Common Rule, OMB Circular A-110, minimum requirements of state and/or federal guidelines, that policies provide for full and open competition and that there were no parties debarred from the procurement process by the federal government.

IX. PROCUREMENT, SUSPENSION AND DEBARMENT

1. Develop an understanding of purchasing policy requirements under the provisions of A-102 Common Rule and OMB Circular A-110.
2. Review subrecipients purchasing policies and assess whether minimum requirements of state and/or federal guidelines including provisions for full and open competition are satisfied by the policies. Summarize assessment.
3. Inquire of management to determine if subrecipient purchasing staff is knowledgeable of **GSA Debarment** list and if any contract was entered into with any party that has been debarred.
4. List items and attributes tested. *This may be a test attribute of disbursements testing covered in II.*

NA	Initials	WP Reference

Summarize the results of the Procurement, Suspension, and Debarment testwork.

The objective of this test is to determine whether the subrecipient received any program income from operating the program funded by state and/or Federal funds. The test is to determine whether any such program income received was applied to reduce the program expenditures or used in accordance to state agency guidelines.

X. PROGRAM INCOME

1. Refer to documentation relevant to the review of the contract(s) to identify if Program Income can be generated from the funding.
2. Review subrecipient audits and internal financial statements for accounts that capture fees, services, fines, seizures, forfeitures, etc. Summarize assessment.
3. Document program income items and attributes tested.

NA	Initials	WP Reference

Summarize the results of Program Income testwork.

The objective of these tests is to determine if there are any federally assisted programs involving the acquisition of real property and/or displacement of households or businesses and to determine that compensation was fair and in accordance with Federal guidelines.

XI. REAL PROPERTY ACQUISITION AND RELOCATION ASSISTANCE

1. Refer to documentation relevant to the review of the contract(s) and inquire of management to determine if these tests are applicable. If so, do the following tests.
2. Review records to ascertain that compensation offered was based on the appraisal process.
3. Determine that a review appraiser reviewed the appraisal and that the review appraiser prepared a signed statement explaining the basis of any adjustments.

NA	Initials	WP Reference

Summarize the results of Real Estate Acquisition and Relocation Assistance testwork.

The objective of this test is to verify whether the subrecipient complied with all reporting requirements of the program including Policy 03, and other specific program reports.

XII. REPORTING

1. Refer to documentation relevant to the review of the contract(s) and state agency policy to determine reporting requirements.
2. Identify the specific reports required by the contract or state agency policy.
3. Select a sample of reports to test. Document the selection by listing the reports and the attributes tested. Include attributes for accuracy, timeliness, and adequacy of support.
4. Test compliance with Policy 03 Uniform Reporting Requirements. Ensure that amounts reported are consistent with the plan and supported by the accounting records.
 - a. Is this subrecipient subject to Policy 03 requirements? Governmental and agencies operating **one** program only are not subject to the requirements. The following tests should be done if the subrecipient is subject to the requirements.
 - b. Is there a Cost Allocation Plan approved by the cognizant state agency? Secure a copy for the workpaper file.
 - c. Is the required Policy 03 report being filed. Test for accuracy (supported by accounting records) and timeliness.
 - d. Are administrative costs being allocated according to the approved plan?

NA	Initials	WP Reference

Summarize the results of the Reporting testwork.

The objective of these tests is to identify and test compliance provisions specific to the type program being reviewed. Testwork for this core area may be included with Section I for Activities Allowed or Unallowed. Additional testwork may be performed under this section as needed.

XIII. SPECIAL TESTS AND PROVISIONS

1. Design tests for specific grant requirements that are not included in the above testing.

2. Specific Contract Requirements:
 - a. Subcontracting – Section D.5 of most contracts set forth specific rules regarding subcontracting the service. Was state agency approval secured and does the subcontract(s) contain the required clauses?

 - b. Public Accountability – Section D.9 of most contracts requires posting of the Comptroller’s hotline number. Is this posted?

 - c. Public Notice – Section D.10 of most contracts requires that specific language be included on public notices. Do notice, pamphlets, press releases, etc. include the required language?

NA	Initials	WP Reference

Summarize the results of the Special Tests and Provision(s) testwork.

The objective of the test of Title VI is to provide assurance that policies and actions taken by the subrecipient do not exclude any person from employment or participation in the program based on the grounds of race, color, or national origin.

XIV. Title VI

1. Assess Title VI compliance for the subrecipient contracts being monitored. Some state agencies may have unique requirements.
2. Design and test attributes to ensure compliance requirements are met.
3. Document testwork performed.

NA	Initials	WP Reference

Summarize the results of the Title VI testwork.

Attachment C: Conflict of Interest and Confidentiality Statement

AGENCY: _____

LOCATION: _____

PERIOD REVIEWED: _____

All staff should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. All staff members should be independent in fact and appearance, to the extent possible, when conducting monitoring on behalf of their agency.

- Objectivity is a state of mind, a quality that lends value to a member's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair staff's objectivity in conducting monitoring.
- Staff should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.
- Staff should be independent in fact and appearance.

Strict standards of confidentiality of records and information shall be maintained in accordance with applicable state and federal law. All material and information, regardless of form, medium or method of communication, provided to the State or acquired by the State shall be regarded as confidential information in accordance with the provisions of applicable state and federal law, state and federal rules and regulations, departmental policy and ethical standards.

I, the undersigned, hereby acknowledge that I am independent in all matters relating to this monitoring review. I certify that my participation in this monitoring review is free from any external impairments to my independence, that I am organizationally independent, and that I have an independent mental attitude. I certify that confidential information shall not be disclosed, and all necessary steps shall be taken to safeguard the confidentiality of such material or information in conformance with applicable state and federal law, state and federal rules and regulations, departmental policy and ethical standards.

Monitor(s) _____

Attachment D: Title VI Compliance Commission Advisory Memorandum



Phil Bredesen
GOVERNOR

STATE OF TENNESSEE
DEPARTMENT OF PERSONNEL
FIRST FLOOR, JAMES K. POLK BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-0635
(615) 741-2958

Randy C. Camp
COMMISSIONER

MEMORANDUM

TO: All State Agencies

FROM: Tennessee Title VI Compliance Commission

DATE: April 14, 2004

RE: **Tennessee Title VI Compliance Commission
Advisory Memorandum No.3**

As you know, the Tennessee Title VI Compliance Commission (the "Commission") was established in August 2002 by Executive Order No. 34. Title VI of the Civil Rights Act of 1964 provides as follows:

No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.

See also Tenn. Code Ann. § 4-21-904. Pursuant to Executive Order No. 34, it is the policy of the State of Tennessee to comply with Title VI, to prohibit discrimination, and to avoid the loss of federal funding. As one of many steps towards ensuring full compliance with Title VI by the State of Tennessee, the Commission is issuing this Advisory Memorandum.

Most state agencies administer continuing programs subject to Title VI and must take affirmative steps to monitor the compliance efforts of their sub-recipients. With the foregoing in mind, we advise you of the following.

I. Oversight and Monitoring of Continuing State Programs

When a state agency is given discretionary authority by a federal agency to dispense assistance to sub-recipients, said state agency must have an effective and verifiable oversight and monitoring program in place to monitor its sub recipient's compliance with Title VI. The state agency's method of administration should, as a minimum, include the following:

- [1] A public outreach and education program to inform sub-recipients of their compliance responsibilities.
- [2] A training program for sub-recipients regarding Title VI compliance requirements.
- [3] Consistent procedures for responding to complaints and notifying beneficiaries of their rights under Title VI.
- [4] Compliance review procedures to assess and measure whether a sub-recipient is meeting the requirements of Title VI [more than a self-survey and/or a checklist of activities].
- [5] Collect racial and ethnic [include National Origin] data on each sub-recipient's program.
- [6] Procedures for effective and verifiable pre-award and post-award evaluation of sub-recipient's compliance programs.

II. Data Collection and Analysis

Data collection and analyses is an essential, critical component of a Title VI implementation strategy. It is impossible to measure the success of your Title VI program without knowing the makeup of potential and actual participants and beneficiaries, the racial makeup of the affected communities, and the racial and ethnic makeup of staff administering federal assisted programs and activities. Each state agency should develop and maintain a database of program participants and beneficiaries.

Demographic information relative to program administration staff should be evaluated and studied to determine whether there is a causal nexus employment discrimination against beneficiaries. Language addressing this issue can be found in the "Title VI Legal Manual" published by the U. S. Department of Justice, Civil Rights Division," which provides:

In regard to Federal financial assistance which does not have providing employment as a primary objective, the provisions of paragraph [c] [1] [prohibitions where objective is employment] apply to the employment practices of the recipient if discrimination on the grounds of race, color, national origin in such employment practices tends, on the grounds of race, color or national origin, to exclude persons from participation in, to deny them the benefits of or be

subject them to discrimination under the program receiving Federal financial assistance. In any case, the provisions of paragraph [c] [1] of this section shall apply to the extent necessary to assure equality of opportunity to and nondiscriminatory treatment of beneficiaries.

The Commission hereby urges state agencies to collect employment data on their sub-recipients to improve their ability to effectively monitor their sub-recipient's efforts to comply with Title VI.

The "Guidelines for the Enforcement of Title VI, Civil Rights Act of 1964," allow state agency recipients to defer decisions on sub-recipient applications for assistance. Moreover, said guidelines provide that "it is legal permissible temporarily to defer action on an application for assistance, pending initiation and completion of [statutory remedial] procedures—including attempts to secure voluntary compliance with Title VI." State agencies can adopt a flexible case by case approach to determine when deferral is appropriate. When a decision is made to defer approval of a sub-recipient's application for assistance, the state agency should, without delay, seek a voluntary resolution and, if no settlement is reached, refuse to award assistance.

Over and above the matters set forth in this Advisory Memorandum, it is the responsibility of your agency to know, understand and comply with all of the requirements, and prohibitions, arising from Title VI and its regulations. The Commission stands ready to assist in the same.

Your assistance in ensuring that the State of Tennessee complies in all respects with Title VI is greatly appreciated. If you have any questions or require any assistance, please contact me at (615) 244-9270 or John Birdsong, Director of the Tennessee Title VI Compliance Commission, at (615) 253-6717. Any written correspondence to the Commission should be directed as follows:

John Birdsong, Director
Tennessee Title VI Compliance Commission
Tennessee Department of Personnel
First Floor, James K. Polk Building
505 Deaderick Street
Nashville, Tennessee 37243-0635
John.Birdsong@state.tn.us

Attachment E: Internal Control Questionnaire

AGENCY INFORMATION SUMMARY

Subrecipient Name _____

Street Address _____ Phone Number _____

City, State, Zip _____ Federal ID (FEIN) _____

Executive Director _____

Fiscal Director/Accountant _____ Phone Number _____

List sources and estimated contract/grant budget of federal and/or state funds your agency contracts/grants for the current fiscal year.

State Agency	Program	Grant Amount

How many years in business? Less than 3 Over 5

How long has agency been contracting with the state? Less than 3 Over 5

How many programs are operated by the agency? 1-2 3-5 Over 5

Do you have a copy of the *Accounting and Financial Reporting Manual for Not-For-Profit Recipients of Grant Funds In Tennessee*? Yes No

Date of last independent audit: _____

Name of CPA firm/ Audit unit _____ Phone Number _____

EXISTENCE OF ACCOUNTING RECORDS:

	<u>Yes</u>	<u>No</u>	<u>Comment</u>
1. Is there a cash receipts journal?	<input type="checkbox"/>	<input type="checkbox"/>	_____
2. Is there a cash disbursement journal?	<input type="checkbox"/>	<input type="checkbox"/>	_____
3. Is there a general ledger?	<input type="checkbox"/>	<input type="checkbox"/>	_____
4. Is documentation adequate to provide audit trail to/from original source documentation to the books of account?	<input type="checkbox"/>	<input type="checkbox"/>	_____
5. Is the general ledger maintained in a manner that provides ease in the preparation of required reports?	<input type="checkbox"/>	<input type="checkbox"/>	_____
6. Are revenues and expenditures classified in the books of account in the same categories included in the budget?	<input type="checkbox"/>	<input type="checkbox"/>	_____
7. If not, are reports linked to the books by worksheets?	<input type="checkbox"/>	<input type="checkbox"/>	_____
8. Are bank accounts reconciled monthly?	<input type="checkbox"/>	<input type="checkbox"/>	_____
9. Are internal control procedures documented? i.e. separation of duties, approvals, etc.?	<input type="checkbox"/>	<input type="checkbox"/>	_____
10. Is there a comparison of budget to actual expenditures?	<input type="checkbox"/>	<input type="checkbox"/>	_____
11. Is there an approved cost allocation plan for allocating indirect cost to grant programs?	<input type="checkbox"/>	<input type="checkbox"/>	_____
12. If so, does the allocation process seem appropriate?	<input type="checkbox"/>	<input type="checkbox"/>	_____

METHOD FOR DRAWING FUNDS

	<u>Yes</u>	<u>No</u>	<u>Comment</u>
1. Are funds requested based on actual cost?	<input type="checkbox"/>	<input type="checkbox"/>	_____
2. Does the state disburse funds to your agency based on a spending plan?	<input type="checkbox"/>	<input type="checkbox"/>	_____
3. Are there times when excess cash is on hand?	<input type="checkbox"/>	<input type="checkbox"/>	_____

VENDOR PAYMENTS

1. Is there approval for payment of invoices prior to payment- actually being made?	<input type="checkbox"/>	<input type="checkbox"/>	_____
2. Is the approval evidenced by an initial on the face of the invoice?	<input type="checkbox"/>	<input type="checkbox"/>	_____
3. Are Invoices cancelled when paid?	<input type="checkbox"/>	<input type="checkbox"/>	_____
4. Are invoices coded with account codes to facilitate tracing through, the accounting records?	<input type="checkbox"/>	<input type="checkbox"/>	_____
5. Are payments ever made based on a statement of account?	<input type="checkbox"/>	<input type="checkbox"/>	_____
6. Are documents supporting payments filed in such a way as to be readily located?	<input type="checkbox"/>	<input type="checkbox"/>	_____
7. Are expenditures made within the time restraints of the grant and charged to the correct accounting period?	<input type="checkbox"/>	<input type="checkbox"/>	_____
8. Are purchase orders used?	<input type="checkbox"/>	<input type="checkbox"/>	_____
9. If so, are expenditures supported by an approved purchase order?	<input type="checkbox"/>	<input type="checkbox"/>	_____
10. Are all contracts in writing?	<input type="checkbox"/>	<input type="checkbox"/>	_____
11. Are expenditures in compliance with applicable cost principles?	<input type="checkbox"/>	<input type="checkbox"/>	_____
12. Is prior approval by the grantor being obtained when required?	<input type="checkbox"/>	<input type="checkbox"/>	_____

TRAVEL

	<u>Yes</u>	<u>No</u>	<u>Comment</u>
1. Are expenditures charged to travel supported by a travel claim?	<input type="checkbox"/>	<input type="checkbox"/>	_____
2. What is the rate used to reimburse mileage?			_____

TIME AND ATTENDANCE RECORDS

1. Are salaries/wages supported by time and attendance records?	<input type="checkbox"/>	<input type="checkbox"/>	_____
2. Are all the leave types addressed in the personnel policies?	<input type="checkbox"/>	<input type="checkbox"/>	_____
3. Are all fringe benefits, except those required by law, addressed in the personnel policies?	<input type="checkbox"/>	<input type="checkbox"/>	_____

PROCUREMENT POLICIES

1. Are there written procurement policies?	<input type="checkbox"/>	<input type="checkbox"/>	_____
2. Will adherence to the policies in your judgement result in obtaining the best quality of service or product at the best price?	<input type="checkbox"/>	<input type="checkbox"/>	_____

MATCHING SHARE DOCUMENTATION

1. Is match required and if so, is the match?	<input type="checkbox"/>	<input type="checkbox"/>	_____
1.1. Cash	<input type="checkbox"/>	<input type="checkbox"/>	_____
1.2. In-kind	<input type="checkbox"/>	<input type="checkbox"/>	_____
2. Is the source of match other than another federal or state source?	<input type="checkbox"/>	<input type="checkbox"/>	_____
3. If not, has the source been approved?	<input type="checkbox"/>	<input type="checkbox"/>	_____
4. Do the accounting records adequately reflect that required match is expended according to the same criteria as the grant/contract funds being matched?	<input type="checkbox"/>	<input type="checkbox"/>	_____

	<u>Yes</u>	<u>No</u>	<u>Comment</u>
5. Are there in-kind revenues and expenditures recorded in the accounting records?	<input type="checkbox"/>	<input type="checkbox"/>	_____
5.1. If yes, is there adequate documentation to value	<input type="checkbox"/>	<input type="checkbox"/>	_____
5.1.1. Services (time and attendance records, pay rate used, etc.)	<input type="checkbox"/>	<input type="checkbox"/>	_____
5.1.2. Goods (Basis of evaluation)	<input type="checkbox"/>	<input type="checkbox"/>	_____
5.1.3. Space (Rental comparisons, etc.)	<input type="checkbox"/>	<input type="checkbox"/>	_____

LISTING OF PERSONS PERFORMING VARIOUS FUNCTIONS

ACTION

NAME & TITLE

APPROVES:

1. Invoices and Vouchers for payment _____
2. Journal Entries _____
3. Personnel Actions _____
4. Replenishment of Petty Cash Fund _____
5. Petty Cash Vouchers _____
6. Purchase Orders _____
7. Employee Timesheets _____
8. Capital Expenditures _____

SIGNS:

1. Checks _____
2. Receiving Documents _____

REVIEWS TIMESHEETS _____

CERTIFIES PAYROLLS FOR:

1. Accuracy _____
2. Authenticity of payee _____

PREPARES PERSONNEL ACTIONS _____

DISTRIBUTES PAYROLL CHECKS _____

OPENS:

1. Mail _____
2. Bank Statements _____

LISTING OF PERSONS PERFORMING VARIOUS FUNCTIONS

ACTION

NAME & TITLE

PREPARES:

1. Daily Receipt Log _____
2. Daily Bank Deposit _____
3. Bank Reconciliation _____

MAKES BANK DEPOSIT _____

CUSTODIAN OF:

1. Blank Checks _____
2. Mechanical Check Signer _____
3. Undelivered Checks _____
4. Petty Cash _____

RECORDING OF TRANSACTIONS:

1. Leave transactions to employee records _____
2. Transactions to Cash Receipts Journal _____
3. Transactions to Cash Disbursements Journal _____
4. Transactions to General Journal _____
5. Transactions to the General Ledger _____

PREPARES TRIAL BALANCE _____

MAINTAINS:

1. Equipment records _____
2. Supplies Inventory records _____
3. Employee Personnel Files _____

LISTING OF PERSONS PERFORMING VARIOUS FUNCTIONS

ACTION

NAME & TITLE

MAKES SURPRISE COUNTS OF:

1. Equipment _____
2. Petty Cash _____
3. Supplies Inventory _____

GENERAL OPERATIONAL INFORMATION:

Yes No

1. Has there been any change in structure/operations of your programs?
If yes, please describe in detail.

2. Has there been a staff turnover in key positions?
If yes, what are the affected positions and reasons for the turnover?

3. Do you have written policies and procedure manual?
If yes, does it address the civil rights issues?

4. How do you to ensure that minorities of knowledgeable about your services?

5. What kinds of accommodations are made to better serve the disabled?

6. When did you last conduct civil rights training for your staff? ____/____/____

Comments.

7. Has there been any client grievances filed against you?
If yes, what were the nature of the grievances, dates and other pertinent information?

Yes No

8. Has there been any client incidents or runaways at your agency?
If yes, what were the nature incidents/runaways, dates and other pertinent information?

9. Are you licensed?
If yes, has there been any change in the license status recently?

10. Are you accredited by any organization?
If yes, has there been any change in the accreditation recently?

11. Do you operate your own school?
If yes, what were the nature incidents/runaways, dates and other pertinent information?

12. Do you operate any satellite sites?
13. How many locations do you operate? _____
14. Is the management of the satellite offices decentralized or centralized?
15. Describe procedures for safeguarding confidential information.

Other Comments:

I hereby certify that the information reported is true and correct to the best of my knowledge and belief.

Signature of Executive Director

Date signed

Attachment F: Summary of Findings Template (Example)

The following chart highlights those core areas in which findings were the most prevalent during FY 2004. The absence of an “X” does not indicate zero findings in that area, it simply indicates that it was not considered to be a “trouble spot”.

Core Areas Reviewed*	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	XIII	XIV	Total Core Areas Per Program
Program 1	X		X	X											3
Program 2	X														1
Program 3	X		X								X		X		4
Program 4			X										X		2
Program 5															0
Program 6	X	X	X	X							X		X		6
Total Programs Per Core Area FY '04	4	1	4	2	0	0	0	0	0	0	2	0	3	0	

Total Number and Dollar Value of Contracts Monitored During FY 2004:

Total Subrecipient Contract Population	100
Number of Contracts Reviewed	38
Dollar Value of Subrecipient Contract Population	\$1,500,000
Dollar Value of Subrecipient Contracts Reviewed	\$1,000,000

*Core Areas

- | | |
|--|---|
| I. Activities Allowed or Unallowed | VIII. Period of Availability of Funds |
| II. Allowable Costs/Cost Principles | IX. Procurement, Suspension and Debarment |
| III. Cash Management | X. Program Income |
| IV. Davis-Bacon Act | XI. Real Property Acquisition and Relocation Assistance |
| V. Eligibility | XII. Reporting |
| VI. Equipment and Real Property Management | XIII. Special Tests and Provisions |
| VII. Matching, Level of Effort, Earmarking | XIV. Title VI |

Attachment G: Circular A-133

Revised to show changes published in the
Federal Register June 27, 2003

Audits of States, Local Governments, and Non-Profit Organizations

Accompanying *Federal Register* Materials:

- Audits of States, Local Governments, and Non-Profit Organizations
June 30, 1997
- Revision published June 27, 2003

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Audits of States, Local Governments, and Non-Profit Organizations

1. **Purpose.** This Circular is issued pursuant to the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156. It sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of States, local governments, and non-profit organizations expending Federal awards.

2. **Authority.** Circular A-133 is issued under the authority of sections 503, 1111, and 7501 *et seq.* of title 31, United States Code, and Executive Orders 8248 and 11541.

3. **Rescission and Supersession.** This Circular rescinds Circular A-128, "Audits of State and Local Governments," issued April 12, 1985, and supersedes the prior Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions," issued April 22, 1996. For effective dates, see paragraph 10.

4. **Policy.** Except as provided herein, the standards set forth in this Circular shall be applied by all Federal agencies. If any statute specifically prescribes policies or specific requirements that differ from the standards provided herein, the provisions of the subsequent statute shall govern.

Federal agencies shall apply the provisions of the sections of this Circular to non-Federal entities, whether they are recipients expending Federal awards received directly from Federal awarding agencies, or are subrecipients expending Federal awards received from a pass-through entity (a recipient or another subrecipient).

This Circular does not apply to non-U.S. based entities expending Federal awards received either directly as a recipient or indirectly as a subrecipient.

5. **Definitions.** The definitions of key terms used in this Circular are contained in §____.105 in the Attachment to this Circular.

6. **Required Action.** The specific requirements and responsibilities of Federal agencies and non-Federal entities are set forth in the Attachment to this Circular. Federal agencies making awards to non-Federal entities, either directly or indirectly, shall adopt the language in the Circular in codified regulations as provided in Section 10 (below), unless different

provisions are required by Federal statute or are approved by the Office of Management and Budget (OMB).

7. **OMB Responsibilities.** OMB will review Federal agency regulations and implementation of this Circular, and will provide interpretations of policy requirements and assistance to ensure uniform, effective and efficient implementation.

8. **Information Contact.** Further information concerning Circular A-133 may be obtained by contacting the Financial Standards and Reporting Branch, Office of Federal Financial Management, Office of Management and Budget, Washington, DC 20503, telephone (202) 395-3993.

9. **Review Date.** This Circular will have a policy review three years from the date of issuance.

10. **Effective Dates.** The standards set forth in §____.400 of the Attachment to this Circular, which apply directly to Federal agencies, shall be effective July 1, 1996, and shall apply to audits of fiscal years beginning after June 30, 1996, except as otherwise specified in §____.400(a).

The standards set forth in this Circular that Federal agencies shall apply to non-Federal entities shall be adopted by Federal agencies in codified regulations not later than 60 days after publication of this final revision in the **Federal Register**, so that they will apply to audits of fiscal years beginning after June 30, 1996, with the exception that §____.305(b) of the Attachment applies to audits of fiscal years beginning after June 30, 1998. The requirements of Circular A-128, although the Circular is rescinded, and the 1990 version of Circular A-133 remain in effect for audits of fiscal years beginning on or before June 30, 1996.

The revisions published in the *Federal Register* June 27, 2003, are effective for fiscal years ending after December 31, 2003, and early implementation is not permitted with the exception of the definition of *oversight agency for audit*, which is effective July 28, 2003.

/S/
Augustine T. Smythe
Acting Director

Attachment

PART__ --AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS

Subpart A--General

Sec.

____.100 Purpose.

____.105 Definitions.

Subpart B--Audits

- ___ .200 Audit requirements.
- ___ .205 Basis for determining Federal awards expended.
- ___ .210 Subrecipient and vendor determinations.
- ___ .215 Relation to other audit requirements.
- ___ .220 Frequency of audits.
- ___ .225 Sanctions.
- ___ .230 Audit costs.
- ___ .235 Program-specific audits.

Subpart C--Auditees

- ___ .300 Auditee responsibilities.
- ___ .305 Auditor selection.
- ___ .310 Financial statements.
- ___ .315 Audit findings follow-up.
- ___ .320 Report submission.

Subpart D--Federal Agencies and Pass-Through Entities

- ___ .400 Responsibilities.
- ___ .405 Management decision.

Subpart E--Auditors

- ___ .500 Scope of audit.
- ___ .505 Audit reporting.
- ___ .510 Audit findings.
- ___ .515 Audit working papers.
- ___ .520 Major program determination.
- ___ .525 Criteria for Federal program risk.
- ___ .530 Criteria for a low-risk auditee.

Subpart A--General

§ ___ .100 Purpose.

This part sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards.

§ ___ .105 Definitions.

Auditee means any non-Federal entity that expends Federal awards which must be audited under this part. **Auditor** means an auditor, that is a public accountant or a Federal, State or local government audit organization, which meets the general standards specified in generally accepted government auditing standards (GAGAS). The term **auditor** does not include internal auditors of non-profit organizations.

Audit finding means deficiencies which the auditor is required by § ___ .510(a) to report in the schedule of findings and questioned costs.

CFDA number means the number assigned to a Federal program in the **Catalog of Federal Domestic Assistance** (CFDA).

Cluster of programs means a grouping of closely related programs that share common compliance requirements. The types of clusters of programs are research and development (R&D), student financial aid (SFA), and other clusters. "Other clusters" are as defined by the Office of Management and Budget (OMB) in the compliance supplement or as designated by a State for Federal awards the State provides to its subrecipients that meet the definition of a cluster of programs. When designating an "other cluster," a State shall identify the Federal awards included in the cluster and advise the subrecipients of compliance requirements applicable to the cluster, consistent with §____.400(d)(1) and §____.400(d)(2), respectively. A cluster of programs shall be considered as one program for determining major programs, as described in §____.520, and, with the exception of R&D as described in §____.200(c), whether a program-specific audit may be elected.

Cognizant agency for audit means the Federal agency designated to carry out the responsibilities described in §____.400(a).

Compliance supplement refers to the **Circular A-133 Compliance Supplement**, included as Appendix B to Circular A-133, or such documents as OMB or its designee may issue to replace it. This document is available from the Government Printing Office, Superintendent of Documents, Washington, DC 20402-9325.

Corrective action means action taken by the auditee that:

- (1) Corrects identified deficiencies;
- (2) Produces recommended improvements; or
- (3) Demonstrates that audit findings are either invalid or do not warrant auditee action.

Federal agency has the same meaning as the term **agency** in Section 551(1) of title 5, United States Code.

Federal award means Federal financial assistance and Federal cost-reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies or indirectly from pass-through entities. It does not include procurement contracts, under grants or contracts, used to buy goods or services from vendors. Any audits of such vendors shall be covered by the terms and conditions of the contract. Contracts to operate Federal Government owned, contractor operated facilities (GOCOs) are excluded from the requirements of this part.

Federal awarding agency means the Federal agency that provides an award directly to the recipient.

Federal financial assistance means assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance, but does not include amounts received as reimbursement for services rendered to individuals as described in §____.205(h) and §____.205(i).

Federal program means:

- (1) All Federal awards to a non-Federal entity assigned a single number in the CFDA.
- (2) When no CFDA number is assigned, all Federal awards from the same agency made for the same purpose should be combined and considered one program.
- (3) Notwithstanding paragraphs **(1)** and **(2)** of this definition, a cluster of programs. The types of clusters of programs are:
 - (i) Research and development (R&D);
 - (ii) Student financial aid (SFA); and
 - (iii) "Other clusters," as described in the definition of cluster of programs in this section.

GAGAS means generally accepted government auditing standards issued by the Comptroller General of the United States, which are applicable to financial audits.

Generally accepted accounting principles has the meaning specified in generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA).

Indian tribe means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporation (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

Internal control means a process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- (1) Effectiveness and efficiency of operations;
- (2) Reliability of financial reporting; and
- (3) Compliance with applicable laws and regulations.

Internal control pertaining to the compliance requirements for Federal programs (Internal control over Federal programs) means a process--effected by an entity's management and other personnel--designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs:

- (1) Transactions are properly recorded and accounted for to:
 - (i) Permit the preparation of reliable financial statements and Federal reports;
 - (ii) Maintain accountability over assets; and

(iii) Demonstrate compliance with laws, regulations, and other compliance requirements;

(2) Transactions are executed in compliance with:

(i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and

(ii) Any other laws and regulations that are identified in the compliance supplement; and

(3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

Loan means a Federal loan or loan guarantee received or administered by a non-Federal entity.

Local government means any unit of local government within a State, including a county, borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of governments, and any other instrumentality of local government.

Major program means a Federal program determined by the auditor to be a major program in accordance with §____.520 or a program identified as a major program by a Federal agency or pass-through entity in accordance with §____.215(c).

Management decision means the evaluation by the Federal awarding agency or pass-through entity of the audit findings and corrective action plan and the issuance of a written decision as to what corrective action is necessary.

Non-Federal entity means a State, local government, or non-profit organization.

Non-profit organization means:

(1) any corporation, trust, association, cooperative, or other organization that:

(i) Is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;

(ii) Is not organized primarily for profit; and

(iii) Uses its net proceeds to maintain, improve, or expand its operations; and

(2) The term **non-profit organization** includes non-profit institutions of higher education and hospitals.

OMB means the Executive Office of the President, Office of Management and Budget.

Oversight agency for audit means the Federal awarding agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency

for audit. When there is no direct funding, the Federal agency with the predominant indirect funding shall assume the oversight responsibilities. The duties of the oversight agency for audit are described in §____.400(b).

Effective July 28, 2003, the following is added to this definition:

A Federal agency with oversight for an auditee may reassign oversight to another Federal agency which provides substantial funding and agrees to be the oversight agency for audit. Within 30 days after any reassignment, both the old and the new oversight agency for audit shall notify the auditee, and, if known, the auditor of the reassignment.

Pass-through entity means a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.

Program-specific audit means an audit of one Federal program as provided for in §____.200(c) and §____.235.

Questioned cost means a cost that is questioned by the auditor because of an audit finding:

(1) Which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds;

(2) Where the costs, at the time of the audit, are not supported by adequate documentation; or

(3) Where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

Recipient means a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program.

Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-Federal entity. **Research** is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. The term research also includes activities involving the training of individuals in research techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function. **Development** is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

Single audit means an audit which includes both the entity's financial statements and the Federal awards as described in §____.500.

State means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, any multi-State, regional, or interstate entity which has governmental functions, and any Indian tribe as defined in this section.

Student Financial Aid (SFA) includes those programs of general student assistance, such as those authorized by Title IV of the Higher Education Act of 1965, as amended, (20 U.S.C. 1070 **et seq.**) which is administered by the U.S. Department of Education, and similar programs provided by other Federal agencies. It does not include programs which provide fellowships or similar Federal awards to students on a competitive basis, or for specified studies or research.

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. A subrecipient may also be a recipient of other Federal awards directly from a Federal awarding agency. Guidance on distinguishing between a subrecipient and a vendor is provided in **§____.210**.

Types of compliance requirements refers to the types of compliance requirements listed in the compliance supplement. Examples include: activities allowed or unallowed; allowable costs/cost principles; cash management; eligibility; matching, level of effort, earmarking; and, reporting.

Vendor means a dealer, distributor, merchant, or other seller providing goods or services that are required for the conduct of a Federal program. These goods or services may be for an organization's own use or for the use of beneficiaries of the Federal program. Additional guidance on distinguishing between a subrecipient and a vendor is provided in **§____.210**.

Subpart B--Audits

§____.200 Audit requirements.

(a) **Audit required.** Non-Federal entities that expend \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in **§____.205**.

(b) **Single audit.** Non-Federal entities that expend \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) or more in a year in Federal awards shall have a single audit conducted in accordance with **§____.500** except when they elect to have a program-specific audit conducted in accordance with paragraph (c) of this section.

(c) **Program-specific audit election.** When an auditee expends Federal awards under only one Federal program (excluding R&D) 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 conducted in accordance with **§____.235**. A program-specific audit may not be elected for R&D 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.

(d) **Exemption when Federal awards expended are less than \$300,000 (\$500,000 for fiscal years ending after December 31, 2003).** Non-Federal entities that expend less than \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) a year in Federal awards are exempt from Federal audit requirements for that year, except as noted in §____.215(a), but records must be available for review or audit by appropriate officials of the Federal agency, pass-through entity, and General Accounting Office (GAO).

(e) **Federally Funded Research and Development Centers (FFRDC).** Management of an auditee that owns or operates a FFRDC may elect to treat the FFRDC as a separate entity for purposes of this part.

§____.205 Basis for determining Federal awards expended.

(a) **Determining Federal awards expended.** The determination of when an award is expended should be based on when the activity related to the award occurs. Generally, the activity pertains to events that require the non-Federal entity to comply with laws, regulations, and the provisions of contracts or grant agreements, such as: expenditure/expense transactions associated with grants, cost-reimbursement contracts, cooperative agreements, and direct appropriations; the disbursement of funds passed through to subrecipients; the use of loan proceeds under loan and loan guarantee programs; the receipt of property; the receipt of surplus property; the receipt or use of program income; the distribution or consumption of food commodities; the disbursement of amounts entitling the non-Federal entity to an interest subsidy; and, the period when insurance is in force.

(b) **Loan and loan guarantees (loans).** Since the Federal Government is at risk for loans until the debt is repaid, the following guidelines shall be used to calculate the value of Federal awards expended under loan programs, except as noted in paragraphs (c) and (d) of this section:

- (1) Value of new loans made or received during the fiscal year; plus
- (2) Balance of loans from previous years for which the Federal Government imposes continuing compliance requirements; plus
- (3) Any interest subsidy, cash, or administrative cost allowance received.

(c) **Loan and loan guarantees (loans) at institutions of higher education.** When loans are made to students of an institution of higher education but the institution does not make the loans, then only the value of loans made during the year shall be considered Federal awards expended in that year. The balance of loans for previous years is not included as Federal awards expended because the lender accounts for the prior balances.

(d) **Prior loan and loan guarantees (loans).** Loans, the proceeds of which were received and expended in prior-years, are not considered Federal awards expended under this part when the laws, regulations, and the provisions of contracts or grant agreements pertaining to such loans impose no continuing compliance requirements other than to repay the loans.

(e) **Endowment funds.** The cumulative balance of Federal awards for endowment funds which are federally restricted are considered awards expended in each year in which the funds are still restricted.

(f) **Free rent.** Free rent received by itself is not considered a Federal award expended under this part. However, free rent received as part of an award to carry out a Federal program shall be included in determining Federal awards expended and subject to audit under this part.

(g) **Valuing non-cash assistance.** Federal non-cash assistance, such as free rent, food stamps, food commodities, donated property, or donated surplus property, shall be valued at fair market value at the time of receipt or the assessed value provided by the Federal agency.

(h) **Medicare.** Medicare payments to a non-Federal entity for providing patient care services to Medicare eligible individuals are not considered Federal awards expended under this part.

(i) **Medicaid.** Medicaid payments to a subrecipient for providing patient care services to Medicaid eligible individuals are not considered Federal awards expended under this part unless a State requires the funds to be treated as Federal awards expended because reimbursement is on a cost-reimbursement basis.

(j) **Certain loans provided by the National Credit Union Administration.** For purposes of this part, loans made from the National Credit Union Share Insurance Fund and the Central Liquidity Facility that are funded by contributions from insured institutions are not considered Federal awards expended.

§____.210 Subrecipient and vendor determinations.

(a) **General.** An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered Federal awards. The guidance in paragraphs (b) and (c) of this section should be considered in determining whether payments constitute a Federal award or a payment for goods and services.

(b) **Federal award.** Characteristics indicative of a Federal award received by a subrecipient are when the organization:

- (1) Determines who is eligible to receive what Federal financial assistance;
- (2) Has its performance measured against whether the objectives of the Federal program are met;
- (3) Has responsibility for programmatic decision making;
- (4) Has responsibility for adherence to applicable Federal program compliance requirements; and
- (5) Uses the Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

(c) **Payment for goods and services.** Characteristics indicative of a payment for goods and services received by a vendor are when the organization:

- (1) Provides the goods and services within normal business operations;
- (2) Provides similar goods or services to many different purchasers;
- (3) Operates in a competitive environment;
- (4) Provides goods or services that are ancillary to the operation of the Federal program; and
- (5) Is not subject to compliance requirements of the Federal program.

(d) **Use of judgment in making determination.** There may be unusual circumstances or exceptions to the listed characteristics. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present and judgment should be used in determining whether an entity is a subrecipient or vendor.

(e) **For-profit subrecipient.** Since this part does not apply to for-profit subrecipients, the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients. The contract 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 contract, and post-award audits.

(f) **Compliance responsibility for vendors.** In most cases, the auditee's compliance responsibility for vendors is only to ensure that the procurement, receipt, and payment for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. Program compliance requirements normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine program compliance. Also, when these vendor transactions relate to a major program, the scope of the audit shall include determining whether these transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements.

§ ____.215 Relation to other audit requirements.

(a) **Audit under this part in lieu of other audits.** An audit made in accordance with this part shall be in lieu of any financial audit required under individual Federal awards. To the extent this audit meets a Federal agency's needs, it shall rely upon and use such audits. The provisions of this part neither limit the authority of Federal agencies, including their Inspectors General, or GAO to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor authorize any auditee to constrain Federal agencies from carrying out additional audits. Any additional audits shall be planned and performed in such a way as to build upon work performed by other auditors.

(b) **Federal agency to pay for additional audits.** A Federal agency that conducts or contracts for additional audits shall, consistent with other applicable laws and regulations, arrange for funding the full cost of such additional audits.

(c) **Request for a program to be audited as a major program.** A Federal agency may request an auditee to have a particular Federal program audited as a major program in lieu of the Federal agency conducting or arranging for the additional audits. To allow for planning, such requests should be made at least 180 days prior to the end of the fiscal year to be audited. The auditee, after consultation with its auditor, should promptly respond to such request by informing the Federal agency whether the program would otherwise be audited as a major program using the risk-based audit approach described in §____.520 and, if not, the estimated incremental cost. The Federal agency shall then promptly confirm to the auditee whether it wants the program audited as a major program. If the program is to be audited as a major program based upon this Federal agency request, and the Federal agency agrees to pay the full incremental costs, then the auditee shall have the program audited as a major program. A pass-through entity may use the provisions of this paragraph for a subrecipient.

§____.220 Frequency of audits.

Except for the provisions for biennial audits provided in paragraphs (a) and (b) of this section, audits required by this part shall be performed annually. Any biennial audit shall cover both years within the biennial period.

(a) A State or local government that is required by constitution or statute, in effect on January 1, 1987, to undergo its audits less frequently than annually, is permitted to undergo its audits pursuant to this part biennially. This requirement must still be in effect for the biennial period under audit.

(b) Any non-profit organization that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, is permitted to undergo its audits pursuant to this part biennially.

§____.225 Sanctions.

No audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

(a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;

(b) Withholding or disallowing overhead costs;

(c) Suspending Federal awards until the audit is conducted; or

(d) Terminating the Federal award.

§____.230 Audit costs.

(a) **Allowable costs.** Unless prohibited by law, the cost of audits made in accordance with the provisions of this part are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, as determined in accordance with the provisions of applicable OMB cost principles circulars, the Federal Acquisition Regulation (FAR) (48 CFR parts 30 and 31), or other applicable cost principles or regulations.

(b) **Unallowable costs.** A non-Federal entity shall not charge the following to a Federal award:

(1) The cost of any audit under the Single Audit Act Amendments of 1996 (31 U.S.C. 7501 **et seq.**) not conducted in accordance with this part.

(2) The cost of auditing a non-Federal entity which has Federal awards expended of less than \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) per year and is thereby exempted under **§ ____.200(d)** from having an audit conducted under this part. However, this does not prohibit a pass-through entity from charging Federal awards for the cost of limited scope audits to monitor its subrecipients in accordance with **§ ____.400(d)(3)**, provided the subrecipient does not have a single audit. For purposes of this part, limited scope audits only include agreed-upon procedures engagements conducted in accordance with either the AICPA's generally accepted auditing standards or attestation standards, that are paid for and arranged by a pass-through entity and address only one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

§ ____.235 Program-specific audits.

(a) **Program-specific audit guide available.** In many cases, a program-specific audit guide will be available to provide specific guidance to the auditor with respect to internal control, compliance requirements, suggested audit procedures, and audit reporting requirements. The auditor should contact the Office of Inspector General of the Federal agency to determine whether such a guide is available. When a current program-specific audit guide is available, the auditor shall follow GAGAS and the guide when performing a program-specific audit.

(b) **Program-specific audit guide not available.** (1) When a program-specific audit guide is not available, the auditee and auditor shall have basically the same responsibilities for the Federal program as they would have for an audit of a major program in a single audit.

(2) The auditee shall prepare the financial statement(s) for the Federal program that includes, at a minimum, a schedule of expenditures of Federal awards for the program and notes that describe the significant accounting policies used in preparing the schedule, a summary schedule of prior audit findings consistent with the requirements of **§ ____.315(b)**, and a corrective action plan consistent with the requirements of **§ ____.315(c)**.

(3) The auditor shall:

(i) Perform an audit of the financial statement(s) for the Federal program in accordance with GAGAS;

(ii) Obtain an understanding of internal control and perform tests of internal control over the Federal program consistent with the requirements of §____.500(c) for a major program;

(iii) Perform procedures to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on the Federal program consistent with the requirements of §____.500(d) for a major program; and

(iv) Follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee, and report, 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 in accordance with the requirements of §____.500(e).

(4) The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:

(i) An opinion (or disclaimer of opinion) as to whether the financial statement(s) of the Federal program is presented fairly in all material respects in conformity with the stated accounting policies;

(ii) A report on internal control related to the Federal program, which shall describe the scope of testing of internal control and the results of the tests;

(iii) A report on compliance which includes an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on the Federal program; and

(iv) A schedule of findings and questioned costs for the Federal program that includes a summary of the auditor's results relative to the Federal program in a format consistent with §____.505(d)(1) and findings and questioned costs consistent with the requirements of §____.505(d)(3).

(c) Report submission for program-specific audits.

(1) The audit shall be completed and the reporting required by paragraph (c)(2) or (c)(3) of this section submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the Federal agency that provided the funding or a different period is specified in a program-specific audit guide. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the required reporting shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period, unless a different

period is specified in a program-specific audit guide.) Unless restricted by law or regulation, the auditee shall make report copies available for public inspection.

(2) When a program-specific audit guide is available, the auditee shall submit to the Federal clearinghouse designated by OMB the data collection form prepared in accordance with §____.320(b), as applicable to a program-specific audit, and the reporting required by the program-specific audit guide to be retained as an archival copy. Also, the auditee shall submit to the Federal awarding agency or pass-through entity the reporting required by the program-specific audit guide.

(3) When a program-specific audit guide is not available, the reporting package for a program-specific audit shall consist of the financial statement(s) of the Federal program, a summary schedule of prior audit findings, and a corrective action plan as described in paragraph (b)(2) of this section, and the auditor's report(s) described in paragraph (b)(4) of this section. The data collection form prepared in accordance with §____.320(b), as applicable to a program-specific audit, and one copy of this reporting package shall be submitted to the Federal clearinghouse designated by OMB to be retained as an archival copy. Also, when the schedule of findings and questioned costs disclosed audit findings or the summary schedule of prior audit findings reported the status of any audit findings, the auditee shall submit one copy of the reporting package to the Federal clearinghouse on behalf of the Federal awarding agency, or directly to the pass-through entity in the case of a subrecipient. Instead of submitting the reporting package to the pass-through entity, when a subrecipient is not required to submit a reporting package to the pass-through entity, the subrecipient shall provide written notification to the pass-through entity, consistent with the requirements of §____.320(e)(2). A subrecipient may submit a copy of the reporting package to the pass-through entity to comply with this notification requirement.

(d) **Other sections of this part may apply.** Program-specific audits are subject to §____.100 through §____.215(b), §____.220 through §____.230, §____.300 through §____.305, §____.315, §____.320(f) through §____.320(j), §____.400 through §____.405, §____.510 through §____.515, and other referenced provisions of this part unless contrary to the provisions of this section, a program-specific audit guide, or program laws and regulations.

Subpart C--Auditees

§____.300 Auditee responsibilities.

The auditee shall:

(a) Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

- (c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.
- (d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with §____.310.
- (e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by §____.320(a) are granted by the cognizant or oversight agency for audit, promptly notify the Federal clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.
- (f) Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with §____.315(b) and §____.315(c), respectively.

§____.305 Auditor selection.

- (a) **Auditor procurement.** In procuring audit services, auditees shall follow the procurement standards prescribed by the Grants Management Common Rule (hereinafter referred to as the "A-102 Common Rule") published March 11, 1988 and amended April 19, 1995 [insert appropriate CFR citation], Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations," or the FAR (48 CFR part 42), as applicable (OMB Circulars are available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503). Whenever possible, auditees shall make positive efforts to utilize small businesses, minority-owned firms, and women's business enterprises, in procuring audit services as stated in the A-102 Common Rule, OMB Circular A-110, or the FAR (48 CFR part 42), as applicable. In requesting proposals for audit services, the objectives and scope of the audit should be made clear. Factors to be considered in evaluating each proposal for audit services include the responsiveness to the request for proposal, relevant experience, availability of staff with professional qualifications and technical abilities, the results of external quality control reviews, and price.
- (b) **Restriction on auditor preparing indirect cost proposals.** An auditor who prepares the indirect cost proposal or cost allocation plan may not also be selected to perform the audit required by this part when the indirect costs recovered by the auditee during the prior year exceeded \$1 million. This restriction applies to the base year used in the preparation of the indirect cost proposal or cost allocation plan and any subsequent years in which the resulting indirect cost agreement or cost allocation plan is used to recover costs. To minimize any disruption in existing contracts for audit services, this paragraph applies to audits of fiscal years beginning after June 30, 1998.
- (c) **Use of Federal auditors.** Federal auditors may perform all or part of the work required under this part if they comply fully with the requirements of this part.

§____.310 Financial statements.

- (a) **Financial statements.** The auditee shall prepare financial statements that reflect its financial position, results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. The financial statements

shall be for the same organizational unit and fiscal year that is chosen to meet the requirements of this part. However, organization-wide financial statements may also include departments, agencies, and other organizational units that have separate audits in accordance with §____.500(a) and prepare separate financial statements.

(b) **Schedule of expenditures of Federal awards.** The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. While not required, the auditee may choose to provide information requested by Federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a Federal program has multiple award years, the auditee may list the amount of Federal awards expended for each award year separately. At a minimum, the schedule shall:

(1) List individual Federal programs by Federal agency. For Federal programs included in a cluster of programs, list individual Federal programs within a cluster of programs. For R&D, total Federal awards expended shall be shown either by individual award or by Federal agency and major subdivision within the Federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services.

(2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.

(3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.

(4) Include notes that describe the significant accounting policies used in preparing the schedule.

(5) To the extent practical, pass-through entities should identify in the schedule the total amount provided to subrecipients from each Federal program.

(6) Include, in either the schedule or a note to the schedule, the value of the Federal awards expended in the form of non-cash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end. While not required, it is preferable to present this information in the schedule.

§____.315 Audit findings follow-up.

(a) **General.** The auditee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the auditee shall prepare a summary schedule of prior audit findings. The auditee shall also prepare a corrective action plan for current year audit findings. The summary schedule of prior audit findings and the corrective action plan shall include the reference numbers the auditor assigns to audit findings under §____.510(c). Since the summary schedule may include audit findings from multiple years, it shall include the fiscal year in which the finding initially occurred.

(b) **Summary schedule of prior audit findings.** The summary schedule of prior audit findings shall report the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to Federal awards. The summary schedule shall also include audit findings reported in the prior audit's summary

schedule of prior audit findings except audit findings listed as corrected in accordance with paragraph **(b)(1)** of this section, or no longer valid or not warranting further action in accordance with paragraph **(b)(4)** of this section.

(1) When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.

(2) When audit findings were not corrected or were only partially corrected, the summary schedule shall describe the planned corrective action as well as any partial corrective action taken.

(3) When corrective action taken is significantly different from corrective action previously reported in a corrective action plan or in the Federal agency's or pass-through entity's management decision, the summary schedule shall provide an explanation.

(4) When the auditee believes the audit findings are no longer valid or do not warrant further action, the reasons for this position shall be described in the summary schedule. A valid reason for considering an audit finding as not warranting further action is that all of the following have occurred:

(i) Two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse;

(ii) The Federal agency or pass-through entity is not currently following up with the auditee on the audit finding; and

(iii) A management decision was not issued.

(c) **Corrective action plan.** At the completion of the audit, the auditee shall prepare a corrective action plan to address each audit finding included in the current year auditor's reports. The corrective action plan shall provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If the auditee does not agree with the audit findings or believes corrective action is not required, then the corrective action plan shall include an explanation and specific reasons.

§ ____.320 Report submission.

(a) **General.** The audit shall be completed and the data collection form described in paragraph **(b)** of this section and reporting package described in paragraph **(c)** of this section shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the data collection form and reporting package shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period.) Unless restricted by law or regulation, the auditee shall make copies available for public inspection.

(b) **Data Collection.** (1) The auditee shall submit a data collection form which states whether the audit was completed in accordance with this part and provides

information about the auditee, its Federal programs, and the results of the audit. The form shall be approved by OMB, available from the Federal clearinghouse designated by OMB, and include data elements similar to those presented in this paragraph. A senior level representative of the auditee (e.g., State controller, director of finance, chief executive officer, or chief financial officer) shall sign a statement to be included as part of the form certifying that: the auditee complied with the requirements of this part, the form was prepared in accordance with this part (and the instructions accompanying the form), and the information included in the form, in its entirety, are accurate and complete.

(2) The data collection form shall include the following data elements:

(i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

(ii) Where applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses.

(iii) A statement as to whether the audit disclosed any noncompliance which is material to the financial statements of the auditee.

(iv) Where applicable, a statement that reportable conditions in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses.

(v) The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

(vi) A list of the Federal awarding agencies which will receive a copy of the reporting package pursuant to **§____.320(d)(2)** of OMB Circular A-133.

(vii) A yes or no statement as to whether the auditee qualified as a low-risk auditee under **§____.530** of OMB Circular A-133.

(viii) The dollar threshold used to distinguish between Type A and Type B programs as defined in **§____.520(b)** of OMB Circular A-133.

(ix) The **Catalog of Federal Domestic Assistance** (CFDA) number for each Federal program, as applicable.

(x) The name of each Federal program and identification of each major program. Individual programs within a cluster of programs should be listed in the same level of detail as they are listed in the schedule of expenditures of Federal awards.

(xi) The amount of expenditures in the schedule of expenditures of Federal awards associated with each Federal program.

(xii) For each Federal program, a yes or no statement as to whether there are audit findings in each of the following types of compliance requirements and the total amount of any questioned costs:

- (A) Activities allowed or unallowed.
- (B) Allowable costs/cost principles.
- (C) Cash management.
- (D) Davis-Bacon Act.
- (E) Eligibility.
- (F) Equipment and real property management.
- (G) Matching, level of effort, earmarking.
- (H) Period of availability of Federal funds.
- (I) Procurement and suspension and debarment.
- (J) Program income.
- (K) Real property acquisition and relocation assistance.
- (L) Reporting.
- (M) Subrecipient monitoring.
- (N) Special tests and provisions.

(xiii) Auditee Name, Employer Identification Number(s), Name and Title of Certifying Official, Telephone Number, Signature, and Date.

(xiv) Auditor Name, Name and Title of Contact Person, Auditor Address, Auditor Telephone Number, Signature, and Date.

(xv) Whether the auditee has either a cognizant or oversight agency for audit.

(xvi) The name of the cognizant or oversight agency for audit determined in accordance with §____.400(a) and §____.400(b), respectively.

(3) Using the information included in the reporting package described in paragraph (c) of this section, the auditor shall complete the applicable sections of the form. The auditor shall sign a statement to be included as part of the data collection form that indicates, at a minimum, the source of the information included in the form, the auditor's responsibility for the information, that the form is not a substitute for the

reporting package described in paragraph (c) of this section, and that the content of the form is limited to the data elements prescribed by OMB.

(c) **Reporting package.** The reporting package shall include the:

- (1) Financial statements and schedule of expenditures of Federal awards discussed in §____.310(a) and §____.310(b), respectively;
- (2) Summary schedule of prior audit findings discussed in §____.315(b);
- (3) Auditor's report(s) discussed in §____.505; and
- (4) Corrective action plan discussed in §____.315(c).

(d) **Submission to clearinghouse.** All auditees shall submit to the Federal clearinghouse designated by OMB the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section for:

- (1) The Federal clearinghouse to retain as an archival copy; and
- (2) Each Federal awarding agency when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the Federal awarding agency provided directly or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the Federal awarding agency provided directly.

(e) **Additional submission by subrecipients.** (1) In addition to the requirements discussed in paragraph (d) of this section, auditees that are also subrecipients shall submit to each pass-through entity one copy of the reporting package described in paragraph (c) of this section for each pass-through entity when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the pass-through entity provided or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the pass-through entity provided.

(2) Instead of submitting the reporting package to a pass-through entity, when a subrecipient is not required to submit a reporting package to a pass-through entity pursuant to paragraph (e)(1) of this section, the subrecipient shall provide written notification to the pass-through entity that: an audit of the subrecipient was conducted in accordance with this part (including the period covered by the audit and the name, amount, and CFDA number of the Federal award(s) provided by the pass-through entity); the schedule of findings and questioned costs disclosed no audit findings relating to the Federal award(s) that the pass-through entity provided; and, the summary schedule of prior audit findings did not report on the status of any audit findings relating to the Federal award(s) that the pass-through entity provided. A subrecipient may submit a copy of the reporting package described in paragraph (c) of this section to a pass-through entity to comply with this notification requirement.

(f) **Requests for report copies.** In response to requests by a Federal agency or pass-through entity, auditees shall submit the appropriate copies of the reporting

package described in paragraph (c) of this section and, if requested, a copy of any management letters issued by the auditor.

(g) **Report retention requirements.** Auditees shall keep one copy of the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section on file for three years from the date of submission to the Federal clearinghouse designated by OMB. Pass-through entities shall keep subrecipients' submissions on file for three years from date of receipt.

(h) **Clearinghouse responsibilities.** The Federal clearinghouse designated by OMB shall distribute the reporting packages received in accordance with paragraph (d)(2) of this section and § ____.235(c)(3) to applicable Federal awarding agencies, maintain a data base of completed audits, provide appropriate information to Federal agencies, and follow up with known auditees which have not submitted the required data collection forms and reporting packages.

(i) **Clearinghouse address.** The address of the Federal clearinghouse currently designated by OMB is Federal Audit Clearinghouse, Bureau of the Census, 1201 E. 10th Street, Jeffersonville, IN 47132.

(j) **Electronic filing.** Nothing in this part shall preclude electronic submissions to the Federal clearinghouse in such manner as may be approved by OMB. With OMB approval, the Federal clearinghouse may pilot test methods of electronic submissions.

Subpart D--Federal Agencies and Pass-Through Entities

§ ____.400 Responsibilities.

(a) **Cognizant agency for audit responsibilities.** Recipients expending more than \$25 million (*\$50 million for fiscal years ending after December 31, 2003*) a year in Federal awards shall have a cognizant agency for audit. The designated cognizant agency for audit shall be the Federal awarding agency that provides the predominant amount of direct funding to a recipient unless OMB makes a specific cognizant agency for audit assignment.

Following is effective for fiscal years ending on or before December 31, 2003: To provide for continuity of cognizance, the determination of the predominant amount of direct funding shall be based upon direct Federal awards expended in the recipient's fiscal years ending in 1995, 2000, 2005, and every fifth year thereafter. For example, audit cognizance for periods ending in 1997 through 2000 will be determined based on Federal awards expended in 1995. (However, for States and local governments that expend more than \$25 million a year in Federal awards and have previously assigned cognizant agencies for audit, the requirements of this paragraph are not effective until fiscal years beginning after June 30, 2000.)

Following is effective for fiscal years ending after December 31, 2003: The determination of the predominant amount of direct funding shall be based upon direct Federal awards expended in the recipient's fiscal

years ending in 2004, 2009, 2014, and every fifth year thereafter. For example, audit cognizance for periods ending in 2006 through 2010 will be determined based on Federal awards expended in 2004. (However, for 2001 through 2005, the cognizant agency for audit is determined based on the predominant amount of direct Federal awards expended in the recipient's fiscal year ending in 2000).

Notwithstanding the manner in which audit cognizance is determined, a Federal awarding agency with cognizance for an auditee may reassign cognizance to another Federal awarding agency which provides substantial direct funding and agrees to be the cognizant agency for audit. Within 30 days after any reassignment, both the old and the new cognizant agency for audit shall notify the auditee, and, if known, the auditor of the reassignment. The cognizant agency for audit shall:

- (1) Provide technical audit advice and liaison to auditees and auditors.
 - (2) Consider auditee requests for extensions to the report submission due date required by **§____.320(a)**. The cognizant agency for audit may grant extensions for good cause.
 - (3) Obtain or conduct quality control reviews of selected audits made by non-Federal auditors, and provide the results, when appropriate, to other interested organizations.
 - (4) Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any direct reporting by the auditee or its auditor of irregularities or illegal acts, as required by GAGAS or laws and regulations.
 - (5) Advise the auditor and, where appropriate, the auditee of any deficiencies found in the audits when the deficiencies require corrective action by the auditor. When advised of deficiencies, the auditee shall work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency for audit shall notify the auditor, the auditee, and applicable Federal awarding agencies and pass-through entities of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance by auditors shall be referred to appropriate State licensing agencies and professional bodies for disciplinary action.
 - (6) Coordinate, to the extent practical, audits or reviews made by or for Federal agencies that are in addition to the audits made pursuant to this part, so that the additional audits or reviews build upon audits performed in accordance with this part.
 - (7) Coordinate a management decision for audit findings that affect the Federal programs of more than one agency.
 - (8) Coordinate the audit work and reporting responsibilities among auditors to achieve the most cost-effective audit.
 - (9) For biennial audits permitted under **§____.220**, consider auditee requests to qualify as a low-risk auditee under **§____.530(a)**.
- (b) **Oversight agency for audit responsibilities.** An auditee which does not have a designated cognizant agency for audit will be under the general oversight of the

Federal agency determined in accordance with §____.105. The oversight agency for audit:

- (1) Shall provide technical advice to auditees and auditors as requested.
- (2) May assume all or some of the responsibilities normally performed by a cognizant agency for audit.

(c) **Federal awarding agency responsibilities.** The Federal awarding agency shall perform the following for the Federal awards it makes:

- (1) Identify Federal awards made by informing each recipient of the CFDA title and number, award name and number, award year, and if the award is for R&D. When some of this information is not available, the Federal agency shall provide information necessary to clearly describe the Federal award.
- (2) Advise recipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements.
- (3) Ensure that audits are completed and reports are received in a timely manner and in accordance with the requirements of this part.
- (4) Provide technical advice and counsel to auditees and auditors as requested.
- (5) Issue a management decision on audit findings within six months after receipt of the audit report and ensure that the recipient takes appropriate and timely corrective action.
- (6) Assign a person responsible for providing annual updates of the compliance supplement to OMB.

(d) **Pass-through entity responsibilities.** A pass-through entity shall perform the following for the Federal awards it makes:

- (1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.
- (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.
- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- (4) Ensure that subrecipients expending \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

(6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

(7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

§ ____.405 Management decision.

(a) **General.** The management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given. Prior to issuing the management decision, the Federal agency or pass-through entity may request additional information or documentation from the auditee, including a request for auditor assurance related to the documentation, as a way of mitigating disallowed costs. The management decision should describe any appeal process available to the auditee.

(b) **Federal agency.** As provided in **§ ____.400(a)(7)**, the cognizant agency for audit shall be responsible for coordinating a management decision for audit findings that affect the programs of more than one Federal agency. As provided in **§ ____.400(c)(5)**, a Federal awarding agency is responsible for issuing a management decision for findings that relate to Federal awards it makes to recipients. Alternate arrangements may be made on a case-by-case basis by agreement among the Federal agencies concerned.

(c) **Pass-through entity.** As provided in **§ ____.400(d)(5)**, the pass-through entity shall be responsible for making the management decision for audit findings that relate to Federal awards it makes to subrecipients.

(d) **Time requirements.** The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible.

(e) **Reference numbers.** Management decisions shall include the reference numbers the auditor assigned to each audit finding in accordance with **§ ____.510(c)**.

Subpart E--Auditors

§ ____.500 Scope of audit.

(a) **General.** The audit shall be conducted in accordance with GAGAS. The audit shall cover the entire operations of the auditee; or, at the option of the auditee, such audit shall include a series of audits that cover departments, agencies, and other organizational units which expended or otherwise administered Federal awards

during such fiscal year, provided that each such audit shall encompass the financial statements and schedule of expenditures of Federal awards for each such department, agency, and other organizational unit, which shall be considered to be a non-Federal entity. The financial statements and schedule of expenditures of Federal awards shall be for the same fiscal year.

(b) **Financial statements.** The auditor shall determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles. The auditor shall also determine whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole.

(c) **Internal control.** (1) In addition to the requirements of GAGAS, the auditor shall perform procedures to obtain an understanding of internal control over Federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs.

(2) Except as provided in paragraph (c)(3) of this section, the auditor shall:

(i) Plan the testing of internal control over major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program; and

(ii) Perform testing of internal control as planned in paragraph (c)(2)(i) of this section.

(3) When internal control over some or all of the compliance requirements for a major program are likely to be ineffective in preventing or detecting noncompliance, the planning and performing of testing described in paragraph (c)(2) of this section are not required for those compliance requirements. However, the auditor shall report a reportable condition (including whether any such condition is a material weakness) in accordance with §____.510, assess the related control risk at the maximum, and consider whether additional compliance tests are required because of ineffective internal control.

(d) **Compliance.** (1) In addition to the requirements of GAGAS, the auditor shall 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.

(2) The principal compliance requirements applicable to most Federal programs and the compliance requirements of the largest Federal programs are included in the compliance supplement.

(3) For the compliance requirements related to Federal programs contained in the compliance supplement, an audit of these compliance requirements will meet the requirements of this part. Where there have been changes to the compliance requirements and the changes are not reflected in the compliance supplement, the auditor shall determine the current compliance requirements and modify the audit procedures accordingly. For those Federal programs not covered in the compliance supplement, the auditor should use the types of compliance requirements contained in the compliance supplement as guidance for identifying the types of compliance

requirements to test, and determine the requirements governing the Federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements.

(4) The compliance testing shall include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient evidence to support an opinion on compliance.

(e) **Audit follow-up.** The auditor shall follow-up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee in accordance with §____.315(b), and report, 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. The auditor shall perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year.

(f) **Data Collection Form.** As required in §____.320(b)(3), the auditor shall complete and sign specified sections of the data collection form.

§____.505 Audit reporting.

The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:

(a) An opinion (or disclaimer of opinion) as to whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and an opinion (or disclaimer of opinion) as to whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole.

(b) A report on internal control related to the financial statements and major programs. This report shall describe the scope of testing of internal control and the results of the tests, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(c) A report on compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements. This report shall also include an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on each major program, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(d) A schedule of findings and questioned costs which shall include the following three components:

(1) A summary of the auditor's results which shall include:

(i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);

(ii) Where applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses;

(iii) A statement as to whether the audit disclosed any noncompliance which is material to the financial statements of the auditee;

(iv) Where applicable, a statement that reportable conditions in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses;

(v) The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);

(vi) A statement as to whether the audit disclosed any audit findings which the auditor is required to report under **§____.510(a)**;

(vii) An identification of major programs;

(viii) The dollar threshold used to distinguish between Type A and Type B programs, as described in **§____.520(b)**; and

(ix) A statement as to whether the auditee qualified as a low-risk auditee under **§____.530**.

(2) Findings relating to the financial statements which are required to be reported in accordance with GAGAS.

(3) Findings and questioned costs for Federal awards which shall include audit findings as defined in **§____.510(a)**.

(i) Audit findings (e.g., internal control findings, compliance findings, questioned costs, or fraud) which relate to the same issue should be presented as a single audit finding. Where practical, audit findings should be organized by Federal agency or pass-through entity.

(ii) Audit findings which relate to both the financial statements and Federal awards, as reported under paragraphs **(d)(2)** and **(d)(3)** of this section, respectively, should be reported in both sections of the schedule. However, the reporting in one section of the schedule may be in summary form with a reference to a detailed reporting in the other section of the schedule.

§____.510 Audit findings.

(a) **Audit findings reported.** The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(1) Reportable conditions in internal control over major programs. The auditor's determination of whether a deficiency in internal control is a reportable condition for

the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement. The auditor shall identify reportable conditions which are individually or cumulatively material weaknesses.

(2) Material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program. The auditor's determination of whether a noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement.

(3) Known questioned costs which are greater than \$10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor shall also report known questioned costs when likely questioned costs are greater than \$10,000 for a type of compliance requirement for a major program. In reporting questioned costs, the auditor shall include information to provide proper perspective for judging the prevalence and consequences of the questioned costs.

(4) Known questioned costs which are greater than \$10,000 for a Federal program which is not audited as a major program. Except for audit follow-up, the auditor is not required under this part to perform audit procedures for such a Federal program; therefore, the auditor will normally not find questioned costs for a program which is not audited as a major program. However, if the auditor does become aware of questioned costs for a Federal program which is not audited as a major program (e.g., as part of audit follow-up or other audit procedures) and the known questioned costs are greater than \$10,000, then the auditor shall report this as an audit finding.

(5) The circumstances concerning why the auditor's report on compliance for major programs is other than an unqualified opinion, unless such circumstances are otherwise reported as audit findings in the schedule of findings and questioned costs for Federal awards.

(6) Known fraud affecting a Federal award, unless such fraud is otherwise reported as an audit finding in the schedule of findings and questioned costs for Federal awards. This paragraph does not require the auditor to make an additional reporting when the auditor confirms that the fraud was reported outside of the auditor's reports under the direct reporting requirements of GAGAS.

(7) Instances where the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings prepared by the auditee in accordance with § ____.315(b) materially misrepresents the status of any prior audit finding.

(b) **Audit finding detail.** Audit findings shall be presented in sufficient detail for the auditee to prepare a corrective action plan and take corrective action and for Federal agencies and pass-through entities to arrive at a management decision. The following specific information shall be included, as applicable, in audit findings:

- (1) Federal program and specific Federal award identification including the CFDA title and number, Federal award number and year, name of Federal agency, and name of the applicable pass-through entity. When information, such as the CFDA title and number or Federal award number, is not available, the auditor shall provide the best information available to describe the Federal award.
 - (2) The criteria or specific requirement upon which the audit finding is based, including statutory, regulatory, or other citation.
 - (3) The condition found, including facts that support the deficiency identified in the audit finding.
 - (4) Identification of questioned costs and how they were computed.
 - (5) Information to provide proper perspective for judging the prevalence and consequences of the audit findings, such as whether the audit findings represent an isolated instance or a systemic problem. Where appropriate, instances identified shall be related to the universe and the number of cases examined and be quantified in terms of dollar value.
 - (6) The possible asserted effect to provide sufficient information to the auditee and Federal agency, or pass-through entity in the case of a subrecipient, to permit them to determine the cause and effect to facilitate prompt and proper corrective action.
 - (7) Recommendations to prevent future occurrences of the deficiency identified in the audit finding.
 - (8) Views of responsible officials of the auditee when there is disagreement with the audit findings, to the extent practical.
- (c) **Reference numbers.** Each audit finding in the schedule of findings and questioned costs shall include a reference number to allow for easy referencing of the audit findings during follow-up.

§___.515 Audit working papers.

- (a) **Retention of working papers.** The auditor shall retain working papers and reports for a minimum of three years after the date of issuance of the auditor's report(s) to the auditee, unless the auditor is notified in writing by the cognizant agency for audit, oversight agency for audit, or pass-through entity to extend the retention period. When the auditor is aware that the Federal awarding agency, pass-through entity, or auditee is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and reports.
- (b) **Access to working papers.** Audit working papers shall be made available upon request to the cognizant or oversight agency for audit or its designee, a Federal agency providing direct or indirect funding, or GAO at the completion of the audit, as part of a quality review, to resolve audit findings, or to carry out oversight responsibilities consistent with the purposes of this part. Access to working papers includes the right of Federal agencies to obtain copies of working papers, as is reasonable and necessary.

§____.520 Major program determination.

(a) **General.** The auditor shall use a risk-based approach to determine which Federal programs are major programs. This risk-based approach shall include consideration of: Current and prior audit experience, oversight by Federal agencies and pass-through entities, and the inherent risk of the Federal program. The process in paragraphs (b) through (i) of this section shall be followed.

(b) **Step 1.** (1) The auditor shall identify the larger Federal programs, which shall be labeled Type A programs. Type A programs are defined as Federal programs with Federal awards expended during the audit period exceeding the larger of:

(i) \$300,000 or three percent (.03) of total Federal awards expended in the case of an auditee for which total Federal awards expended equal or exceed \$300,000 but are less than or equal to \$100 million.

(ii) \$3 million or three-tenths of one percent (.003) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed \$100 million but are less than or equal to \$10 billion.

(iii) \$30 million or 15 hundredths of one percent (.0015) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed \$10 billion.

(2) Federal programs not labeled Type A under paragraph (b)(1) of this section shall be labeled Type B programs.

(3) The inclusion of large loan and loan guarantees (loans) should not result in the exclusion of other programs as Type A programs. When a Federal program providing loans significantly affects the number or size of Type A programs, the auditor shall consider this Federal program as a Type A program and exclude its values in determining other Type A programs.

(4) For biennial audits permitted under §____.220, the determination of Type A and Type B programs shall be based upon the Federal awards expended during the two-year period.

(c) **Step 2.** (1) The auditor shall identify Type A programs which are low-risk. For a Type A program to be considered low-risk, it shall have been audited as a major program in at least one of the two most recent audit periods (in the most recent audit period in the case of a biennial audit), and, in the most recent audit period, it shall have had no audit findings under §____.510(a). However, the auditor may use judgment and consider that audit findings from questioned costs under §____.510(a)(3) and §____.510(a)(4), fraud under §____.510(a)(6), and audit follow-up for the summary schedule of prior audit findings under §____.510(a)(7) do not preclude the Type A program from being low-risk. The auditor shall consider: the criteria in §____.525(c), §____.525(d)(1), §____.525(d)(2), and §____.525(d)(3); the results of audit follow-up; whether any changes in personnel or systems affecting a Type A program have significantly increased risk; and apply professional judgment in determining whether a Type A program is low-risk.

(2) Notwithstanding paragraph **(c)(1)** of this section, OMB may approve a Federal awarding agency's request that a Type A program at certain recipients may not be considered low-risk. For example, it may be necessary for a large Type A program to be audited as major each year at particular recipients to allow the Federal agency to comply with the Government Management Reform Act of 1994 (31 U.S.C. 3515). The Federal agency shall notify the recipient and, if known, the auditor at least 180 days prior to the end of the fiscal year to be audited of OMB's approval.

(d) **Step 3.** (1) The auditor shall identify Type B programs which are high-risk using professional judgment and the criteria in §____.525. However, should the auditor select Option 2 under Step 4 (paragraph **(e)(2)(i)(B)** of this section), the auditor is not required to identify more high-risk Type B programs than the number of low-risk Type A programs. Except for known reportable conditions in internal control or compliance problems as discussed in §____.525**(b)(1)**, §____.525**(b)(2)**, and §____.525**(c)(1)**, a single criteria in §____.525 would seldom cause a Type B program to be considered high-risk.

(2) The auditor is not expected to perform risk assessments on relatively small Federal programs. Therefore, the auditor is only required to perform risk assessments on Type B programs that exceed the larger of:

(i) \$100,000 or three-tenths of one percent (.003) of total Federal awards expended when the auditee has less than or equal to \$100 million in total Federal awards expended.

(ii) \$300,000 or three-hundredths of one percent (.0003) of total Federal awards expended when the auditee has more than \$100 million in total Federal awards expended.

(e) **Step 4.** At a minimum, the auditor shall audit all of the following as major programs:

(1) All Type A programs, except the auditor may exclude any Type A programs identified as low-risk under Step 2 (paragraph **(c)(1)** of this section).

(2) (i) High-risk Type B programs as identified under either of the following two options:

(A) **Option 1.** At least one half of the Type B programs identified as high-risk under Step 3 (paragraph **(d)** of this section), except this paragraph **(e)(2)(i)(A)** does not require the auditor to audit more high-risk Type B programs than the number of low-risk Type A programs identified as low-risk under Step 2.

(B) **Option 2.** One high-risk Type B program for each Type A program identified as low-risk under Step 2.

(ii) When identifying which high-risk Type B programs to audit as major under either Option 1 or 2 in paragraph **(e)(2)(i)(A)** or **(B)**, the auditor is encouraged to use an approach which provides an opportunity for different high-risk Type B programs to be audited as major over a period of time.

(3) Such additional programs as may be necessary to comply with the percentage of coverage rule discussed in paragraph (f) of this section. This paragraph (e)(3) may require the auditor to audit more programs as major than the number of Type A programs.

(f) **Percentage of coverage rule.** The auditor shall audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the auditee meets the criteria in §____.530 for a low-risk auditee, the auditor need only audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 25 percent of total Federal awards expended.

(g) **Documentation of risk.** The auditor shall document in the working papers the risk analysis process used in determining major programs.

(h) **Auditor's judgment.** When the major program determination was performed and documented in accordance with this part, the auditor's judgment in applying the risk-based approach to determine major programs shall be presumed correct. Challenges by Federal agencies and pass-through entities shall only be for clearly improper use of the guidance in this part. However, Federal agencies and pass-through entities may provide auditors guidance about the risk of a particular Federal program and the auditor shall consider this guidance in determining major programs in audits not yet completed.

(i) **Deviation from use of risk criteria.** For first-year audits, the auditor may elect to determine major programs as all Type A programs plus any Type B programs as necessary to meet the percentage of coverage rule discussed in paragraph (f) of this section. Under this option, the auditor would not be required to perform the procedures discussed in paragraphs (c), (d), and (e) of this section.

(1) A first-year audit is the first year the entity is audited under this part or the first year of a change of auditors.

(2) To ensure that a frequent change of auditors would not preclude audit of high-risk Type B programs, this election for first-year audits may not be used by an auditee more than once in every three years.

§____.525 Criteria for Federal program risk.

(a) **General.** The auditor's determination should be based on an overall evaluation of the risk of noncompliance occurring which could be material to the Federal program. The auditor shall use auditor judgment and consider criteria, such as described in paragraphs (b), (c), and (d) of this section, to identify risk in Federal programs. Also, as part of the risk analysis, the auditor may wish to discuss a particular Federal program with auditee management and the Federal agency or pass-through entity.

(b) **Current and prior audit experience.** (1) Weaknesses in internal control over Federal programs would indicate higher risk. Consideration should be given to the control environment over Federal programs and such factors as the expectation of management's adherence to applicable laws and regulations and the provisions of

contracts and grant agreements and the competence and experience of personnel who administer the Federal programs.

(i) A Federal program administered under multiple internal control structures may have higher risk. When assessing risk in a large single audit, the auditor shall consider whether weaknesses are isolated in a single operating unit (e.g., one college campus) or pervasive throughout the entity.

(ii) When significant parts of a Federal program are passed through to subrecipients, a weak system for monitoring subrecipients would indicate higher risk.

(iii) The extent to which computer processing is used to administer Federal programs, as well as the complexity of that processing, should be considered by the auditor in assessing risk. New and recently modified computer systems may also indicate risk.

(2) Prior audit findings would indicate higher risk, particularly when the situations identified in the audit findings could have a significant impact on a Federal program or have not been corrected.

(3) Federal programs not recently audited as major programs may be of higher risk than Federal programs recently audited as major programs without audit findings.

(c) **Oversight exercised by Federal agencies and pass-through entities.** (1) Oversight exercised by Federal agencies or pass-through entities could indicate risk. For example, recent monitoring or other reviews performed by an oversight entity which disclosed no significant problems would indicate lower risk. However, monitoring which disclosed significant problems would indicate higher risk.

(2) Federal agencies, with the concurrence of OMB, may identify Federal programs which are higher risk. OMB plans to provide this identification in the compliance supplement.

(d) **Inherent risk of the Federal program.** (1) The nature of a Federal program may indicate risk. Consideration should be given to the complexity of the program and the extent to which the Federal program contracts for goods and services. For example, Federal programs that disburse funds through third party contracts or have eligibility criteria may be of higher risk. Federal programs primarily involving staff payroll costs may have a high-risk for time and effort reporting, but otherwise be at low-risk.

(2) The phase of a Federal program in its life cycle at the Federal agency may indicate risk. For example, a new Federal program with new or interim regulations may have higher risk than an established program with time-tested regulations. Also, significant changes in Federal programs, laws, regulations, or the provisions of contracts or grant agreements may increase risk.

(3) The phase of a Federal program in its life cycle at the auditee may indicate risk. For example, during the first and last years that an auditee participates in a Federal

program, the risk may be higher due to start-up or closeout of program activities and staff.

(4) Type B programs with larger Federal awards expended would be of higher risk than programs with substantially smaller Federal awards expended.

§ ____.530 Criteria for a low-risk auditee.

An auditee which meets all of the following conditions for each of the preceding two years (or, in the case of biennial audits, preceding two audit periods) shall qualify as a low-risk auditee and be eligible for reduced audit coverage in accordance with **§ ____.520:**

(a) Single audits were performed on an annual basis in accordance with the provisions of this part. A non-Federal entity that has biennial audits does not qualify as a low-risk auditee, unless agreed to in advance by the cognizant or oversight agency for audit.

(b) The auditor's opinions on the financial statements and the schedule of expenditures of Federal awards were unqualified. However, the cognizant or oversight agency for audit may judge that an opinion qualification does not affect the management of Federal awards and provide a waiver.

(c) There were no deficiencies in internal control which were identified as material weaknesses under the requirements of GAGAS. However, the cognizant or oversight agency for audit may judge that any identified material weaknesses do not affect the management of Federal awards and provide a waiver.

(d) None of the Federal programs had audit findings from any of the following in either of the preceding two years (or, in the case of biennial audits, preceding two audit periods) in which they were classified as Type A programs:

(1) Internal control deficiencies which were identified as material weaknesses;

(2) Noncompliance with the provisions of laws, regulations, contracts, or grant agreements which have a material effect on the Type A program; or (3) Known or likely questioned costs that exceed five percent of the total Federal awards expended for a Type A program during the year.

Attachment H: A-133 Compliance Supplement Part 1

Background, Purpose, and Applicability

BACKGROUND

The Single Audit Act of 1984 established requirements for audits of States, local governments, and Indian tribal governments that administer Federal financial assistance programs. In 1985, the Office of Management and Budget (OMB) issued OMB Circular A-128, "Audits of State and Local Governments," to provide implementing guidance. In 1990, OMB administratively extended the single audit process to non-profit organizations by issuing OMB Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Organizations."

On July 5, 1996, the President signed the Single Audit Act Amendments of 1996 (31 USC Chapter 75). The 1996 Amendments extended the statutory audit requirement to non-profit organizations and substantially revised various provisions of the 1984 Act. On June 30, 1997, OMB issued revisions to Circular A-133 (62 FR 35278) to implement the 1996 Amendments, extend OMB Circular A-133's coverage to States, local governments, and Indian tribal governments, and rescind OMB Circular A-128. The 1996 Amendments required the Director, OMB, to periodically review the audit threshold. On June 27, 2003, OMB amended Circular A-133 (68 FR 38401) to increase the audit threshold to an aggregate expenditure of \$500,000 in Federal funds and to make changes in the thresholds for cognizant and oversight agencies. Those changes take effect for fiscal years ending after December 31, 2003.

This Compliance Supplement is based on the requirements of the 1996 Amendments and 1997 revisions to OMB Circular A-133, which provide for the issuance of a compliance supplement to assist auditors in performing the required audits. The Senate and House Reports supporting the 1996 Amendments cited studies of the single audit process performed by the General Accounting Office, the President's Council on Integrity and Efficiency and the National State Auditors Association (NSAA). All three studies supported the need for a current compliance supplement. The NSAA study stated, "The Compliance Supplement provides an invaluable tool to both Federal agencies and auditors in setting forth the important provisions of Federal assistance programs. This tool allows Federal agencies to effectively communicate items that they believe are important to the successful management of the program and legislative intent. Such a valuable tool requires constant review and update."

This document serves to identify existing important compliance requirements that the Federal Government expects to be considered as part of an audit required by the 1996 Amendments. Without this Supplement, auditors would need to research many laws and regulations for each program under audit to determine which compliance requirements are important to the Federal Government and could have a direct and material effect on a program. Providing this Supplement is a more efficient and cost effective approach to performing this research. For the programs contained herein, this Supplement provides a source of information for auditors to understand the Federal program's objectives, procedures, and compliance requirements relevant to the audit as well as audit objectives and suggested audit procedures for determining compliance with these requirements.

This Supplement also provides guidance to assist auditors in determining compliance requirements relevant to the audit, audit objectives, and suggested audit procedures for programs not included herein. For single audits, this Supplement replaces agency audit guides and other audit requirement documents for individual Federal programs.

OMB Circular A-133 provides that Federal agencies are responsible to annually inform OMB of any updates needed to this Supplement. This responsibility includes ensuring that program objectives, procedures, and compliance requirements, noncompliance with which could have a direct and material effect on these individual Federal programs, are provided to OMB for inclusion in this Supplement, and that agencies keep current these program objectives, procedures, and compliance requirements (including statutory and regulatory citations). To facilitate agency efforts to meet this responsibility, Parts 4 and 5 of this Supplement provide a stand-alone section for each program included in this Supplement, which contains program objectives, program procedures, and compliance requirements. For some programs a separate subsection (IV. Other Information), is also included to communicate additional information concerning the program. For example, when a program allows funds to be transferred to another program, subsection IV will provide guidance on how those funds should be treated on the Schedule of Expenditures of Federal Awards and Type A program determinations. See Appendix IV for a list of programs that contain this subsection. These program-specific sections can be updated or replaced as Federal programs change. Also, sections will be included as part of the annual update for additional programs once the program objectives, program procedures, and compliance requirements relevant to the program are developed.

PURPOSE AND APPLICABILITY (Part 1)

Purpose

This Supplement is effective for audits of fiscal years beginning after June 30, 2003, and supersedes the OMB Circular A-133 Compliance Supplement issued in March 2003.

OMB Circular A-133 describes the non-Federal entity's responsibilities for managing Federal assistance programs (§___.300) and the auditor's responsibility with respect to the scope of audit (§___.500). Auditors are required to follow the provisions of OMB Circular A-133 and this Supplement.

Applicability

General

Auditors shall consider this Supplement and the referenced laws, regulations, and OMB Circulars (whether codified by Federal agencies implementing the Circulars in agency regulations or implemented by other means) in determining the compliance requirements that could have a direct and material effect on the programs included herein. That is, use of this Supplement is mandatory. Accordingly, adherence to this Supplement satisfies the requirements of OMB Circular A-133. For program-specific audits performed in accordance with a Federal agency's program-specific audit guide, the auditor shall follow such program-specific audit guide. Finally, for major programs not included in this Supplement, the auditor shall follow the guidance in Part 7 and use the types of compliance requirements in Part 3 to identify the applicable compliance requirements which could have a direct and material effect on the program.

Update of Requirements

OMB Circular A-133 provides that Federal agencies are responsible for annually informing OMB of any updates needed to this Supplement. However, auditors should recognize that laws and regulations change periodically and that delays will occur between such changes and revisions to this Supplement. Moreover, auditors should recognize that there may be provisions of contract and grant agreements that are not specified in law or regulation and, therefore, the specifics of such are not included in this Supplement. For example, the grant agreement may specify a certain matching percentage or set a priority for how funds should be spent (e.g., a requirement to not fund certain size projects). Another example is a Federal agency imposing additional requirements on a recipient because it is high-risk in accordance with the A-102 Common Rule or an agency's implementation of Circular A-110, or as part of resolution of prior audit findings.

Accordingly, the auditor should perform reasonable procedures to ensure that compliance requirements are current and to determine whether there are any additional provisions of contract and grant agreements that should be covered by an audit under the 1996 Amendments.

Reasonable procedures would be inquiry of non-Federal entity management and review of the contract and grant agreements for programs selected for testing (i.e., major programs).

Safe Harbor Status

Because the suggested audit procedures were written to be able to apply to many different programs administered by many different entities, they are necessarily general in nature. Auditor judgment will be necessary to determine whether the suggested audit procedures are sufficient to achieve the stated audit objectives or whether additional or alternative audit procedures are needed. Therefore, the auditor should **not** consider this Supplement to be a “safe harbor” for identifying the audit procedures to apply in a particular engagement.

However, the auditor can consider this Supplement a “safe harbor” for identification of compliance requirements to be tested for the programs included herein if, as discussed above, the auditor (1) performs reasonable procedures to ensure that the requirements in this Supplement are current and to determine whether there are any additional provisions of contract and grant agreements that should be covered by an audit under the 1996 Amendments, and (2) updates or augments the requirements contained in this Supplement as appropriate.

Responsibility for Other Requirements

Although the focus of this Supplement is on compliance requirements that could have a direct and material effect on a major program, auditors also have responsibility under *Generally Accepted Government Auditing Standards* (GAGAS) for other requirements when specific information comes to the auditors’ attention that provides evidence concerning the existence of possible noncompliance that could have a material indirect effect on a major program.

OVERVIEW OF THIS SUPPLEMENT

Matrix of Compliance Requirements (Part 2)

The Matrix of Compliance Requirements (Matrix) identifies the Federal programs and compliance requirements addressed in this Supplement, and associates the programs with the applicable compliance requirements. The Matrix also identifies the applicable Federal agency and *Catalog of Federal Domestic Assistance* (CFDA) number for each program included in this Supplement.

Compliance Requirements (Part 3)

Part 3 lists and describes the 14 types of compliance requirements and, except for Special Tests and Provisions, the related audit objectives that the auditor shall consider in every audit conducted under OMB Circular A-133, with the exception of program-specific audits performed in accordance with a Federal agency's program-specific audit guide. Suggested audit procedures are also provided to assist the auditor in planning and performing tests of non-Federal entity compliance with the requirements of Federal programs. Auditor judgment will be necessary to determine whether the suggested audit procedures are sufficient to achieve the stated audit objectives and whether additional or alternative audit procedures are needed. Determining the nature, timing, and extent of the audit procedures necessary to meet the audit objectives is the auditor's responsibility.

The compliance requirements for Special Tests and Provisions are unique to each Federal program; therefore, compliance requirements, audit objectives, and suggested audit procedures for Special Tests and Provisions are not included in Part 3.

Consistent with the requirements of OMB Circular A-133, this Part includes audit objectives and suggested audit procedures to test internal control. However, the auditor must determine the specific procedures to test internal control on a case-by-case basis considering factors such as the non-Federal entity's internal control, the compliance requirements, the audit objectives for compliance, the auditor's assessment of control risk, and the audit requirement to test internal control as prescribed in OMB Circular A-133.

Agency Program Requirements (Part 4)

For each Federal program included in this Supplement, Part 4 discusses program objectives, program procedures, and compliance requirements that are specific to the program. With the exception of "N. Special Tests and Provisions," the auditor shall refer to Part 3 for the audit objectives and suggested audit procedures that pertain to the compliance requirements associated with the programs. Since Special Tests and Provisions are unique to the program, the specific audit objectives and suggested audit procedures for the program are included in Part 4 with the exception of audit objectives and suggested audit procedures for internal control, which are included in Part 3.

The description of program procedures is general in nature. Some programs may operate somewhat differently than described due to: (1) the complexity of governing Federal and State laws and regulations; (2) the administrative flexibility afforded non-Federal entities; and (3) the nature, size, and volume of transactions involved. Accordingly, the auditor should obtain an understanding of the applicable compliance requirements and program procedures in operation at the non-Federal entity to properly plan and perform the audit.

Clusters of Programs (Part 5)

A cluster of programs is a grouping of closely related programs that have similar compliance requirements. The types of clusters are: Research and Development (R&D), Student Financial Aid (SFA), and other clusters. “Other clusters” are as identified in this Supplement or designated in a State award document.

Although the programs within a cluster are administered as separate programs, a cluster of programs is treated as a single program for the purpose of meeting the audit requirements of OMB Circular A-133 (§__.105). Part 5 provides compliance requirements, audit objectives, and suggested audit procedures for R&D and SFA clusters and lists other clusters.

In planning and performing the audit, the auditor should determine whether programs administered by the non-Federal entity are part of a cluster by referring to the provisions of Part 5 of this Supplement and the State award documents.

Internal Control (Part 6)

As a condition of receiving Federal awards, non-Federal entities agree to comply with applicable laws, regulations, and the provisions of contract and grant agreements, and to maintain internal control to provide reasonable assurance of compliance with these requirements. OMB Circular A-133 requires auditors to obtain an understanding of the non-Federal entity’s internal control over Federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs, plan the testing of internal control over major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program, and, unless internal control is likely to be ineffective, perform testing of internal control as planned. Part 6 is intended to assist non-Federal entities and their auditors in complying with these requirements by presenting characteristics of internal control which may be used to reasonably ensure compliance with the types of compliance requirements in Part 3. The characteristics of internal control presented in Part 6 are neither mandatory nor all-inclusive.

Guidance for Auditing Programs Not Included in this Compliance Supplement (Part 7)

Part 7 provides guidance to auditors in identifying the compliance requirements and designing tests of compliance with such requirements for programs not included in this Supplement.

Federal Programs Excluded from the A-102 Common Rule (Appendix I)

This Appendix lists block grants and other programs excluded from the requirements of the “Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments” (also known as the “A-102 Common Rule”).

Federal Agency Codification of Certain Governmentwide Grants Requirements (Appendix II)

This Appendix provides regulatory citations and Federal agencies’ codification of the A-102 Common Rule and OMB Circular A-110, “Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations,” in agency regulations. Some agencies have not codified the November 1993 revision to OMB Circular A-110, but have provided such policies to grantees through other means such as grant agreements.

Federal Agency Contacts for A-133 Audits (Appendix III)

This Appendix identifies Federal agency contacts from which auditors can request information or materials about Federal programs or the audit requirements of OMB Circular A-133.

Internal Reference Tables (Appendix IV)

This Appendix provides a listing of programs in Parts 4 and 5 that include IV. “Other Information.” This listing allows the auditor to quickly determine which programs have other information, such as guidance on Type A and Type B program determination or display on the Schedule of Expenditures of Federal Awards. This Appendix also indicates that the Medicaid Cluster is the only program currently identified as higher risk by OMB pursuant to Circular A-133, §____.525(c)(2).

List of Changes for the 2004 Compliance Supplement (Appendix V)

This Appendix provides a list of changes from the OMB Circular A-133 Compliance Supplement issued in March 2003 to this 2004 Supplement.

Department of Homeland Security and the Compliance Supplement (Appendix VI)

This Appendix addresses the effect on audits under OMB Circular A-133 of the transfer of programs and activities to the Department of Homeland Security.

Other OMB Circular A-133 Advisories (Appendix VII)

Reserved.

SAS 70 Examinations of EBT Service Organizations (Appendix VIII)

This Appendix provides guidance on audits of State electronic benefits transfer (EBT) service providers (service organizations) regarding the issuance, redemption, and settlement of benefits under the Food Stamps program (CFDA 10.551) in accordance with the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 70, Service Organizations.

Compliance Supplement Core Team (Appendix IX)

This Appendix provides a listing of the Compliance Supplement Core Team members who were responsible for the production of this Supplement.

TECHNICAL INFORMATION

Page Numbering Scheme

The following page numbering scheme is used in this Supplement to facilitate future revisions.

Each page included in Parts 1, 2, 3 (Introduction), 6 (Introduction), and 7 is identified by a label that represents the part number and sequential page number. A dash (-) separates the part number from the page number. For example, Part 1 is numbered as follows: 1-1, 1-2, 1-3, and so on.

Each page included in Parts 3 (excluding Introduction), 4, 5, and 6 (excluding Introduction) is identified by a label that represents the part number, section number identifier, and sequential page number. For example, Section A of Part 3 is numbered 3-A-1, 3-A-2, 3-A-3, and so on. The section number identifier for Part 4 represents the CFDA number of the applicable program. For example, the Department of Labor (DOL) Unemployment Insurance program, CFDA number 17.225, is numbered 4-17.225-1, 4-17.225-2, 4-17.225-3, and so on.

Code of Federal Regulations

The Code of Federal Regulations (CFR) is a codification of the rules issued by Federal agencies. The CFR is divided into 50 titles, which comprise the broad areas subject to Federal regulation. Each title is further divided into parts and sections, with most references to the CFR being made at this level.

Portions of the CFR are revised daily and these changes are published in the *Federal Register*. However, a revised version of the CFR is published only once each calendar year, on a quarterly basis as follows: titles 1–16 on January 1, titles 17–27 on April 1, titles 28–41 on July 1, and titles 42–50 on October 1.

In the event that changes to a particular section of a title have changed since the last published update of that section, a notation is made in the List of CFR Sections Affected (LSA), which is

published monthly. The LSA cites the *Federal Register* page number that contains the changes to the CFR section.

In order to obtain the most current regulations, the user should consult not only the latest version of the CFR, but also the LSA issued in the current month. The *Federal Register* home page (<http://www.gpoaccess.gov/nara/index.html>) offers links to both the *Federal Register* and the CFR. A beta test site for an updated electronic CFR is available at <http://www.gpoaccess.gov/ecfr/>. Please note that on-line versions of the CFR may not be the most current available.

HOW TO OBTAIN ADDITIONAL GUIDANCE

Guidance to assist auditors in performing audits in accordance with OMB Circular A-133 can be obtained from the following sources.

Office of Management and Budget

The following information is located under the grants management heading on OMB's Internet home page (<http://www.omb.gov>).

- OMB publications, including OMB Circulars and this Supplement for audits under OMB Circular A-133.
- SF-SAC, *Data Collection Form for Reporting on Audits of States, Local Governments, and Non-Profit Organizations*.
- Codification of Certain Governmentwide Grants Requirements by Department (including the A-102 Common Rule and OMB Circular A-110)

General Services Administration (GSA)

Federal Domestic Assistance Catalog Division
General Services Administration
Room 4032
1800 F Street, NW
Washington DC 20405
Telephone: (202) 208-1582

- *Catalog of Federal Domestic Assistance (CFDA)*.

A searchable copy of the CFDA is available through the Internet on the GSA Home Page (<http://www.cfda.gov>). The CFDA is also available in hard copy (from the Government Printing Office), and on machine-readable magnetic tape, high-density floppy diskettes, and CD-ROM (from GSA at 202-208-4296).

Government Printing Office (GPO)

Superintendent of Documents
P.O. Box 371954
Pittsburgh, PA 15250-7954
Telephone: (202) 512-1800

- *Catalog of Federal Domestic Assistance.*
- Government Auditing Standards (stock number 020-000-00-265-4).
- March 2004 Circular A-133 Compliance Supplement (stock numbers: 041-001-00604-4)

Inspectors General

IGnet Home Page on the Internet (<http://www.ignet.gov>) contains an Inspector General Directory and the Inspector General Act.

Federal Audit Clearinghouse

The Federal Audit Clearinghouse acts as an agent for OMB to: (1) establish and maintain a governmentwide database of single audit results and related Federal award information; (2) serve as the Federal repository of single audit reports; and (3) distribute single audit reports to Federal agencies.

The Clearinghouse maintains a site on the Internet at <http://harvester.census.gov/sac/>. For Data Collection Form (SF-SAC) and OMB Circular A-133 submission questions, contact the Federal Audit Clearinghouse by e-mail (govs.fac@census.gov), phone (301-763-1551 (voice) and 800-253-0696 (toll free)), or fax 301-457-1540. The Form SF-SAC and A-133 Submission should be mailed to Federal Audit Clearinghouse, 1201 E. 10th Street, Jeffersonville, IN 47132.

Attachment I: A-133 Compliance Supplement Part 2

Matrix of Compliance Requirements

INTRODUCTION

This Part identifies the compliance requirements that are applicable to the programs included in this Supplement. Because Part 4 (Agency Program Requirements) and Part 5 (Clusters of Programs) do not include guidance for all types of compliance requirements that pertain to the program, (see introduction to Part 4 for additional information), the auditor should use this Part to identify the types of compliance requirements that are applicable. The boxes for each type of compliance requirement will either contain a “Y” (for “yes” if the type of compliance requirement may apply) or be shaded (if the program normally does not have activity subject to this type of compliance requirement).

Even though a “Y” indicates that the compliance requirement applies to the Federal program, it may not apply at a particular non-Federal entity, either because that entity does not have activity subject to that type of compliance requirement or the activity could not have a material effect on a major program. For example, even though Real Property Acquisition/Relocation Assistance may apply to a particular program, it would not apply to a non-Federal entity that did not acquire real property covered by the Uniform Relocation Assistance and Real Property Acquisition Policies Act. Similarly, a “Y” may be included under “Procurement;” however, the audit would not be expected to address this type of compliance requirement if the non-Federal entity charges only small amounts of purchases to a major program. The auditor should exercise professional judgment when determining which compliance requirements marked “Y” need to be tested at a particular non-Federal entity.

When a “Y” is present on the matrix and the auditor determines that the requirement should be tested at the non-Federal entity, the auditor should use Part 3, Compliance Requirements, and Part 4 (or 5), if applicable, in planning and performing the tests of compliance. For example, if a program entry in the matrix includes a “Y” in the Program Income column, Part 3 provides a general description of the compliance requirement. Part 3 also provides the audit objective and the suggested audit procedures for testing program income. Part 4 (or 5) may also include specific information on program income criteria pertaining to the program, such as restrictions on how program income may be used. Part 6, Internal Control, may be useful in assessing control risk and designing tests of internal control with respect to each applicable compliance requirement.

When a compliance requirement is shaded in the matrix, it normally does not apply to the program. However, if specific information comes to the auditor’s attention (e.g., during the normal review of the grant agreement or discussions with management) that provides evidence that a compliance requirement shaded in the matrix could have a material effect on a major program, the auditor would be expected to test the requirement. This circumstance should arise infrequently.

CFDA	<i>Types of Compliance Requirements</i>													
	A. <i>Activities Allowed or Unallowed</i>	B. <i>Allowable Costs/Cost Principles</i>	C. <i>Cash Management</i>	D. <i>Davis-Bacon Act</i>	E. <i>Eligibility</i>	F. <i>Equipment and Real Property Management</i>	G. <i>Matching, Level of Effort, Earmarking</i>	H. <i>Period of Availability of Federal Funds</i>	I. <i>Procurement and Suspension and Debarment</i>	J. <i>Program Income</i>	K. <i>Real Property Acquisition/Relocation Assistance</i>	L. <i>Reporting</i>	M. <i>Subrecipient Monitoring</i>	N. <i>Special Tests and Provisions</i>
02 - United States Agency for International Development (USAID)														
02.001*	Y	Y	Y			Y		Y	Y	Y		Y		Y
10 - United States Department of Agriculture (USDA)														
10.001*	Y	Y	Y			Y		Y	Y	Y		Y		Y
10.500	Y	Y	Y			Y	Y	Y	Y	Y		Y		
10.551														
10.561	Y	Y	Y		See Part 4	Y	Y	Y	Y			Y	Y	Y
10.553														
10.555														
10.556														
10.559	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	Y
10.557	Y	Y	Y		Y	Y		Y	Y	Y		Y	Y	Y
10.558	Y	Y	Y		Y	Y	Y	Y	Y			Y	Y	Y
10.566	Y	Y	Y		Y	Y	Y	Y	Y			Y		Y
10.568														
10.569	Y	Y	Y		Y	Y	Y	Y	Y			Y	Y	Y
10.665														
10.666	Y	Y	Y	Y			Y		Y					
10.760	Y	Y	Y			Y	Y	Y	Y			Y		
10.766	Y	Y	Y	Y		Y		Y	Y			Y		
11 - Department of Commerce (DOC)														
11.300														
11.307	Y	Y	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y
12 - Department of Defense (DoD)														
12.401	Y	Y	Y	Y		Y	Y	Y	Y	Y		Y		

CFDA	Types of Compliance Requirements													
	A. Activities Allowed or Unallowed	B. Allowable Costs/Cost Principles	C. Cash Management	D. Davis-Bacon Act	E. Eligibility	F. Equipment and Real Property Management	G. Matching, Level of Effort, Earmarking	H. Period of Availability of Federal Funds	I. Procurement and Suspension and Debarment	J. Program Income	K. Real Property Acquisition/Relocation Assistance	L. Reporting	M. Subrecipient Monitoring	N. Special Tests and Provisions
14 - Department of Housing and Urban Development (HUD)														
14.157	Y	Y	Y	Y	Y	Y			Y		Y			Y
14.181	Y	Y	Y	Y	Y	Y			Y		Y			Y
14.182														
14.195														
14.249														
14.856			Y		Y	Y						Y	Y	Y
14.218														
14.219	Y	Y	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y
14.228	Y	Y	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y
14.231	Y	Y	Y			Y	Y	Y	Y	Y	Y	Y	Y	Y
14.235	Y	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
14.238	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
14.239	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y		Y	Y
14.241	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
14.850		Y	Y		Y	Y		Y	Y			Y		Y
14.854	Y	Y	Y	Y		Y		Y	Y			Y		
14.862	Y	Y	Y			Y	Y	Y	Y	Y	Y	Y	Y	Y
14.867	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
14.871	Y	Y	Y		Y							Y	Y	Y
14.872	Y	Y	Y	Y		Y		Y	Y		Y	Y		
15 - Department of the Interior (DOI)														
15.021	Y	Y				Y		Y	Y	Y		Y		Y
15.022	Y	Y		Y		Y		Y	Y	Y			Y	Y
15.030	Y	Y				Y		Y	Y	Y		Y		Y
15.042	Y	Y				Y		Y	Y	Y				Y
15.605	Y	Y	Y			Y	Y	Y	Y	Y	Y	Y	Y	Y

CFDA	Types of Compliance Requirements													
	A. <i>Activities Allowed or Unallowed</i>	B. <i>Allowable Costs/Cost Principles</i>	C. <i>Cash Management</i>	D. <i>Davis-Bacon Act</i>	E. <i>Eligibility</i>	F. <i>Equipment and Real Property Management</i>	G. <i>Matching, Level of Effort, Earmarking</i>	H. <i>Period of Availability of Federal Funds</i>	I. <i>Procurement and Suspension and Debarment</i>	J. <i>Program Income</i>	K. <i>Real Property Acquisition/Relocation Assistance</i>	L. <i>Reporting</i>	M. <i>Subrecipient Monitoring</i>	N. <i>Special Tests and Provisions</i>
15.611														
16 - Department of Justice (DOJ)														
16.579	Y	Y	Y			Y	Y	Y	Y			Y	Y	
16.710	Y	Y	Y			Y	Y	Y	Y			Y	Y	
17 - Department of Labor (DOL)														
17.207														
17.801														
17.804	Y	Y	Y			Y	Y	Y	Y	Y		Y		
17.225	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y		Y
17.235	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	
17.245	Y	Y	Y		Y	Y		Y	Y	Y		Y	Y	
17.253	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	Y
17.258														
17.259														
17.260	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	
17.263	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	
17.264	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	
17.265	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	
20 - Department of Transportation (DOT)														
20.106	Y	Y	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y
20.205	Y	Y	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y
23.003														
20.500														
20.507	Y	Y	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y
20.509	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y

CFDA	<i>Types of Compliance Requirements</i>													
	A. <i>Activities Allowed or Unallowed</i>	B. <i>Allowable Costs/Cost Principles</i>	C. <i>Cash Management</i>	D. <i>Davis-Bacon Act</i>	E. <i>Eligibility</i>	F. <i>Equipment and Real Property Management</i>	G. <i>Matching, Level of Effort, Earmarking</i>	H. <i>Period of Availability of Federal Funds</i>	I. <i>Procurement and Suspension and Debarment</i>	J. <i>Program Income</i>	K. <i>Real Property Acquisition/Relocation Assistance</i>	L. <i>Reporting</i>	M. <i>Subrecipient Monitoring</i>	N. <i>Special Tests and Provisions</i>
20.600														
20.601														
20.602														
20.603														
20.604														
20.605	Y	Y	Y			Y	Y	Y	Y	Y		Y	Y	
21 - Department of the Treasury (TREAS)														
21.020	Y	Y	Y		Y	Y	Y		Y			Y	Y	
45 - National Endowment for the Humanities (NEH)														
45.129	Y	Y	Y			Y	Y	Y	Y	Y		Y	Y	
66 - Environmental Protection Agency (EPA)														
66.458	Y	Y	Y			Y	Y	Y	Y	Y	Y	Y	Y	Y
66.468	Y	Y	Y			Y	Y	Y	Y	Y	Y	Y	Y	Y
81 - Department of Energy (DOE)														
81.042	Y	Y	Y		Y	Y	Y		Y	Y		Y	Y	
84 - Department of Education (ED)														
84.002	Y	Y	Y			Y	Y	Y	Y			Y	Y	
84.010	Y	Y	Y		Y	Y	Y	Y	Y			Y	Y	Y
84.011	Y	Y	Y			Y	Y	Y	Y			Y	Y	Y
84.027														
84.173	Y	Y	Y			Y	Y	Y	Y			Y	Y	Y
84.032	See Part 4											Y		Y
84.041	Y	Y		Y			Y					Y		Y

CFDA	<i>Types of Compliance Requirements</i>													
	A. <i>Activities Allowed or Unallowed</i>	B. <i>Allowable Costs/Cost Principles</i>	C. <i>Cash Management</i>	D. <i>Davis-Bacon Act</i>	E. <i>Eligibility</i>	F. <i>Equipment and Real Property Management</i>	G. <i>Matching, Level of Effort, Earmarking</i>	H. <i>Period of Availability of Federal Funds</i>	I. <i>Procurement and Suspension and Debarment</i>	J. <i>Program Income</i>	K. <i>Real Property Acquisition/Relocation Assistance</i>	L. <i>Reporting</i>	M. <i>Subrecipient Monitoring</i>	N. <i>Special Tests and Provisions</i>
84.042														
84.044														
84.047														
84.066														
84.217	Y	Y	Y		Y	Y	Y	Y	Y			Y		
84.048	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	Y
84.126	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y		
84.181	Y	Y	Y			Y	Y	Y	Y			Y		
84.186	Y	Y	Y			Y	Y	Y	Y			Y	Y	Y
84.278	Y	Y	Y		Y		Y					Y	Y	Y
84.282	Y	Y	Y		Y	Y	Y	Y	Y			Y	Y	
84.287	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	Y
84.288														
84.290														
84.291	Y	Y	Y			Y	Y	Y	Y			Y		Y
84.298	Y	Y	Y			Y	Y	Y	Y			Y	Y	Y
84.318	Y	Y	Y			Y	Y	Y	Y			Y	Y	Y
84.338	Y	Y	Y		Y		Y	Y	Y			Y	Y	Y
84.357	Y	Y	Y		Y		Y	Y	Y			Y	Y	Y
84.365	Y	Y	Y			Y	Y	Y	Y			Y	Y	Y
84.367	Y	Y	Y		Y		Y	Y	Y			Y	Y	Y
93 - Department of Health and Human Services (HHS)														
93.044														
93.045														
93.053	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	Y
93.210	Y	Y			Y			Y		Y				
93.217	Y	Y	Y			Y	Y	Y	Y	Y		Y	Y	

CFDA	<i>Types of Compliance Requirements</i>													
	A. <i>Activities Allowed or Unallowed</i>	B. <i>Allowable Costs/Cost Principles</i>	C. <i>Cash Management</i>	D. <i>Davis-Bacon Act</i>	E. <i>Eligibility</i>	F. <i>Equipment and Real Property Management</i>	G. <i>Matching, Level of Effort, Earmarking</i>	H. <i>Period of Availability of Federal Funds</i>	I. <i>Procurement and Suspension and Debarment</i>	J. <i>Program Income</i>	K. <i>Real Property Acquisition/Relocation Assistance</i>	L. <i>Reporting</i>	M. <i>Subrecipient Monitoring</i>	N. <i>Special Tests and Provisions</i>
93.151 93.224 93.246 93.927	Y	Y	Y		Y	Y		Y	Y	Y		Y		Y
93.268	Y	Y	Y		Y			Y	Y	Y		Y	Y	Y
93.556	Y	Y	Y			Y	Y	Y	Y			Y	Y	
93.558	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	Y
93.563	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	Y
93.566	Y	Y	Y		Y			Y	Y			Y		
93.568	Y	Y	Y		Y		Y	Y	Y			Y	Y	
93.569	Y	Y	Y		Y		Y	Y	Y			Y	Y	Y
93.575 93.596	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	
93.600	Y	Y	Y	Y		Y	Y	Y	Y	Y		Y	Y	Y
93.645	Y	Y	Y				Y	Y	Y			Y		
93.658	Y	Y	Y		Y	Y	Y	Y	Y			Y	Y	
93.659	Y	Y	Y		Y	Y	Y	Y	Y			Y	Y	
93.667	Y	Y	Y				Y	Y	Y				Y	
93.767	Y	Y	Y		Y		Y	Y	Y	Y		Y	Y	
93.775 93.777 93.778	Y	Y	Y		Y		Y	Y	Y	Y		Y	Y	Y
93.914	Y	Y	Y		Y		Y	Y	Y	Y		Y	Y	
93.917	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	
93.918	Y	Y	Y			Y	Y	Y	Y	Y		Y		
93.958	Y	Y	Y			Y	Y	Y	Y			Y	Y	Y
93.959	Y	Y	Y			Y	Y	Y	Y			Y	Y	Y

CFDA	Types of Compliance Requirements													
	A. <i>Activities Allowed or Unallowed</i>	B. <i>Allowable Costs/Cost Principles</i>	C. <i>Cash Management</i>	D. <i>Davis-Bacon Act</i>	E. <i>Eligibility</i>	F. <i>Equipment and Real Property Management</i>	G. <i>Matching, Level of Effort, Earmarking</i>	H. <i>Period of Availability of Federal Funds</i>	I. <i>Procurement and Suspension and Debarment</i>	J. <i>Program Income</i>	K. <i>Real Property Acquisition/Relocation Assistance</i>	L. <i>Reporting</i>	M. <i>Subrecipient Monitoring</i>	N. <i>Special Tests and Provisions</i>
93.991	Y	Y	Y			Y	Y	Y	Y	Y		Y	Y	
93.994	Y	Y	Y			Y	Y	Y	Y	Y		Y	Y	
94 - Corporation for National and Community Service (CNCS)														
94.006	Y	Y	Y		Y		Y	Y	Y	Y		Y	Y	
94.011														
94.016	Y	Y	Y		Y		Y	Y	Y	Y		Y		
96 - Social Security Administration (SSA)														
96.001														
96.006	Y	Y	Y			Y		Y	Y			Y		
97 - Department of Homeland Security (DHS)														
97.036	Y	Y	Y		Y	Y	Y	Y	Y			Y	Y	Y
97.039	Y	Y	Y		Y	Y	Y	Y	Y	Y		Y	Y	
Clusters of Programs														
R&D	Y	Y	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y
SFA	Y		Y		Y		Y	Y	Y	Y		Y	Y	Y

Legend:

Y Yes, this type of compliance requirement may apply to the Federal program.

Shaded box Indicates the program normally does not have activity subject to this type of compliance requirement.

* Program does not have a CFDA number, so the Part 4 page number is used

Attachment J: A-133 Compliance Supplement Part 3

Compliance Requirements

INTRODUCTION

The objectives of most compliance requirements for Federal programs administered by States, local governments, Indian tribal governments, and non-profit organizations are generic in nature. For example, most programs have eligibility requirements for individuals or organizations. While the criteria for determining eligibility vary by program, the objective of the compliance requirement that only eligible individuals or organizations participate is consistent across all programs.

Rather than repeat these compliance requirements, audit objectives, and suggested audit procedures for each of the programs contained in Part 4 - Agency Program Requirements and Part 5 - Clusters of Programs, they are provided once in this part. For each program in this Compliance Supplement (this Supplement), Part 4 or Part 5 contains additional information about the compliance requirements that arise from laws and regulations applicable to each program, including the requirements specific to each program that should be tested using the guidance in this part.

Administrative Requirements

The administrative requirements that apply to most programs arise from two sources: the “Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments” (also known as the “A-102 Common Rule”) and OMB Circular A-110, “Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations,” and the agencies’ codification (or other form of implementation) of OMB Circular A-110. The applicable guidance followed depends on the type of organization undergoing audit. Other administrative compliance requirements unique to a single program or a cluster of programs are provided in the Special Tests and Provisions sections of Parts 4 and 5.

State, Local, and Indian Tribal Governments

Governmentwide guidance for administering grants and cooperative agreements to States, local governments, and Indian tribal governments is contained in the A-102 Common Rule, which was codified by each Federal funding agency in its title of the *Code of Federal Regulations*. The A-102 Common Rule section numbers are referred to without the Federal agency’s part number (e.g., §____.37 would refer to sections in all agency regulations). This allows auditors to refer to the same section numbers when discussing administrative issues with different Federal funding agencies.

These requirements, which incorporate the cost principles by reference, apply to all grants and subgrants to governments, except grants and subgrants to State or local (public) institutions of higher education and hospitals, and except where they are inconsistent with Federal statutes or

with regulations authorized in accordance with the exception provision of the A-102 Common Rule. Block grants authorized by the Omnibus Budget Reconciliation Act of 1981 and several other specifically identified programs are exempted from the A-102 Common Rule. Appendix I to this Supplement specifies legislation and programs where exclusions exist.

In some cases the A-102 Common Rule permits States to follow their own laws and procedures, e.g., when addressing equipment management. These are noted in the sections that follow. The auditor will have to refer to an individual State's rules in those situations.

Non-Profit Organizations

The major source of requirements applicable to institutions of higher education, hospitals and other non-profit organizations is OMB Circular A-110, which incorporates the cost principles by reference. The provisions of OMB Circular A-110 are codified in agency regulations, generally following the section numbers in the circular. The OMB Circular A-110 section numbers are referenced in a manner similar to the A-102 Common Rule references. However, unlike the A-102 Common Rule, with OMB approval, agencies could modify certain provisions of A-110 to meet their special needs. OMB Circular A-110 states "Federal agencies responsible for awarding and administering grants . . . shall adopt the language in the circular unless different provisions are required by Federal statute or are approved by OMB." Subpart A, §____.4, of OMB Circular A-110 states that "Federal awarding agencies may apply more restrictive requirements to a class of recipients when approved by OMB." Federal awarding agencies may apply less restrictive requirements when awarding small awards, except for those requirements which are statutory. Exceptions on a case-by-case basis may also be made by Federal awarding agencies.

Appendix II to this supplement contains a list of agencies that have codified OMB Circular A-110 and the CFR citations for these codifications.

Subrecipients

Governmental subrecipients are subject to the provisions of the A-102 Common Rule. However, the A-102 Common Rule permits States to impose their own requirements on their governmental subrecipients, e.g., equipment management or procurement. Thus, in some circumstances, the auditor may need to refer to State rules and regulations rather than Federal requirements.

All subrecipients who are institutions of higher education, hospitals, or other non-profits, regardless of the type of organization making the subaward, shall follow the provisions of OMB Circular A-110, as implemented by the agency, when awarding or administering subgrants except under block grants authorized by the Omnibus Budget Reconciliation Act of 1981 and the Job Training Partnership Act where State rules apply instead.

Compliance Requirements, Audit Objectives, and Suggested Audit Procedures

Auditors shall consider the compliance requirements and related audit objectives in Part 3 and Part 4 or 5 (for programs included in this Supplement) in every audit of non-Federal entities

conducted under OMB Circular A-133, with the exception of program-specific audits performed in accordance with a Federal agency's program-specific audit guide. In making a determination not to test a compliance requirement, the auditor must conclude that the requirement either does not apply to the particular non-Federal entity or that noncompliance with the requirement could not have a material effect on a major program (e.g., the auditor would not be expected to test Procurement if the non-Federal entity charges only small amounts of purchases to a major program). The descriptions of the compliance requirements in Parts 3, 4, and 5 are generally a summary of the actual compliance requirements. The auditor should refer to the referenced citations (e.g., laws and regulations) for the complete statement of the compliance requirements.

The suggested audit procedures are provided to assist auditors in planning and performing tests of non-Federal entity compliance with the requirements of Federal programs. Auditor judgment will be necessary to determine whether the suggested audit procedures are sufficient to achieve the stated audit objective and whether additional or alternative audit procedures are needed.

The suggested procedures are in lieu of specifying audit procedures for each of the programs included in this Supplement. This approach has several advantages. First, it provides guidelines to assist auditors in designing audit procedures that are appropriate in the circumstance. Second, it helps auditors develop audit procedures for programs that are not included in this Supplement. Finally, it simplifies future updates to this Supplement.

The suggested audit procedures for compliance testing may be accomplished using dual-purpose testing.

Internal Control

Consistent with the requirements of OMB Circular A-133, this Part includes generic audit objectives and suggested audit procedures to test internal control. However, the auditor must determine the specific procedures to test internal control on a case-by-case basis considering factors such as the non-Federal entity's internal control, the compliance requirements, the audit objectives for compliance, the auditor's assessment of control risk, and the audit requirement to test internal control as prescribed in OMB Circular A-133.

The suggested audit procedures for internal control testing may be accomplished using dual-purpose testing.

Improper Payments

Under OMB budgetary guidance and Pub. L. 107-300, Federal agencies are required to review Federal awards and, as applicable, provide an estimate of improper payments. Improper payments mean:

1. Any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements, and includes any payment to an ineligible recipient; and

2. Any payment for an ineligible service, any duplicate payment, any payment for services not received, and any payment that does not account for credit for applicable discounts.

Auditors should be alert to improper payments, particularly when testing A, “Activities Allowed or Unallowed;” B, “Allowable Costs/Cost Principles;” E, “Eligibility;” and, in some cases N, “Special Tests and Provisions.”

A. ACTIVITIES ALLOWED OR UNALLOWED

Compliance Requirements

The specific requirements for activities allowed or unallowed are unique to each Federal program and are found in the laws, regulations, and the provisions of contract or grant agreements pertaining to the program. For programs listed in this Supplement, the specific requirements of the governing statutes and regulations are included in Part 4 - Agency Program Requirements or Part 5 - Clusters of Programs, as applicable. This type of compliance requirement specifies the activities that can or cannot be funded under a specific program.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
2. Determine whether Federal awards were expended only for allowable activities.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for activities allowed or unallowed and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures – Compliance

1. Identify the types of activities which are either specifically allowed or prohibited by the laws, regulations, and the provisions of contract or grant agreements pertaining to the program.
2. When allowability is determined based upon summary level data, perform procedures to verify that:
 - a. Activities were allowable.

- b. Individual transactions were properly classified and accumulated into the activity total.
3. When allowability is determined based upon individual transactions, select a sample of transactions and perform procedures to verify that the transaction was for an allowable activity.
4. The auditor should be alert for large transfers of funds from program accounts which may have been used to fund unallowable activities.

B. ALLOWABLE COSTS/COST PRINCIPLES

Applicability of OMB Cost Principles Circulars

The following OMB cost principles circulars prescribe the cost accounting policies associated with the administration of Federal awards by: (1) States, local governments, and Indian tribal governments (State rules for expenditures of State funds apply for block grants authorized by the Omnibus Budget Reconciliation Act of 1981 and for other programs specified in Appendix I); (2) institutions of higher education; and (3) non-profit organizations. Federal awards administered by publicly owned hospitals and other providers of medical care are exempt from OMB's cost principles circulars, but are subject to requirements promulgated by the sponsoring Federal agencies (e.g., the Department of Health and Human Services' 45 CFR part 74, appendix E). The cost principles applicable to a non-Federal entity apply to all Federal awards received by the entity, regardless of whether the awards are received directly from the Federal Government or indirectly through a pass-through entity. The circulars describe selected cost items, allowable and unallowable costs, and standard methodologies for calculating indirect costs rates (e.g., methodologies used to recover facilities and administrative costs (F&A) at institutions of higher education). Federal awards include Federal programs and cost-type contracts and may be in the form of grants, contracts, and other agreements.

The three cost principles circulars are as follows:

- **OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments."**
- **OMB Circular A-21, "Cost Principles for Educational Institutions."** - All institutions of higher education are subject to the cost principles contained in OMB Circular A-21, which incorporates the four Cost Accounting Standards Board (CASB) Standards and the Disclosure Statement (DS-2) requirements as described in OMB Circular A-21, sections C.10 through C.14 and Appendices A and B.
- **OMB Circular A-122, "Cost Principles for Non-Profit Organizations."** - Non-profit organizations are subject to OMB Circular A-122, except those non-profit organizations listed in OMB Circular A-122, Attachment C that are subject to the commercial cost principles contained in the Federal Acquisition Regulation (FAR). Also, by contract terms and conditions, some non-profit organizations may be subject to the CASB's Standards and the Disclosure Statement (DS-1) requirements.

The cost principles articulated in the three OMB cost principles circulars are in most cases substantially identical, but a few differences do exist. These differences are necessary because of the nature of the Federal/State/local/non-profit organizational structures, programs administered, and breadth of services offered by some grantees and not others. Exhibit 1 of this part of the Supplement, Selected Items of Cost, lists the treatment of the selected cost items in the different circulars.

Compliance Requirements - Allowability of Costs - General Criteria (applicable to both direct and indirect costs)

The general criteria affecting allowability of costs under Federal awards are:

- *Reasonable and Necessary* - Costs must be reasonable and necessary for the performance and administration of Federal awards.
- *Allocable* - Costs must be allocable to the Federal awards under the provisions of the cost principles or CASB Standards, as applicable. A cost is allocable to a particular cost objective (e.g., a specific function, program, project, department, or the like) if the goods or services involved are charged or assigned to such cost objective in accordance with relative benefits received.
- *Consistency* - Costs must be given consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances. 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 was allocated to the Federal award as an indirect cost.
- *Conformity to Laws, Regulations and Sponsored Agreements* - Costs must conform to any limitations or exclusions set forth in the circulars, Federal laws, State or local laws, sponsored agreements, or other governing regulations as to types or amounts of cost items.
- *Transactions that Reduce or Offset Direct or Indirect Costs* - Costs must be net of all applicable credits that result from transactions that reduce or offset direct or indirect costs. Examples of such transactions include purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments for overpayments or erroneous charges.
- *Costs Documentation* - Costs must be documented in accordance with OMB Circular A-110 for non-profit organizations and institutions of higher education or the A-102 Common Rule for State, local and Indian tribal governments.

Compliance Requirements - Indirect Costs

Indirect costs are those costs that benefit common activities and, therefore, cannot be readily assigned to a specific direct cost objective or project. Three different types of indirect cost rates can be approved by the cognizant agency for indirect cost negotiation: predetermined, fixed, and provisional/final.

- *Predetermined rates* - rates established for the current or multiple future period(s) based on current data (usually data from the most recently ended fiscal year, known as the base period). Predetermined rates are not subject to adjustment, except under very unusual circumstances.

- *Fixed rates* - rates based on current data in the same manner as predetermined rates, except that the difference between the costs of the base period used to establish the rate and the actual costs of the current period is carried forward as an adjustment to the rate computation for a subsequent period.
- *Provisional rates* - temporary rates used for funding and billing indirect costs, pending the establishment of a final rate for a period.

Sometimes award-specific indirect cost rates are negotiated that are different from those set forth in negotiated rate agreements. Terms and conditions in an award specific to indirect cost rates take precedence over indirect cost rates set forth in negotiated agreements.

Organization by Applicable Cost Principles Circular

The following sections are organized by the applicable OMB cost principles circular (i.e., A-87, A-21, and A-122). The compliance requirements for direct and indirect costs in the following sections identify general information, special compliance requirements, the availability of other information, audit objectives, and suggested audit procedures for each of the three OMB cost principles circulars.

OMB CIRCULAR A-87 COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS

Introduction

OMB Circular A-87 (A-87) establishes principles and standards for determining allowable direct and indirect costs for Federal awards. This section is organized into the following areas of allowable costs: State/Local-Wide Central Service Costs; State/Local Department or Agency Costs (Direct and Indirect); and State Public Assistance Agency Costs.

Cognizant Agency

A-87, Attachment A, paragraph B.6. defines “cognizant agency” as the Federal agency responsible for reviewing, negotiating, and approving cost allocation plans or indirect cost proposals developed under A-87 on behalf of all Federal agencies. OMB publishes a listing of cognizant agencies (*Federal Register*, 51 FR 552, January 6, 1986). References to cognizant agency in this section should not be confused with the cognizant Federal agency for audit responsibilities, which is defined in OMB Circular A-133, Subpart D. §____.400(a).

Availability of Other Information

Additional information on cost allocation plans and indirect cost rates is found in the Department of Health and Human Services (HHS) publications: *A Guide for State, Local and Indian Tribal Governments* (ASMB C-10); *Review Guide for State and Local Governments State/Local-Wide Central Service Cost Allocation Plans and Indirect Cost Rates*; and the *Review Guide for Public Assistance Cost Allocation Plans* which are available on the Internet at <http://rates.psc.gov/>.

Allowable Costs - State/Local-Wide Central Service Costs

Most governmental entities provide services, such as accounting, purchasing, computer services, and fringe benefits, to operating agencies on a centralized basis. Since the Federal awards are performed within the individual operating agencies, there must be a process whereby these central service costs are identified and assigned to benefiting operating agency activities on a reasonable and consistent basis. The State/local-wide central service cost allocation plan (CAP) provides that process. (Refer to A-87, Attachment C, State/Local-Wide Central Service Cost Allocation Plans, for additional information and specific requirements.)

The allowable costs of central services that a governmental unit provides to its agencies may be allocated or billed to the user agencies. The State/local-wide central service CAP is the required documentation of the methods used by the governmental unit to identify and accumulate these costs, and to allocate them or develop billing rates based on them.

Allocated central service costs (referred to as Section I costs) are allocated to benefiting operating agencies on some reasonable basis. These costs are usually negotiated and approved for a future year on a “fixed-with-carry-forward” basis. Examples of such services might include

general accounting, personnel administration, and purchasing. Section I costs assigned to an operating agency through the State/local-wide central service CAP are typically included in the agency's indirect cost pool.

Billed central service costs (referred to as Section II costs) are billed to benefiting agencies and/or programs on an individual fee-for-service or similar basis. The billed rates are usually based on the estimated costs for providing the services. An adjustment will be made at least annually for the difference between the revenue generated by each billed service and the actual allowable costs. Examples of such billed services include computer services, transportation services, self- insurance, and fringe benefits. Section II costs billed to an operating agency may be charged as direct costs to the agency's Federal awards or included in its indirect cost pool.

1. Compliance Requirements - State/Local-Wide Central Service Costs

a. Basic Guidelines

- (1) The basic guidelines affecting allowability of costs (direct and indirect) are identified in A-87, Attachment A, paragraph C.
- (2) To be allowable under Federal awards, costs must meet the following general criteria (A-87, Attachment A, paragraph C.1):
 - (a) Be necessary and reasonable for the performance and administration of Federal awards. (Refer to A-87, Attachment A, paragraph C.2 for additional information on reasonableness of costs.)
 - (b) Be allocable to Federal awards under the provisions of A-87. (Refer to A-87, Attachment A, paragraph C.3 for additional information on allocable costs.)
 - (c) Be authorized or not prohibited under State or local laws or regulations.
 - (d) Conform to any limitations or exclusions set forth in A-87, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.
 - (e) Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.
 - (f) 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.

- (g) Be determined in accordance with generally accepted accounting principles, except as otherwise provided in A-87.
- (h) Not be included as a cost or used to meet cost sharing or matching requirements of any other Federal award, except as specifically provided by Federal law or regulation.
- (i) Be net of all applicable credits. (Refer to A-87, Attachment A, paragraph C.4 for additional information on applicable credits.)
- (j) Be adequately documented.

b. *Selected Items of Cost*

- (1) Sections 1 through 42 of A-87, Attachment B, provide the principles to be applied in establishing the allowability or unallowability of certain items of cost. (For a listing of costs, refer to Exhibit 1 of this part of the Supplement.) These principles apply whether a cost is treated as direct or indirect. Failure to mention a particular item of cost in this section of A-87 is not intended to imply that it is either allowable or unallowable; rather, determination of allowability in each case should be based on the treatment or standards provided for similar or related items of cost.
- (2) A cost is allowable for Federal reimbursement only to the extent of benefits received by Federal awards and its conformance with the general policies and principles stated in A-87, Attachment A.

c. *Submission Requirements*

- (1) Submission requirements are identified in A-87, Attachment C, paragraph D.
- (2) A State is required to submit a State-wide central service CAP to HHS for each year in which it claims central service costs under Federal awards.
- (3) A local government that has been designated as a “major local government” by OMB is required to submit a central service CAP to its cognizant agency annually. All other local governments claiming central service costs must develop a CAP in accordance with the requirements described in A-87 and maintain the plan and related supporting documentation for audit. Local governments are not required to submit the plan for Federal approval unless they are specifically requested to do so by the cognizant agency. If a local government receives funds as a subrecipient only, the primary recipient will be responsible for negotiating and/or monitoring the local government’s plan.
- (4) All central service CAPs will be prepared and, when required, submitted within the 6 months prior to the beginning of the governmental unit’s fiscal

years in which it proposes to claim central service costs. Extensions may be granted by the cognizant agency.

d. *Documentation Requirements*

- (1) The central service CAP must include all central service costs that will be claimed (either as an allocated or a billed cost) under Federal awards. Costs of central services omitted from the CAP will not be reimbursed.
- (2) The documentation requirements for all central service CAPs are contained in A-87, Attachment C, paragraph E. All plans and related documentation used as a basis for claiming costs under Federal awards must be retained for audit in accordance with the record retention requirements contained in the A-102 Common Rule.

e. *Required Certification* - No proposal to establish a central service CAP, whether submitted to a Federal cognizant agency or maintained on file by the governmental unit, shall be accepted and approved unless such costs have been certified by the governmental unit using the Certificate of Cost Allocation Plan as set forth in A-87, Attachment C.

f. *Allocated Central Service Costs (Section I Costs)* - A carry-forward adjustment is not permitted for a central service activity that was not included in the previously approved plan or for unallowable costs that must be reimbursed immediately (A-87, Attachment C, paragraph G.3).

g. *Billed Central Service Costs (Section II Costs)*

- (1) Internal service funds for central service activities are allowed a working capital reserve of up to 60 days cash expenses for normal operating purposes (A- 87, Attachment C, paragraph G.2). A working capital reserve exceeding 60 days may be approved by the cognizant Federal agency in exceptional cases.
- (2) Adjustments of billed central services are required when there is a difference between the revenue generated by each billed service and the actual allowable costs (A-87, Attachment C, paragraph G.4). The adjustments will be made through one of the following methods:
 - (a) A cash refund to the Federal Government for the Federal share of the adjustment, if revenue exceeds costs,
 - (b) Credits to the amounts charged to the individual programs,
 - (c) Adjustments to future billing rates, or

(d) Adjustments to allocated central service costs (Section I) if the total amount of the adjustment for a particular service does not exceed \$500,000.

(3) Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund), refunds shall be made to the Federal Government for its share of funds transferred, including earned or imputed interest from the date of transfer (A-87, Attachment B, paragraph 25).

2. *Audit Objectives - State/Local-Wide Central Service Costs*

a. Obtain an understanding of internal control over the compliance requirements for central service costs, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).

b. Determine whether the governmental unit complied with the provisions of A-87 as follows:

(1) Direct charges to Federal awards were for allowable costs.

(2) Charges to cost pools allocated to Federal awards through the central service CAPs were for allowable costs.

(3) The methods of allocating the costs are in accordance with the applicable cost principles, and produce an equitable and consistent distribution of costs, which benefit from the central service costs being allocated (e.g., cost allocation bases include all activities, including all State departments and agencies and, if appropriate, non-State organizations which receive services).

(4) Cost allocations were in accordance with central service CAPs approved by the cognizant agency or, in cases where such plans are not subject to approval, in accordance with the plan on file.

3. *Suggested Internal Control Audit Procedures - State/Local-Wide Central Service Costs*

a. Using the guidance provided in Part 6 - Internal Control for allowable costs/cost principles, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.

b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and

considering whether additional compliance tests and reporting are required because of ineffective internal control.

- c. Consider the results of the testing of internal control in assessing the risk of non-compliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures - State/Local-Wide Central Service Costs*

- a. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.
 - (1) In reviewing the State/local-wide central service costs, the auditor may not need to test all central service costs (allocated or billed) every year; for example, the auditor in obtaining sufficient evidence for the opinion may consider testing each central service at least every 5 years, and perform additional testing for central services with operating budgets of \$5 million or more.
 - (2) If the local governmental entity is not required to submit the central service CAP and related supporting documentation, the auditor should consider the risk of the reduced level of oversight in designing the nature, timing and extent of compliance testing.
- b. *General Audit Procedures for State/Local-Wide Central Service CAPs* - The following procedures apply to direct charges to Federal awards as well as charges to cost pools that are allocated wholly or partially to Federal awards or used in formulating indirect cost rates used for recovering indirect costs under Federal awards.
 - (1) Test a sample of transactions for conformance with:
 - (a) The criteria contained in the “Basic Guidelines” section of A-87, Attachment A, paragraph C.
 - (b) The principles to establish allowability or unallowability of certain items of cost (A-87, Attachment B).
 - (2) If the auditor identifies unallowable costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would have not been incurred if the other cost had not been incurred. When an unallowable cost is incurred, directly associated costs are also

unallowable. For example, occupancy costs related to unallowable general costs of government are also unallowable.

c. *Special Audit Procedures for State/Local-Wide Central Service CAPs*

(1) Verify that the central service CAP includes the required documentation in accordance with A-87, Attachment C, paragraph E.

(2) *Testing of the State/Local-Wide Central Service CAPs - Allocated Section I Costs*

(a) If new allocated central service costs were added, review the justification for including the item as Section I costs to ascertain if the costs are allowable (e.g., if costs benefit Federal awards).

(b) Identify the central service costs that incurred a significant increase in actual costs from the prior year's costs. Test a sample of transactions to verify the allowability of the costs.

(c) Determine whether the bases used to allocate costs are appropriate, i.e., costs are allocated in accordance with relative benefits received.

(d) Determine whether the proposed bases include all activities that benefit from the central service costs being allocated, including all users that receive the services. For example, the State-wide central service CAP should allocate costs to all benefiting State departments and agencies, and, where appropriate, non-State organizations, such as local government agencies.

(e) Perform an analysis of the allocation bases by selecting agencies with significant Federal awards to determine if the percentage of costs allocated to these agencies has increased from the prior year. For those selected agencies with significant allocation percentage increases, determine that the data included in the bases are current and accurate.

(f) Verify that carry-forward adjustments are properly computed in accordance with A-87, Attachment C, paragraph G.3.

(3) *Testing of the State/Local-Wide Central Service CAPs - Billed Section II Costs*

(a) For billed central service activities accounted for in separate funds (e.g., internal service funds), ascertain if:

- (i) Retained earnings/fund balances (including reserves) are computed in accordance with the applicable cost principles;
- (ii) Working capital reserves are not excessive in amount (generally not greater than 60 days for cash expenses for normal operations incurred for the period exclusive of depreciation, capital costs, and debt principal costs); and
- (iii) Adjustments were made when there is a difference between the revenue generated by each billed service and the actual allowable costs.

Note: A 60-day working capital reserve is not automatic. Refer to the HHS publication, *A Guide for State, Local, and Indian Tribal Governments* (ASMB C-10) for guidelines.

- (b) Test to ensure that all users of services are billed in a consistent manner. For example, examine selected billings to determine if all users (including users outside the governmental unit) are charged the same rate for the same service.
- (c) Test that billing rates exclude unallowable costs, in accordance with applicable cost principles and Federal statutes.
- (d) Test, where billed central service activities are funded through general revenue appropriations, that the billing rates (or charges) are developed based on actual costs and were adjusted to eliminate profits.
- (e) For self-insurance and pension funds, ascertain if independent actuarial studies appropriate for such activities are performed at least biennially and that current period costs were allocated based on an appropriate study that is not over two years old.
- (f) Determine if refunds were made to the Federal Government for its share of funds transferred from the self-insurance reserve to other accounts, including imputed or earned interest from the date of the transfer.

Allowable Costs – State/Local Department or Agency Costs - Direct and Indirect

The individual State/local departments or agencies (also known as operating agencies) are responsible for the performance or administration of Federal awards. In order to receive cost reimbursement under Federal awards, the department or agency usually submits claims asserting that allowable and eligible costs (direct and indirect) have been incurred in accordance with

A-87

While direct costs are those that can be identified specifically with a particular final cost objective, the indirect costs are those that have been incurred for common or joint purposes, and not readily assignable to the cost objectives specifically benefited without effort disproportionate to the results achieved. Indirect costs are normally charged to Federal awards by the use of an indirect cost rate.

The indirect cost rate proposal (ICRP) provides the documentation prepared by a State/local department or agency, to substantiate its request for the establishment of an indirect cost rate. The indirect costs include: (1) costs originating in the department or agency carrying out Federal awards, and (2) costs of central governmental services distributed through the State/local-wide central service CAP that are not otherwise treated as direct costs. The ICRPs are based on the most current financial data and are used to either establish predetermined, fixed, or provisional indirect cost rates or to finalize provisional rates (for rate definitions refer to A-87, Attachment E, paragraph B).

1. *Compliance Requirements - State/Local Department or Agency Costs - Direct and Indirect*

- a. *Basic Guidelines* - Refer to the previous section, “Allowable Costs – State/Local-Wide Central Service Costs, 1.a - Compliance Requirements-Basic Guidelines,” for the guidelines affecting the allowability of costs (direct and indirect) under Federal awards.
- b. *Selected Items of Cost* - Refer to the previous section, “Allowable Costs – State/Local-Wide Central Service Costs, 1.b - Compliance Requirements-Selected Items of Cost,” for the principles to establish allowability or unallowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect.
- c. *Allocation of Indirect Costs and Determination of Indirect Cost Rates*
 - (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 the circular (A-87, Attachment E, paragraph C.2).
 - (b) *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 A-87, Attachment E, 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 A-87, Attachment E, paragraph C.4.)
- (d) *Cost Allocation Plans* - In certain cases, the cognizant agency may require a State or local governmental 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 review, negotiation and approval, or retained on file for inspection during audits.

d. *Submission Requirements*

- (1) Submission requirements are identified in A-87, Attachment E, paragraph D.1. All departments or agencies of a governmental unit claiming indirect costs under Federal awards must prepare an ICRP and related documentation to support those costs.
- (2) A State/local department or agency for which a cognizant Federal agency has been assigned by OMB must submit its ICRP to its cognizant agency. Smaller local government departments or agencies which are not required to submit a proposal to the cognizant Federal agency must develop an ICRP in accordance with the requirements of A-87, and maintain the proposal and related supporting documentation for audit. Where a local government receives funds as a subrecipient only, the primary recipient will be responsible for negotiating and/or monitoring the subrecipient's plan.
- (3) Each Indian tribal government desiring reimbursement of indirect costs must submit its ICRP to the Department of the Interior.

- (4) ICRPs must be developed (and, when required, submitted) within 6 months after the close of the governmental unit's fiscal year.

e. *Documentation and Certification Requirements*

The documentation and certification requirements for ICRPs are included in A-87, Attachment E, paragraphs D.2 and 3, respectively. The proposal and related documentation must be retained for audit in accordance with the record retention requirements contained in the A-102 Common Rule.

2. *Audit Objectives - State/Local Department or Agency Costs - Direct and Indirect*

- a. Obtain an understanding of internal control over the compliance requirements for State/local department or agency costs, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
- b. Determine whether the governmental unit complied with the provisions of A-87 as follows:
 - (1) Direct charges to Federal awards were for allowable costs.
 - (2) Charges to cost pools used in calculating indirect cost rates were for allowable costs.
 - (3) The methods for allocating the costs are in accordance with the applicable cost principles, and produce an equitable and consistent distribution of costs (e.g., all activities that benefit from the indirect cost, including unallowable activities, must receive an appropriate allocation of indirect costs).
 - (4) Indirect cost rates were applied in accordance with approved indirect cost rate agreements (ICRA), or special award provisions or limitations, if different from those stated in negotiated rate agreements.
 - (5) For local departments or agencies that do not have to submit an ICRP to the cognizant Federal agency, indirect cost rates were applied in accordance with the ICRP maintained on file.

3. *Suggested Internal Control Audit Procedures - State/Local Department or Agency Costs- Direct and Indirect*

Refer to the previous section, "Allowable Costs - State/Local-Wide Central Service Costs," items 3.a through 3.c, for suggested internal control audit procedures.

4. *Suggested Compliance Audit Procedures - State/Local Department or Agency Costs - Direct and Indirect*

- a. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance. If the local department or agency is not required to submit an ICRP and related supporting documentation, the auditor should consider the risk of the reduced level of oversight in designing the nature, timing, and extent of compliance testing.
- b. *General Audit Procedures (Direct and Indirect Costs)* - The following procedures apply to direct charges to Federal awards as well as charges to cost pools that are allocated wholly or partially to Federal awards or used in formulating indirect cost rates used for recovering indirect costs from Federal awards.
 - (1) Test a sample of transactions for conformance with:
 - (a) The criteria contained in the “Basic Guidelines” section of A-87, Attachment A, paragraph C.
 - (b) The principles to establish allowability or unallowability of certain items of cost (A-87, Attachment B).
 - (2) If the auditor identifies unallowable costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would have not been incurred if the other cost had not been incurred. When an unallowable cost is incurred, directly associated costs are also unallowable. For example, occupancy costs related to unallowable general costs of government are also unallowable.
- c. *Special Audit Procedures for State/Local Department or Agency ICRPs*
 - (1) Verify that the ICRP includes the required documentation in accordance with A-87, Attachment E, paragraph D.
 - (2) *Testing of the ICRP* - There may be a timing consideration when the audit is completed before the ICRP is completed. In this instance, the auditor should consider performing interim testing of the costs charged to the cost pools and the allocation bases (e.g., determine from management the cost pools that management expects to include in the ICRP and test the costs for compliance with A-87). Should there be audit exceptions, corrective action may be taken earlier to minimize questioned costs. In the next year’s audit, the auditor should complete testing and verify management’s representations against the completed ICRP.

- (a) When the ICRA is the basis for indirect cost charged to a major program, the auditor is required to obtain appropriate assurance that the costs collected in the cost pools and allocation methods are in compliance with the applicable cost principles. The following procedures are some acceptable options the auditor may use to obtain this assurance:
 - (i) *Indirect Cost Pool* - Test the indirect cost pool to ascertain if it includes only allowable costs in accordance with A-87.
 - (A) Test to ensure that unallowable costs are identified and eliminated from the indirect cost pool (e.g., capital expenditures, general costs of government).
 - (B) 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.
 - (C) Trace the central service costs that are included in the indirect cost pool to the approved State/local-wide central service CAP or to plans on file when submission is not required.
 - (ii) *Direct Cost Base* - Test the methods of allocating the costs to ascertain if they are in accordance with the applicable provisions of A-87 and produce an equitable distribution of costs.
 - (A) Determine that the proposed base(s) includes all activities that benefit from the indirect costs being allocated.
 - (B) If the direct cost base is not limited to direct salaries and wages, determine that distorting items are excluded from the base. Examples of distorting items include capital expenditures, flow-through funds (such as benefit payments), and subaward costs in excess of \$25,000 per subaward.
 - (C) Determine the appropriateness of the allocation base (e.g., salaries and wages, modified total direct costs).

(iii) *Other Procedures*

- (A) Examine the employee time report system results (where and if used) to ascertain if they are accurate, and are based on the actual effort devoted to the various functional and programmatic activities to which the salary and wage costs are charged. (Refer to A-87, Attachment B, paragraph 11.h for additional information on support of salaries and wages.)
- (B) For an ICRP using the multiple allocation base method, test statistical data (e.g., square footage, audit hours, salaries and wages) to ascertain if the proposed allocation or rate bases are reasonable, updated as necessary, and do not contain any material omissions.

(3) *Testing of Charges Based Upon the ICRA* - Perform the following procedures to test the application of charges to Federal awards based upon an ICRA:

- (a) Obtain and read the current ICRA and determine the terms in effect.
- (b) Select a sample of claims for reimbursement and verify that the rates used are in accordance with the rate agreement, that rates were applied to the appropriate bases, and that the amounts claimed were the product of applying the rate to the applicable base. Verify that the costs included in the base(s) are consistent with the costs that were included in the base year (e.g., if the allocation base is total direct costs, verify that current-year direct costs do not include costs items that were treated as indirect costs in the base year).

(4) *Other Procedures - No Negotiated ICRA*

- (a) If an indirect cost rate has not been negotiated by a cognizant Federal agency, as required, the auditor should determine whether documentation exists to support the costs. Where the auditee has documentation, the suggested general audit procedures (direct and indirect costs under paragraph 4.b of this section) should be performed to determine the appropriateness of the indirect cost charges to awards.

- (b) If an indirect cost rate has not been negotiated by a cognizant agency, as required, and documentation to support the indirect costs does not exist, the auditor should question the costs based on a lack of supporting documentation.

Allowable Costs – State Public Assistance Agency Costs

State public assistance agency costs are (1) defined as all costs allocated or incurred by the State agency except expenditures for financial assistance, medical vendor payments, and payments for services and goods provided directly to program recipients (e.g., day care services); and (2) normally charged to Federal awards by implementing the public assistance cost allocation plan (CAP). The public assistance CAP provides a narrative description of the procedures that are used in identifying, measuring and allocating all costs (direct and indirect) to each of the programs administered or supervised by State public assistance agencies.

Attachment D of A-87 states that since the federally financed programs administered by State public assistance agencies are funded predominantly by HHS, HHS is responsible for the requirements for the development, documentation, submission, negotiation and approval of public assistance CAPs. These requirements are published in Subpart E of 45 CFR part 95.

Major Federal programs typically administered by State public assistance agencies include: Temporary Assistance for Needy Families (CFDA 93.558), Medicaid (CFDA 93.778), Food Stamps (CFDA 10.561), Child Support Enforcement (CFDA 93.563), Foster Care (CFDA 93.658), Adoption Assistance (CFDA 93.659), and Social Services Block Grant (CFDA 93.667).

1. Compliance Requirements - State Public Assistance Agency Costs

- a. *Basic Guidelines* - Refer to the previous section, “Allowable Costs – State/Local-Wide Central Service Costs, 1.a, Compliance Requirements-Basic Guidelines,” for the guidelines affecting the allowability of costs (direct and indirect) under Federal awards.
- b. *Selected Items of Cost* - Refer to the previous section, “Allowable Costs – State/Local-Wide Central Service Costs 1.b, Compliance Requirements-Selected Items of Cost,” for the principles to establish allowability or unallowability of certain items of costs. These principles apply whether a cost is treated as direct or indirect.
- c. *Submission Requirements*
 - (1) Unlike most State/local-wide central service CAPs and ICRPs, an annual submission of the public assistance CAP is not required. Once a public assistance CAP is approved, State public assistance agencies are required to promptly submit amendments to the plan if any of the following events occur (45 CFR section 95.509):

- (a) The procedures shown in the existing cost allocation plan become outdated because of organizational changes, changes to the Federal law or regulations, or significant changes in the program levels, affecting the validity of the approved cost allocation procedures.
- (b) A material defect is discovered in the cost allocation plan.
- (c) The State plan for public assistance programs is amended so as to affect the allocation of costs.
- (d) Other changes occur which make the allocation basis or procedures in the approved cost allocation plan invalid.

The amendments must be submitted to HHS for review and approval.

- d. *Documentation Requirements* - A State must claim Federal financial participation for costs associated with a program only in accordance with its approved cost allocation plan. The public assistance CAP requirements are contained in 45 CFR section 95.507.
- e. *Implementation of Approved Public Assistance CAPs* - Since public assistance CAPs are of a narrative nature, the Federal Government needs assurance that the cost allocation plan has been implemented as approved. This is accomplished by funding agencies' reviews, single audits, or audits conducted by the cognizant audit agency (A-87, Attachment D, paragraph E.1).

2. *Audit Objectives - State Public Assistance Agency Costs*

- a. Obtain an understanding of internal control over the compliance requirements for State public assistance agency costs, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
- b. Determine whether the governmental unit complied with the provisions of A-87 as follows:
 - (1) Direct charges to Federal awards were for allowable costs.
 - (2) Charges to cost pools allocated to Federal awards through the public assistance CAP were for allowable costs.
 - (3) The approved public assistance CAP correctly describes the actual procedures used to identify, measure, and allocate costs to each of the programs operated by the State public assistance agency. However, the actual procedures or methods of allocating costs must be in accordance with the applicable cost principles, and produce an equitable and consistent distribution of costs.

- (4) Charges to Federal awards are in accordance with the approved public assistance CAP. This does not apply if the auditor first determines that the approved CAP is not in compliance with the applicable cost principles and/or produces an inequitable distribution of costs.
- (5) The employee time reporting systems are implemented and operated in accordance with the methodologies described in the approved public assistance CAP.

3. *Suggested Internal Control Audit Procedures - State Public Assistance Agency Costs*

Refer to the previous section, “Allowable Costs – State/Local-Wide Central Service Costs” items 3.a through 3.c, for suggested internal control audit procedures.

4. *Suggested Compliance Audit Procedures - State Public Assistance Agency Costs*

- a. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.
- b. Since a significant amount of the costs in the public assistance CAP are allocated based on employee time reporting systems (e.g., effort certification, personnel activity report and/or random moment sampling), it is suggested that the auditor consider the risk when designing the nature, timing, and extent of compliance testing.
- c. *General Audit Procedures* - The following procedures apply to direct charges to Federal awards as well as charges to cost pools that are allocated wholly or partially to Federal awards.
 - (1) Test a sample of transactions for conformance with:
 - (a) The criteria contained in the “Basic Guidelines” section of A-87, Attachment A, paragraph C.
 - (b) The principles to establish allowability or unallowability of certain items of cost (A-87, Attachment B).
 - (2) If the auditor identifies unallowable costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would have not been incurred if the other cost had not been incurred. When an unallowable cost is incurred, directly associated costs are also

unallowable. For example, occupancy costs related to unallowable general costs of government are also unallowable.

d. *Special Audit Procedures for Public Assistance CAPs*

- (1) Verify that the State public assistance agency is complying with the submission requirements, i.e., an amendment is promptly submitted when any of the events identified in 45 CFR section 95.509 occur.
- (2) Verify that public assistance CAP includes the required documentation in accordance with 45 CFR section 95.507.
- (3) *Testing of the Public Assistance CAP* - Test the methods of allocating the costs to ascertain if they are in accordance with the applicable provisions of the cost principles and produce an equitable distribution of costs. Appropriate detailed tests may include:
 - (a) Examine the results of the employee time reporting systems to ascertain if they are accurate, and are based on the actual effort devoted to the various functional and programmatic activities to which the salary and wage costs are charged.
 - (b) Since the most significant cost pools in terms of dollars are usually allocated based upon the distribution of income maintenance and social services workers efforts identified through random moment time studies, determine whether the time studies are implemented and operated in accordance with the methodologies described in the approved public assistance CAP. For example, verify the adequacy of the controls governing the conduct and evaluation of the study, determine that the sampled observations were properly selected and performed, the documentation of the observations was properly completed, and that the results of the study were correctly accumulated and applied. Testing may include observing or interviewing staff who participate in the time studies to determine if they are correctly recording their activities.
 - (c) Test statistical data (e.g., square footage, case counts, salaries and wages) to ascertain if the proposed allocation bases are reasonable, updated as necessary, and do not contain any material omissions.
- (4) *Testing of Charges Based Upon the Public Assistance CAP* - If the approved public assistance CAP is determined to be in compliance with the applicable cost principles and produces an equitable distribution of costs, verify that the methods of charging costs to Federal awards are in accordance with the approved CAP and the provisions of the approval documents issued by HHS. Detailed compliance tests may include:

- (a) Verify that the cost allocation schedules, supporting documentation and allocation data are accurate and that the costs are allocated in compliance with the approved CAP.
- (b) Reconcile the allocation statistics of labor costs to completed employee time reporting documents (e.g., personnel activity reports or random moment sampling observation forms).
- (c) Reconcile the allocation statistics of non-labor costs to allocation data, (e.g., square footage or case counts).
- (d) Verify direct charges to supporting documents (e.g., purchase orders).
- (e) Reconcile the costs to the Federal claims.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

OMB CIRCULAR A-21 COST PRINCIPLES FOR EDUCATIONAL INSTITUTIONS

Introduction

OMB Circular A-21 (A-21) establishes principles for determining the costs applicable to research and development, training, and other sponsored work performed by educational institutions under grants, contracts, and other agreements with the Federal Government. These agreements are referred to as sponsored agreements. These principles shall be used in determining the allowable direct and indirect costs under those agreements. At educational institutions, indirect costs are accounted for through Facilities & Administrative (F&A) Cost Proposals. F&A costs, for the purpose of A-21, mean costs that are incurred for common or joint objectives and, therefore, cannot be identified readily and specifically with a particular sponsored project, an instructional activity, or any other institutional activity. F&A costs are synonymous with “indirect” costs, as previously used in A-21 and as currently used in Appendices A and B of A-21. As described in A-21, section F.1, the F&A cost categories include: building and equipment depreciation or use allowance; operation and maintenance expenses; interest expenses; general administrative expenses; departmental administration expenses; sponsored project administration expenses; library expenses; and student administration expenses. F&A costs will be referred to as “indirect costs” in this section.

Cognizant Agency

A-21, section G.11.a, defines “cognizant agency” as the Federal agency responsible for negotiating and approving F&A rates for an educational institution on behalf of all Federal agencies. References to “cognizant agency” in this section should not be confused with the cognizant Federal agency for audit responsibilities, which is defined in OMB Circular A-133, Subpart D., § ____.400(a). Section G.11 of A-21 assigns cost negotiation cognizance to the Department of Health and Human Services and the Department of Defense’s Office of Naval Research.

Availability of Other Information

University Long-Form F&A Cost Proposals

Additional information on indirect cost rates is found in the HHS publication: *Review Guide for Long-Form University Facilities & Administrative Cost Proposals*, which is available on the Internet at <http://rates.psc.gov/>.

Allowable Costs - General Criteria

1. Basic Considerations to Determine Costs

In addition to the general criteria applicable to both direct and indirect costs, the basic guidelines affecting the allowability of costs (direct and indirect) are identified in section C. of A-21. To be allowable under Federal awards, costs must meet the following general criteria:

- a. Be reasonable and necessary for the performance and administration of Federal awards (A-21, section C.3).
- b. Conform with the allocability provisions of A-21 (A-21, section C.4) or Cost Accounting Standards (CAS) Board for educational institutions, as applicable (see 48 CFR part 9905). See “Allowable Costs - Special Requirements - Cost Accounting Standards and Disclosure Statements” in this section for additional guidance on CAS.)
- c. Be given consistent accounting 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 (A-21, sections C.10 and C.11).
- d. Conform with the allowability of costs provisions of A-21, or limitations in the program agreement, program regulations, or program statute. When the maximum amount of allowable cost under a limitation is less than the total amount determined in accordance with A-21, the amount not recoverable under a sponsored agreement may not be charged to other sponsored agreements (A-21, section C.7).
- e. Be net of all applicable credits, e.g., volume or cash discounts, insurance recoveries, refunds, rebates, trade-ins, adjustments for checks not cashed, and scrap sales (A-21, section C.5).
- f. Be supported by appropriate documentation, such as approved purchase orders, receiving reports, vendor invoices, canceled checks, and time and attendance records, and correctly charged as to account, amount, and period. Documentation requirements for salaries and wages, and time and effort distribution are described in A-21. Documentation may be in an electronic form (A-21, section C.4).
- g. Be applied uniformly to Federal and non-Federal activities.
- h. With respect to fringe benefit allocations, charges, or rates, such allocations, charges, or rates are to be based on the benefits received by different classes of employees within the educational institution.

2. *Selected Items of Cost*

Section J. of Circular A-21 includes general provisions for selected items of costs. For a listing of these costs, see Exhibit 1 of this part of the Supplement. These principles apply irrespective of whether a particular item of cost is properly treated as a direct cost or an indirect cost. Failure to mention a particular item of cost is not intended to imply that it is either allowable or unallowable; rather, determination as to allowability in each case should be based on the treatment provided for similar or related items of cost.

Allowable Costs – Direct Costs

1. *Compliance Requirements - Direct Costs*

- a. Direct costs are those costs that can be identified specifically with a particular sponsored project, instructional activity, or any other institutional activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy. Identification with the sponsored work rather than the nature of the goods and services involved is the determining factor in distinguishing direct from indirect costs of a sponsored agreement.
- b. Costs incurred for the same purpose in like circumstances must be treated consistently. Where an educational institution treats a particular type of cost as a direct cost of sponsored agreements, all costs incurred for the same purpose in like circumstances shall be treated as a direct costs of all activities of the institution.

2. *Audit Objectives - Direct Costs*

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
- b. Determine whether the educational institution complied with the provisions of A-21 and CAS as follows:
 - (1) Direct charges to Federal awards were for allowable costs.
 - (2) Cost accounting practice disclosures, described in the Disclosure Statement (DS-2), including amendments, represented actual practice consistently applied. This objective only applies to non-Federal entities that are required to submit the DS-2.
 - (3) Costs are not included as both a direct billing and as a component of indirect costs, e.g., excluded from cost pools, if charged directly to Federal awards.

3. *Suggested Internal Control Audit Procedures - Direct Costs*

- a. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
- b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §__.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
- c. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures - Direct Costs*

- a. Test a sample of transactions for conformance with the following criteria contained in A-21 and CAS, as applicable.
 - (1) If the auditor identifies unallowable direct costs, the auditor should be aware that “directly associated costs” might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would not have been incurred if the other cost had not been incurred. For example, fringe benefits are “directly associated” with payroll costs. When an unallowable cost is incurred, directly associated costs are also unallowable.
 - (2) Costs were approved by the Federal-awarding agency, if required (see Exhibit 1 in this part of the Supplement for selected items of cost that require agency approval when charged to an award as direct costs).
 - (3) Costs were not included as a cost or used to meet cost-sharing requirements of other federally supported activities of the current or a prior period.
 - (4) Costs represent charges for actual costs, not budgeted or projected amounts.
 - (5) Costs were estimated, accumulated, and reported consistently (A-21, section C.10).

- (6) Costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives (A-21, section C.11).
- (7) Costs charged directly to institutional activities (i.e. research and development, instruction, other institutional activities) are accounted for consistent with their disclosed practices, as described in their DS-2, if applicable (A-21, section C.14).
- (8) Departmental costs charged direct to institutional activities (i.e. research and development, instruction, other institutional activities) are consistently charged directly, in like circumstances and are in accordance with the provisions of A-21 and CAS. Salaries of administrative and clerical staff should normally be treated as indirect. Direct charging of these costs may be appropriate where a major project or activity explicitly budgets for the administrative or clerical services and the individuals involved can be specifically identified with the project or activity. "Major project" is defined as a project that requires an extensive amount of administrative or clerical support, which is significantly greater than the routine level of such services provided by academic departments. Examples are found in A-21, Exhibit C.
- (9) Costs for general-purpose equipment charged direct to institution activities (i.e., research and development, instruction, other institutional activities) are consistently charged as direct, were approved by the awarding agency, and are in accordance with the provisions of A-21 and CAS.
- (10) Salaries and wages charged to Federal awards are allowable to the extent that total compensation to the individual employee conforms to established policies of the institution, are consistently applied, and provided that the charges for work performed directly on sponsored awards have been determined in accordance with and supported by the provisions of A-21, section J.8 as follows:
 - (a) Distribution of salaries and wages is based on payrolls documented in accordance with the generally accepted practices of the institution.
 - (b) Apportionment of employees' salaries and wages which are chargeable to more than one sponsored agreement or other cost objective is accomplished by methods which--
 - (i) Comply with A-21, sections A.2 and C,
 - (ii) Produce an equitable distribution of charges for employees' activities, and

- (iii) Distinguish the employees' direct activities from their indirect activities.
- (c) The payroll distribution is based on an after-the-fact confirmation or determination that costs distributed represent actual costs. Confirmation should be by a responsible person with suitable means of verification that the work was performed. Confirmation by the employee is not required if other responsible persons make appropriate confirmations.

Allowable Costs – Indirect Costs

1. Compliance Requirements - Indirect Costs

- a. In order to recover indirect costs, educational institutions must prepare indirect cost rate proposals (ICRPs) in accordance with the guidelines provided in A-21. Educational institutions must submit ICRPs to the cognizant agency for approval (A-21, section G.11).
- b. ICRPs prepared by educational institutions are based on the most current financial data supported by the educational institution's accounting system and audited financial statements. These ICRPs can be used to establish either predetermined rates, fixed rates with carry-forward provisions, or provisional rates (A-21, sections G.4, G.5, and G.6). The ICRP to be used to establish indirect cost rates must be certified by the educational institution in accordance with A-21, section K.2.
- c. Indirect costs are those costs that are incurred for common or joint objectives and, therefore, cannot be identified readily and specifically with a particular sponsored project, an instructional activity, or any other institutional activity.
- d. As described in A-21, section F.1, the indirect cost categories include: building and equipment depreciation or use allowance; operation and maintenance expenses; interest expenses; general administrative expenses; departmental administration expenses; sponsored project administration expense; library expenses; and student administration expenses. In general the cost groupings established within a category should constitute a pool of items of expense that are considered to be of like nature in terms of their relative contribution to the particular cost objectives to which distribution is appropriate (A-21, section E). Cost categories should be established considering the general guidelines in A-21, section E.2.c.
- e. Indirect costs are defined into two broad categories in A-21, section F.

- (1) “Facilities” is defined as depreciation and use allowance, interest in debt associated with certain buildings, equipment, and capital improvements, operation and maintenance expenses, and library expenses.
 - (2) “Administration” is defined as general administration and general expenses, departmental administration, sponsored project administration, student administration and services, and all other types of expenditures not listed specifically under one of the facility categories.
- f. Each educational institution’s indirect cost rate process must be appropriately designed to determine that Federal sponsors do not in any way subsidize the indirect costs of other sponsors, specifically activities sponsored by industry and foreign governments (A-21, section G.).
 - g. Administrative costs charged to sponsored agreements awarded or amended with effective dates beginning on or after the start of the educational institution’s first fiscal year which begins on or after October 1, 1991, shall be limited to 26 percent of modified total direct costs, as defined in A-21, section G.2. Educational institutions should not change their accounting or cost allocation methods which were in effect on May 1, 1991, if the effect is to (1) change the charging of a particular type of cost from indirect to direct, or (2) reclassify or increase allocations from the administrative pools to the facilities pools or fringe benefits cost pools (but also see A-21, section G.8).
 - h. *Submission Requirement for Standard Format for Long-Form Proposals* - For ICRPs submitted on or after July 1, 2001, educational institutions shall use the standard format shown in A-21, Appendix C to submit ICRP to the cognizant agency for indirect costs. The cognizant agency for indirect costs may, on an institution-by-institution basis, grant exceptions from all or portions of Part II of the standard format. This requirement does not apply to educational institutions that use the simplified method for calculating indirect cost rates, as described in A-21, section H.

2. *Audit Objectives - Indirect Costs*

- a. *For educational institutions that charge indirect costs to Federal awards based on federally approved rate(s):*
 - (1) Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §__.500(c).
 - (2) Determine that the rate(s) used to charge indirect costs is consistent with the appropriate cognizant Federal agency rate agreement (A-21, section G.11).

- (3) Determine that the federally approved rate in effect at the time of the initial award is applied throughout the life of the sponsored agreement. “Life” means each competitive segment of a project. A competitive segment is a period of years approved by the Federal-funding agency at the time of the award (A-21, section G.7).
 - (4) Determine that the federally approved rate(s) were applied to the appropriate distribution base (A-21, section G.2).
 - (5) Determine that indirect costs billed to sponsored agreements are the result of applying the approved rate(s) to the appropriate base amount(s).
- b. *For educational institutions that charge indirect costs to Federal awards based on rate(s) which are not approved by the cognizant Federal agency:*
- (1) Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
 - (2) Determine the educational institution’s cognizant Federal agency for approving indirect cost rates in accordance with A-21, section G.11.
 - (3) Determine whether an ICRP was prepared, certified, and submitted by the educational institution to their cognizant Federal agency. (The Federal agency is responsible for negotiating and approving indirect cost rates). Verify that billings are based on the ICRP.
 - (4) Determine that the submitted rate(s) were applied to the appropriate distribution base (a-21, section G.2).
 - (5) Determine that indirect costs billed to sponsored agreements are the result of applying the submitted rate(s) to the appropriate base amount(s).
- c. *For educational institutions that charge indirect costs to Federal awards based on award-specific rate(s) approved by an awarding agency:*
- (1) Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
 - (2) Determine that the award-specific rate(s) are the result of special circumstances such as required by law or regulation, in accordance with A-21, section G.11.
 - (3) Determine whether indirect cost rates were applied in accordance with the approved special award provisions or limitations. Associated billings were the result of applying the approved rate to the proper base amount.

- (4) When the maximum amount of allowable indirect costs under a limitation (i.e. an award-specific rate) is less than the total amount determined in accordance with the principles in A-21, the amount not recoverable under a sponsored agreement may not be charged to other sponsored agreements (A-21, section C.7).

3. *Suggested Internal Control Audit Procedures - Indirect Costs*

- a. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
- b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §__.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
- c. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures - Indirect Costs*

- a. Test a sample of transactions for conformance with the following criteria contained in A-21 and CAS, as applicable.
- b. *For educational institutions that charge indirect cost to Federal awards based on federally approved rate(s):*
 - (1) Ascertain if indirect costs or centralized or administrative services costs were allocated or charged to a major program. If not, the following suggested audit procedures do not apply.
 - (2) Obtain and read the current indirect cost rate agreement and determine the terms in effect.
 - (3) Select a sample of claims for reimbursement and verify that the rates used are in accordance with the rate agreement, that rates were applied to the appropriate bases, and that the amounts claimed were the product of applying the rate to the applicable base. Verify that the costs included in the base(s) are consistent with the costs that were included in the base year (e.g., if the allocation base is total direct costs, verify that current year

direct costs do not include costs items that were treated as indirect costs in the base year).

- (4) Ascertain if the educational institution's accounting practices for determining direct and indirect costs for the fiscal year being audited are consistent with the accounting practices used to establish the federally approved rate and its DS-2. If there accounting changes have occurred, determine if they were approved by the cognizant Federal agency. If accounting changes have not been approved and the accounting changes impact costs charged to federally funded awards, this should be considered a reportable finding. (A-21, section C.14 and CAS, as applicable).

c. *For educational institutions that charge indirect cost to Federal awards based on rate(s) which are not approved by the cognizant Federal agency:*

- (1) If the ICRP has been certified and submitted to the cognizant Federal agency and is based on costs incurred in the year being audited, then the ICRP should be audited for compliance with the provisions of A-21 and CAS, as applicable.
- (2) If the educational institution has a certified ICRP, which is based on costs incurred in the year being audited, but has not submitted it to their Federal cognizant agency. The ICRP should be audited using the procedures listed below.
 - (a) Test the indirect cost pool groupings for compliance with A-21, section F.
 - (b) Test the indirect cost pools to determine if costs are allowable.
 - (c) Test that indirect costs have been treated consistently when incurred for the same purpose, in like circumstances, as indirect costs only with respect to final cost objectives. No final cost objective shall have allocated to it as a cost any cost, if another cost incurred for the same purpose, in like circumstances, has been included as a direct cost of that or any other final cost objective (A-21, section C.11).
 - (d) Test that the indirect cost pools in the rate proposal were developed consistent with the educational institution's disclosed practices as described in its DS-2, if applicable (A-21, section C.14).
 - (e) Test the *depreciation and use allowance* cost pool to determine if:

- (i) Computations of depreciation or use allowance are based on the acquisition cost of the assets. Acquisition costs exclude (A) the cost of land; (B) any portion of the cost of buildings and equipment borne by the Federal Government, irrespective of where title was originally vested or where it is presently located; and (C) any portion of the cost of buildings and equipment contributed by or for the educational institution where law or agreement prohibit recovery (A-21, section J.12).
 - (ii) The depreciation method used to charge the cost of an asset (or group of assets) to accounting periods reflects the pattern of consumption of the asset during its useful life (A-21, section J.12).
 - (iii) Charges for use allowances or depreciation are supported by adequate property records and physical inventories, which must be taken at least once every 2 years (A-21, section J.12).
 - (iv) The depreciation methods used to calculate the depreciation amounts for the ICRP are the same methods used by the educational institution for its financial statements (A-21, section J.12).
 - (v) The allocation method for the depreciation and use allowance cost pool complies with A-21, section F.2.
 - (vi) Gains and losses on the sale, retirement, or other disposition of depreciable property have been appropriately accounted for and complies with A-21, section J.33.
 - (vii) *Large research facilities* – Determine that large research facilities that are included in ICRPs negotiated after January 1, 2000, and on which the design and construction began after July 1, 1998, are compliant with the provisions for determining allowable costs in A-21, section F.2.c.
- (f) Test the *interest* cost pool to determine if:
- (i) Computations for interest comply with the provisions of A-21, section J.22.
 - (ii) The allocation method for the interest cost pool complies with A-21, section F.3.

- (g) Test the *operations and maintenance* cost pool to determine if:
 - (i) Costs are appropriately classified in this cost pool (A-21, section F.4).
 - (ii) Rental costs comply with the provision of A-21, section J.38.
 - (iii) The educational institution's accounting practices for classifying (A) rearrangement and alteration costs and (B) reconversion costs, either as direct or indirect, result in consistent treatment in like circumstances.
 - (iv) The allocation method for the operations and maintenance cost pool complies with A-21, section F.4.

- (h) Tests the *library* cost pool to determine if:
 - (i) Costs are appropriately classified in this cost pool (A-21, section F.8).
 - (ii) The allocation method for the library cost pool complies with A-21, section F.8.
 - (iii) If the allocation method is based on a cost analysis study in accordance with A-21, section E.2.d, determine that the study:
 - (A) Results in an equitable distribution of costs and represents the relative benefits derived,
 - (B) Is appropriately documented in sufficient detail for review by the cognizant Federal agency,
 - (C) Is statistically sound,
 - (D) Is performed specifically at the educational institution,
 - (E) Is reviewed every 2 years, and, if necessary, updated, and
 - (F) Assumptions are clearly stated and adequately explained.

- (i) Test the *administrative* cost pools to determine if:

- (i) Costs are appropriately classified in these cost pools and the distribution bases are compliant with A-21, sections F.5, F.6, and F.7.
- (ii) The administrative cost components comply with the limitation on reimbursement of administrative cost in A-21, section G.8. If the proposal is based on the alternative method for administrative cost in A-21, section G.9, then the limitation does not apply. If the proposal is based on the alternative method for administrative cost, determine that the educational institution meets the criteria of section G.9 and that this is adequately documented in the proposal.
- (iii) *Departmental administration expense pool* – test to determine that this cost pool complies with A-21, section F.6.
- (iv) *Academic Deans' Offices* – test that salaries and operating expenses are limited to those attributable to administrative functions.
- (v) *Academic Departments* – Salaries and fringes attributable to the administrative work (including bid and proposal preparation) of faculty (including department heads), and other professional personnel conducting research and/or instruction, is allowed at a rate of 3.6 percent of modified total direct costs. This category should not include professional business or administrative officers. Determine that this allowance is added to the computation of the indirect cost rate for major functions. Test to determine that the expense covered by this allowance are excluded from the departmental cost pool (A-21, section F.6).

Test for consistent treatment, in like circumstances, of other administrative and supporting expenses incurred within academic departments. For example, items such as office supplies, postage, local telephone, and memberships shall normally be treated as indirect costs.

- (3) If the ICRP has been certified and submitted to the cognizant Federal agency, but is based on costs incurred in a fiscal year prior to the fiscal year being audited, a review of the ICRP is not required.
- (4) If an ICRP has not been prepared and, therefore, the indirect costs charged to Federal awards are not based on a certified ICRP, this may be required

to be reported as an audit finding, in accordance with OMB Circular A-133, §__.510(a)(5).

- (5) *Application of an indirect cost rate(s) not approved by the cognizant agency* – Even though the rate(s) has not been approved by the cognizant agency, an unapproved indirect cost rate(s) should be reviewed for consistent application of the submitted rates to direct cost bases to ensure that the indirect cost rate(s) is applied consistent with the educational institution’s policies and procedures that apply uniformly to both federally funded and other activities of the institutions.
- d. *For educational institutions that also have awards containing award-specific rates (approved by the Federal awarding agency) that take precedence over the negotiated rate for purposes of indirect cost recovery:*
- (1) Ascertain that the award-specific rate is in accordance with special circumstances required by law or regulation.
 - (2) Obtain and review the award terms used to establish an award-specific indirect cost rate(s).
 - (3) Select a sample of claims for reimbursement and verify that the award-specific rate(s) used are in accordance with the terms of the award, that rate(s) were applied to the appropriate bases, and that the amounts claimed were the product of applying the rate to the applicable base. Verify that the costs included in the base(s) are consistent with the terms of the agreement.

Allowable Costs – Special Requirements –Cost Accounting Standards and Disclosure Statements

1. Compliance Requirement - CAS and Disclosure Statements

- a. A-21, section C.14 requires educational institutions (institutions) that receive more than \$25 million in Federal funding in a fiscal year to prepare and submit a Disclosure Statement (DS-2) that describes the institution’s cost accounting practices. These institutions are required to submit a DS-2 within 6 months after the end of the institution’s fiscal year that begins after May 8, 1996, unless the institution is required to submit a DS-2 earlier due to a receipt of a CAS-covered contract in accordance with 48 CFR section 9903.202-1.
- b. These institutions are responsible for maintaining an accurate DS-2 and complying with disclosed cost accounting practices. They are also responsible for filing amendments to the DS-2 when disclosed practices are changed or modified. Amendments should be provided to the cognizant Federal agency for approval.

- c. Federal Acquisition Regulation (FAR) Appendix subpart 9903.201-2, Types of CAS Coverage, requires educational institutions to comply with all of the CAS specified in part 9905 that are in effect on the effective date of a covered contract. Negotiated contracts in excess of \$500,000 are CAS-covered, except for CAS-covered contracts awarded to Federally Funded Research and Development Centers (FFRDCs) operated by an educational institution, which are subject to part 9904.

2. *Audit Objectives - CAS and Disclosure Statements*

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
- b. Determine whether the educational institution's DS-2 is current, accurate, and complete and that it has been approved by the cognizant Federal agency as adequate and compliant with A-21 and CAS (48 CFR part 9905).
- c. Determine whether the educational institution's actual accounting practices are consistent with its disclosed accounting practices.
- d. Determine whether amendments have been filed with and approved by the cognizant Federal agency.
- e. Determine whether the educational institution's accounting practices for direct and indirect costs comply with CAS applicable to educational institutions (48 CFR part 9905).

3. *Suggested Internal Control Audit Procedures - CAS and Disclosure Statements*

- a. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
- b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
- c. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures - CAS and Disclosure Statements*

- a. Obtain a copy of the educational institution's DS-2, amendments, and letters of approval from the cognizant Federal agency.
- b. Read the DS-2 and its amendments and ascertain if the disclosure agrees with the policies prescribed in the educational institution's current policies and procedures documents.
- c. Test that the disclosure agrees with actual practices for the period covered by audit, including whether the practices were consistent throughout the period.
- d. Test direct and indirect charges to Federal awards to determine that the educational institution's practices used in estimating the costs in the proposal were consistent with the institution's cost accounting practices used in accumulating and reporting the costs (A-21, section C.10 and FAR Appendix subpart 9905.501).
- e. For those costs which are sometimes charged direct and sometimes charged indirect, test for consistent classification of these costs, when incurred for the same purpose and under like circumstances (A-21, section C.11 and FAR Appendix subpart 9905.502). For example:
 - (1) Salaries of administrative and clerical staff are normally treated as indirect costs; however, they may be charged direct to a major project or activity under certain conditions. Sample these costs when they have been charged direct to Federal awards to determine consistent treatment for non-Federal awards, instructional activity, or other institutional activity (A-21, section F.6.).
 - (2) Office supplies, postage, local telephone costs and memberships are normally treated as indirect. Sample these costs when they have been charged direct to Federal awards to determine consistent treatment for non-Federal awards, instructional activity, or other institutional activity (A-21, section F.6.).
- f. Capital expenditures for general and special-purpose equipment may be charged direct to awards with approval of the awarding agency. Sample these costs when they have been charged direct to Federal awards to determine consistent treatment for non-Federal awards, instructional activity, or other institutional activity (A-21, section J.16.).
- g. Test costs direct charged to Federal awards and indirect costs accumulated in the educational institution's accounting system for adequate accounting of unallowable costs (A-21 section C.12 and FAR Appendix subpart 9905.505).

- h. Determine that the educational institution's cost accounting period for accumulating costs on Federal awards and indirect cost pools are consistent with the institution's fiscal year. If not, determine that the institution has met the criteria for an exception described in A-21, section C.13 and that it has been approved by the cognizant Federal agency (A-21, section C.13 and FAR Appendix subpart 9905.506).

Allowable Costs – Special Requirements – Internal Service, Central Service, Pension, or Similar Activities or Funds

1. *Compliance Requirement*

Charges made from internal service, central service, pension, or similar activities or funds, must follow the applicable cost principles provided in A-21.

2. *Audit Objectives*

Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c). Determine whether charges made from internal service, central service, pension, or similar activities or funds are in accordance with A-21.

3. *Suggested Internal Control Audit Procedures*

- a. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
- b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in OMB Circular §___.500(c)(3), including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
- c. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures*

The auditor should consider procedures such as the following:

- a. For activities accounted for in separate funds, ascertain if: (1) retained earnings/fund balances (including reserves) were computed in accordance with A-21; (2) working capital reserves were not excessive in amount (generally not greater than 60 days for cash expenses for normal operations incurred for the period exclusive of depreciation, capital costs and debt principal costs); and (3) refunds were made to the Federal Government for its share of any amounts transferred or borrowed from internal service, central service, pension, insurance, or other similar activities or funds for purposes other than to meet the operating liabilities, including interest on debt, of the fund.
- b. Test that all users of services are billed in a consistent manner.
- c. Test that billing rates exclude unallowable costs, in accordance with A-21.
- d. Test, where activities are not accounted for in separate funds, that billing rates (or charges) are developed based on actual costs and were adjusted to eliminate profits.
- e. For educational institutions that have self-insurance and certain types of fringe benefit programs (e.g., pension funds), ascertain if independent actuarial studies appropriate for such activities are performed at least biennially and that current period costs were allocated based on an appropriate study which is not over 2 years old.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

OMB CIRCULAR A-122 COST PRINCIPLES FOR NON-PROFIT ORGANIZATIONS

Introduction

OMB Circular A-122 (A-122) establishes cost principles for determining costs of grants, contracts, and other agreements with non-profit organizations. The principles are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law. These principles are used by all Federal agencies in determining the costs of work performed by non-profit organizations under grants, cooperative agreements, and cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, or settlement. All of these instruments are hereafter referred to as “awards.” In addition to the cost principles established by A-122, the Cost Accounting Standards Board (CASB) has promulgated certain accounting standards that must be followed by non-profit organizations receiving procurement contracts that meet a defined dollar threshold. Generally, organizations are exempt from coverage under CAS unless a single CAS-covered contract or subcontract of at least \$7.5 million has been received. After receipt of this trigger contract, CAS coverage is applied to all negotiated awards over \$500,000 unless they meet certain exemptions. These exemptions and the requirements of CAS can be found in 48 CFR Chapter 99.

Cognizant Agency

A-122, Attachment A, paragraph E.1.a defines “cognizant agency” as the Federal agency responsible for negotiating and approving indirect cost rates for non-profit organizations on behalf of all Federal agencies. References to cognizant agency in this section should not be confused with the cognizant Federal agency for audit responsibilities, which is defined in OMB Circular A-133, Subpart D, §___.400(a).

Availability of Other Information

Additional information on indirect cost rate determination for non-profit organizations can be found at the following web sites:

- Department of Labor - <http://www2.dol.gov/oasam/programs/guide.htm>
- Department of Health and Human Services - http://rates.psc.gov/fms/dca/np_exall2.html
- Department of Education - <http://www.ed.gov/about/offices/list/ocfo/fipao/abouticg.html> - [how-are indirect cost rates determined.](#)

Allowable Costs – General Criteria

1. *Basic Considerations to Determine Cost*

The basic considerations used to determine costs (direct and indirect) are identified in A-122, Attachment A, paragraph A and include the following:

- a. *Composition of cost* – The total cost of an award is the sum of the allowable direct and allocable indirect costs less any applicable credits. The term “applicable credits” refers to those receipts, or reduction of expenditures that operate to offset or reduce expense items that are allocable to awards as direct or indirect costs.
- b. *Allowable costs* – A cost is allowable under an award if the cost meets the following general criteria:
 - (1) Be reasonable for the performance of the award and be allocable in accordance with A-122.
 - (a) A cost is reasonable if, in its nature or 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. Consideration should be given to:
 - (i) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.
 - (ii) The restraints or requirements imposed by such factors as generally accepted sound business practices, arms-length bargaining, Federal and State laws and regulations, and terms and conditions of the award.
 - (iii) Whether the individuals concerned acted with prudence in the circumstances.
 - (iv) Significant deviations from the established practices of the organization that may unjustifiably increase the award costs.
 - (b) A cost is allocable to a particular cost objective, such as a grant, contract, project, service or other activity, in accordance with the relative benefits received. Any cost allocable to a particular award or other cost objective under A-122 may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or terms of the award. A cost is

allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

- (i) Is incurred specifically for the award.
 - (ii) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received.
 - (iii) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.
- (2) Conform to any limitations or exclusions set forth in A-122 or in the award.
 - (3) Be consistent with policies and procedures that apply uniformly to both federally financed and other activities of the organization.
 - (4) Be accorded consistent treatment.
 - (5) Be determined in accordance with generally accepted accounting principles (GAAP).
 - (6) 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.
 - (7) Be adequately documented.
 - (8) Be net of all applicable credits.

2. *Selected Items of Cost*

A-122, Attachment B, paragraphs 1 through 56, provides principles to be applied in establishing the allowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather, determination as to allowability in each case should be based on the treatment or principles provided for similar or related items of cost.

Allowable Costs – Direct Costs

1. *Compliance Requirements - Direct Costs*

Direct costs are those that can be identified specifically with a particular final cost objective, i.e., award, project or other activity of the organization. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where accounting treatment for such cost is consistently applied to all final cost objectives. Certain direct costs are unallowable for computing charges to Federal awards, nonetheless they must be treated as direct costs for determining indirect cost rates and be allocated their share of indirect costs if they represent activities that (a) include the salaries of personnel, (b) occupy space, and (c) benefit from the organization's indirect costs. The cost of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs—whether or not allowable—and be allocated a share of indirect costs. Examples can be found in A-122, Attachment A, subparagraph B.4.

If the auditor identifies unallowable direct costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost that would not have been incurred if the other cost had not been incurred. For example, fringe benefits are directly associated with payroll costs. When a payroll cost is determined to be unallowable than the directly associated fringe benefit would be determined unallowable as well.

2. *Audit Objectives - Direct Costs*

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
- b. Determine whether the organization complied with the provisions of A-122 and CAS (if applicable) as follows:
 - (1) Direct charges to Federal awards were for allowable costs.
 - (2) Unallowable costs, determined to be direct costs, should be included in the allocation base for the purpose of computing an indirect cost rate.

3. *Suggested Internal Control Audit Procedures - Direct Costs*

- a. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
- b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.

- c. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures - Direct Costs*

Test direct costs charged to Federal awards with the following criteria:

- a. Costs were approved by the Federal awarding agency, if required. (See Exhibit 1, Selected Items of Cost, in this part of the Supplement.)
- b. Costs conform to the allowability of cost provisions of A-122, or limitations in the program agreement, program regulations, or program statute.
- c. Costs represent charges for actual costs, not budgeted or projected amounts.
- d. Costs are given consistent accounting 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.
- e. Costs are calculated in conformity with generally accepted accounting principles, or CAS when required.
- f. Costs are not used to meet cost-sharing requirements of other federally supported activities.
- g. Costs are net of all applicable credits, e.g., volume or cash discounts, insurance recoveries, refunds, rebates, trade-ins, adjustments for checks not cashed, and scrap sales.
- h. Costs are not included as both a direct billing and as a component of indirect costs.
- i. Costs are supported by appropriate documentation, such as approved purchase orders, receiving reports, vendor invoices, canceled checks, and time and attendance records, and correctly charged as to account, amount, and period.

Allowable Costs – Indirect Costs

1. *Compliance Requirements - Indirect Costs*

- a. Indirect costs are those costs that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective.

Stated differently, indirect costs are those costs remaining after direct costs have been determined and assigned directly. While it is not possible to specify the types of costs that will be indirect, there are three major categories of indirect costs for non-profit organizations (NPOs):

- (1) *Depreciation and Use Allowance* - The expenses under this category are that portion of the costs of the organization's buildings, capital improvements to land and buildings, and equipment, which are computed in accordance with A-122, Attachment B, section 11. Interest on debt associated with certain buildings, equipment, and capital improvements are computed in accordance with A-122, Attachment B, paragraph 23.
- (2) *Operation and Maintenance* - The expenses under this category are those that have been incurred for the administration, operation, maintenance, preservation, and protection of the organization's physical plant.
- (3) *General and Administrative* - The expenses under this category are those that have been incurred for the overall general executive, and administration of the organization and other expenses of a general nature that do not relate solely to any major function of the organization.

b. Indirect cost rate proposals (ICRPs) prepared by NPOs are based on the most current financial data, supported by the organization's accounting system and audited financial statements. These ICRPs can be used to either establish predetermined rates, fixed rates with carry-forward provision, provisional, or final rates.

- (1) *Predetermined rates* are established for the current or multiple future period(s) based on current costs (usually costs from the most recently ended fiscal year, known as the base period).
- (2) *Fixed rates with carry-forward provisions* - rates based on current costs in the same manner as predetermined rates. However, the difference between the base period indirect costs and actual indirect cost recovery are carried forward as an adjustment to the rate computation for the subsequent period.
- (3) *Provisional rates* - temporary rates used for funding and billing indirect costs, pending the establishment of a final rate after actual costs are determined for the period.
- (3) *Final rates* - indirect cost rates applicable to a specified past period based on actual costs of that period. Final rates are not subject to adjustment.

c. Some Federal awards may contain cost limitations on recovery of indirect costs that differ from the federally negotiated indirect cost rates. Normally, this may be

due to statutory requirements or limitations contained in program announcements. In these cases, the indirect cost rate approved for that award will be specified in the award letter or agreement. For these awards, the award-specific rate takes precedence over the negotiated rate for purposes of indirect cost recovery.

- d. To recover indirect costs, NPOs prepare ICRPs. The ICRP is the rate calculation and supporting schedules used to arrive at the indirect cost pool amounts and the base amounts. NPOs can select one of three different methods to calculate the indirect cost rate.

(1) *Simplified Allocation Method*

- (a) Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization's total costs for the base period as either direct or indirect, and (ii) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate, which is used to distribute indirect costs to individual awards. The rate should be expressed as the percentage that the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to an organization is relatively small.
- (b) For an organization that receives more than \$10 million in Federal funding of direct costs in a fiscal year, a breakout of the indirect cost component into two broad categories, Facilities and Administration, as defined in Circular A-122, Attachment A, paragraph C.3, is required. The rate in each case shall be stated as the percentage that the amount of the particular indirect cost category (i.e., Facilities or Administration) is of the distribution base identified with that category.
- (c) A full discussion of the simplified allocation method can be found in A-122, Attachment A, subparagraphs D.2.a. through D.2.e.

(2) *Multiple Allocation Base Method*

- (a) Where an organization's indirect costs benefit its major functions in varying degrees, indirect costs shall be accumulated into separate cost groupings, as described in A-122, Attachment A, subparagraph D.3.b. Each grouping shall then be allocated individually to benefiting functions by means of a base that best

measures the relative benefits. The default allocation bases by cost pool are described in A-122, Attachment A, subparagraph D.3.c.

- (b) Cost groupings shall be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping shall constitute a pool of expenses that are of like character in terms of functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The groupings are classified within the two broad categories: "Facilities" and "Administration," as described in A-122, Attachment A, subparagraph C.3.
- (c) Except where a special indirect cost rate(s) is required in accordance with A-122, Attachment A, subparagraph D.5, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual awards included in that function by use of a single indirect cost rate.
- (d) Indirect costs shall be distributed to applicable sponsored awards and other benefiting activities within each major function on the basis of modified total direct costs (MTDC). MTDC consists of all salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to the first \$25,000 of each subgrant or subcontract (regardless of the period covered by the subgrant or subcontract). Equipment, capital expenditures, charges for patient care, rental costs and the portion in excess of \$25,000 shall be excluded from MTDC. Participant support costs shall generally be excluded from MTDC. Other items may only be excluded when the Federal cost cognizant agency determines that an exclusion is necessary to avoid a serious inequity in the distribution of indirect costs.
- (e) A full discussion of the multiple allocation base method can be found in A-122, Attachment A, subparagraphs D.3.a. through D.3.g.

(3) *Direct Allocation Method*

- (a) Some NPOs treat all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: (i) General administration and general expenses, (ii) fundraising, and (iii) other direct functions (including projects performed under Federal awards). Joint costs, such as depreciation, rental costs, operation and maintenance of facilities,

telephone expenses, and the like are prorated individually as direct costs to each category and to each award or other activity using a base most appropriate to the particular cost being prorated.

- (b) This method is acceptable, provided each joint cost is prorated using a base which accurately measures the benefits provided to each award or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data.
- (c) A full discussion of the direct allocation base method can be found in A-122, Attachment A, subparagraph D.4.a. through D.4.c.

2. *Audit Objectives - Indirect Costs*

a. *For NPOs that charge indirect costs to Federal awards based on federally approved rates:*

- (1) Obtain an understanding of internal controls, assess risk, and test internal controls as required by OMB Circular A-133, §____.500(c).
- (2) Determine whether the organization complied with the provisions of A-122 and CAS (if applicable) as follows:
 - (a) Indirect cost rates were applied in accordance with approved rate agreements and any special award provisions/limitations (if different from those stated in the negotiated rate agreement).
 - (b) Associated billings were the result of applying the approved rate to the proper base amount(s).
- (3) For fixed rate agreements, predetermined rate agreements, and provisional rate agreements determine whether the base used to distribute the approved indirect cost rate is accurate and reflects the terms of the agreement.
- (4) For fixed rate agreements, determine whether the organization has adequately determined the actual indirect costs for the fiscal year being audited and performed the necessary computations to accurately report the carry-forward adjustment to the rate computation for the subsequent period.

b. *For NPOs that charge indirect costs to Federal awards that are not based on federally approved rates:*

- (1) Obtain an understanding of internal controls, assess risk, and test internal controls as required by OMB Circular A-133, §____.500(c).

- (2) Determine whether costs that are directly allocated to an award using the Direct Allocation Method are prorated using a base that accurately measures the benefits provided to each award or activity.
 - (3) Determine whether an ICRP was prepared and submitted to the organization's cognizant agency (the Federal agency responsible for negotiating and approving indirect cost rates) as required by A-122. Verify that billings are based on the ICRP.
 - (4) Determine whether the NPO's calculated indirect cost rate is (a) consistent with policies and procedures that apply uniformly to both federally funded and other activities of the organization, and (b) applied consistently to the proper allocation bases.
 - (5) Determine whether the organization complied with the provisions of A-122 and CAS as follows:
 - (a) Charges to indirect cost pools were for allowable costs.
 - (b) The base used to distribute indirect costs includes both allowable and unallowable costs.
 - (c) The cost allocation methodology provides equitable and consistent allocation of indirect costs to benefiting awards or activities.
- c. *For NPOs that also have awards containing award-specific rates (approved by the Federal awarding agency) that take precedence over the negotiated rate for purposes of indirect cost recovery:*
- (1) Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
 - (2) Determine if the award-specific rate(s) is the result of special circumstances, e.g., required by law or regulation.
 - (3) Determine whether indirect cost rates were applied in accordance with the approved special award provisions or limitations. Associated billings were the result of applying the approved rate to the proper base amount.
 - (4) When the maximum amount of allowable indirect costs under a limitation (i.e. an award-specific rate) is less than the total amount determined in accordance with the principles in A-122, the amount not recoverable under a sponsored agreement may not be charged to other sponsored agreements.

3. *Suggested Internal Control Audit Procedures - Indirect Costs*

- a. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
- b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
- c. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures - Indirect Costs*

- a. *For NPOs that charge indirect costs to Federal awards based on federally approved rates:*
 - (1) Ascertain if indirect costs are material for the major programs being tested. If not, the following suggested audit procedures, b. through e., do not apply.
 - (2) Obtain and read the current indirect cost rate agreement, including the proposal used in the negotiation of the agreement, and determine the terms in effect.
 - (3) Ascertain whether the indirect cost rate agreement uses a pre-determined rate, fixed rate, provisional rate, or final rate. For definitions of these rates, see A-122, Attachment A, subparagraphs E (b) through (e).
 - (a) If a fixed rate agreement with carry-forward provisions has been negotiated with the cognizant agency, determine that the difference between the indirect costs recovered using the fixed rate and the actual indirect costs of the period has been calculated. This adjustment is to be carried forward to the rate computation of the subsequent period.
 - (b) If a provisional rate was used to bill for indirect costs, determine whether a final rate has been established and appropriate claim adjustments have been made based on the final approved rate.

- (4) For NPOs required to file Disclosure Statements (48 CFR section 9903.202), ascertain if the cognizant agency for indirect cost negotiation has been appropriately notified of changes in the cost accounting practices that occurred during the year to which indirect cost rate agreements are being applied.
 - (1) Select a sample of claims for reimbursement:
 - (a) Verify that the rates used are in accordance with the rate agreement and the amounts claimed were the product of applying the rate to the applicable base.
 - (b) Verify that the base includes both allowable and unallowable costs.
 - (c) When the base is total direct costs or modified total direct costs, verify that the distribution base has been properly calculated and excludes capital expenditures and other distorting items such as major subcontracts or subgrants in excess of \$25,000 as approved in the negotiated rate agreement or by the cognizant Federal agency.
- b. *For NPOs that charge indirect costs to Federal awards that are not based on federally approved rates:*
 - (1) Determine if the indirect costs are based on a certified ICRP that has been submitted to (but not approved by) the NPO's Federal cognizant agency as required by A-122, Attachment A, subparagraph E. If the ICRP is based on costs incurred in the year being audited, then the ICRP should be audited for compliance with the provisions of A-122 (see procedures in paragraphs 4.b(1)(a) through (1)(c) below).

Note: If the NPO has a certified ICRP, which is based on costs incurred in the year being audited, but it has not been submitted to the Federal cognizant agency, the ICRP should still be audited using the procedures in paragraphs 4.b(1)(a) through (1)(c) below.

 - (a) The following procedures should be applied to costs in the indirect cost pool used for recovering indirect costs from Federal awarding agencies. These costs must:
 - (i) Be approved by the Federal awarding agency, if required.
 - (ii) Conform to the allowability of cost provisions of A-122, or limitations in the award agreement, program regulations, or program statute.
 - (iii) Conform to the allocability provisions of A-122 or CAS.

- (iv) Represent charges for actual costs, not budgeted or projected amounts.
 - (v) With respect to fringe benefit allocations, charges, or rates, be based on the benefits received by different classes of employees within the organization.
 - (vi) Be applied uniformly to Federal and non-Federal activities.
 - (vii) Be calculated in conformity with CAS or generally accepted accounting principles, as required.
 - (viii) Not be used to meet cost-sharing requirements of other federally supported activities.
 - (ix) Be net of all applicable credits, e.g., volume or cash discounts, insurance recoveries, refunds, rebates, trade-ins, adjustments for checks not cashed, and scrap sales.
 - (x) Not be included as both a direct billing and as a component of indirect costs.
 - (xi) Be supported by appropriate documentation, such as approved purchase orders, receiving reports, vendor invoices, canceled checks, and time and attendance records, and correctly charged as to account, amount, and period.
 - (xii) Be given consistent accounting 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.
- (b) The following procedures should be applied to costs in the base(s) for recovering indirect costs from Federal awarding agencies. Determine whether:
- (i) All direct costs, including unallowable costs, are identified and included in the base for indirect cost allocations.
 - (A) For fixed price agreements, all direct costs are recorded for the purpose of allocating indirect costs.
 - (B) For cost-reimbursement awards or contracts that include line item costs that exceed budget limits, all

direct costs are recorded for the purpose of allocating indirect costs.

- (ii) Costs have been recorded in accordance with CAS, generally accepted accounting principles, or other comprehensive basis of accounting, as appropriate.
 - (iii) Costs have been assigned to the correct cost objective or activity.
 - (iv) Costs have been given consistent accounting treatment within and between accounting periods.
- (c) The following procedures should be applied to costs allocated using the Direct Allocation Method:
- (i) Test statistical data (e.g., square footage, case counts, salaries and wages) to ascertain if the proposed allocation bases are reasonable, updated as necessary, and do not contain any material omissions.
 - (ii) Review time studies or time and effort reports (where and if used) to ascertain if they are accurate, are implemented as approved, and are based on the actual effort devoted to the various functional and programmatic activities to which the salary and wage costs are charged.
 - (iii) Review the allocation methodology for consistency and test the appropriateness of allocation methods used.
- (2) Determine if the indirect costs are based on a certified ICRP that has been submitted to (but not approved by) the NPO's Federal cognizant agency as required by A-122, Attachment A subparagraph E. If the ICRP is not based on costs incurred in the year being audited (e.g., the year being audited is fiscal year 2004, but the ICRP is based on fiscal year 2003 costs), a review of the ICRP is not required.
- (3) If the indirect costs are not based on a certified and submitted ICRP, in accordance with A-122, this may be required to be reported as an audit finding in accordance with OMB Circular A-133, §__.510(a)(5).
- (5) *Application of indirect cost rates which are not approved by the cognizant agency –* Even though the rate(s) have not been approved by the cognizant agency, unapproved indirect cost rate(s) should be reviewed for consistent application of the submitted rates to direct cost bases to ensure that the indirect cost rate(s) are applied consistent

with the NPO's policies and procedures that apply uniformly to both federally-funded and other activities of the NPO (A-122, Attachment A, paragraph A.(2)(c)).

- c. For NPOs that also have awards containing award-specific rates (approved by the Federal awarding agency) that take precedence over the negotiated rate for purposes of indirect cost recovery:
 - (1) Ascertain that the award-specific rate is only being used for the approved award.
 - (2) Obtain and read the award terms used to establish an award-specific indirect cost rate(s).
 - (3) Select a sample of claims for reimbursement and verify that the award specific rate(s) is in accordance with the terms of the award, that the rate(s) was applied to the appropriate base(s), and that the amount claimed is the product of applying the rate to the applicable base. Verify that the cost included in the base(s) is consistent with the terms of the agreement.

Allowable Costs – Special Requirements – Unallowable Direct Costs

1. Compliance Requirements - Unallowable Direct Costs

- a. The costs of certain activities are not allowable as charges to Federal awards (see, for example, fundraising costs in A-122, Attachment B, paragraph 23). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct costs for purposes of determining indirect cost rates and be allocated their share of the organization's indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs.
- b. Costs should be recorded in the organization's cost records as direct or indirect costs based on their relationship to the cost objectives or activities. The costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs—whether or not allowable—and be allocated an equitable share of indirect costs.

2. Audit Objectives – Unallowable Direct Costs

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §__.500(c).
- b. Determine whether all unallowable costs categorized as direct costs are included in the allocation base for the purpose of allocating indirect costs.

3 *Suggested Internal Control Audit Procedures – Unallowable Direct Costs*

- a. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
- b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
- c. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures - Unallowable Direct Costs*

- a. Determine whether all unallowable costs categorized as direct costs are included in the allocation base for the purpose of allocating indirect costs.
- b. Determine whether the following costs are charged as direct costs and allocated an equitable share of indirect costs.
 - (1) Maintenance of membership rolls, subscriptions, publications, or related functions.
 - (2) Providing services and information to members, legislative or administrative bodies, or the public.
 - (3) Meetings and conferences except those held to conduct the general administration of the organization.
 - (4) Maintenance, protection, and investment of special funds not used in operation of the organization.
 - (5) Administration of group benefits on behalf of members or clients, including life and hospital insurance, annuity or retirements plans, financial aid, etc.

Special Requirements – Disclosure Statements (DS-1) Required by Cost Accounting Standards

1. Compliance Requirements - CAS and Disclosure Statements

- a. Pub. L. 100-679 (41 USC 422) requires certain contractors and subcontractors (which includes NPOs) to comply with CAS and to disclose in writing and follow consistently their cost accounting practices.
- b. 48 CFR section 9903.201-1 (FAR Appendix) describes the rules for determining whether a proposed contract or subcontract is exempt from CAS. Negotiated contracts not exempt in accordance with 48 CFR section 9903.201-1(b) are subject to CAS. A CAS-covered contract may be subject to either full or modified coverage. The rules for determining whether full or modified coverage applies are in 48 CFR section 9903.201-2 (FAR Appendix).
 - (1) Full coverage requires that a business unit comply with all the CAS specified in part 9904 that are in effect on the date of the contract award and with any CAS that become applicable because of later award of a CAS-covered contract. Full coverage applies to contractor business units that (a) receive a single CAS-covered contract award of \$50 million or more; or (b) receive \$50 million or more in net CAS-covered awards during their preceding cost accounting period (48 CFR section 9903.201-2(a)).
 - (2) *Modified Coverage* (48 CFR section 9903.201-2(b))
 - (a) Modified CAS coverage requires only that the contractor comply with Standard 9904.401, Consistency in Estimating, Accumulating, and Reporting Costs; Standard 9904.402, Consistency in Allocating Costs Incurred for the Same Purpose; Standard 9904.405, Accounting for Unallowable Costs; and Standard 9904.406, Cost Accounting Standard—Cost Accounting Period. Modified, rather than full, CAS coverage may be applied to a covered contract of less than \$50 million awarded to a business unit that received less than \$50 million in net CAS-covered awards in the immediately preceding cost accounting period.
 - (b) If any one contract is awarded with modified CAS coverage, all CAS-covered contracts awarded to that business unit during that cost accounting period must also have modified coverage with the following exception: if the business unit receives a single CAS-covered contract award of \$50 million or more, that contract must be subject to full CAS coverage. Thereafter, any covered contract awarded in the same cost accounting period must also be subject to full CAS coverage.

- (c) A contract awarded with modified CAS coverage shall remain subject to such coverage throughout its life regardless of changes in the business unit's CAS status during subsequent cost accounting periods.
- b. 48 CFR section 9903.202 (FAR Appendix) describes the general Disclosure Statement requirements. A Disclosure Statement is a written description of a contractor's cost accounting practices and procedures. The submission of a new or revised Statement is not required for any non-CAS covered contract or from any small business concern. Completed Disclosure Statements are required under the following circumstances:
 - (1) Any business unit that is selected to receive a CAS-covered contract or subcontract of \$50 million or more shall submit a Disclosure Statement before award.
 - (2) Any company which, together with its segments, receive net awards of negotiated prime contracts and subcontracts subject to CAS totaling \$50 million or more in its most recent cost accounting period, must submit a Disclosure Statement before award of its first CAS-covered contract in the immediately following cost accounting period. However, if the first CAS-covered contract is received within 90 days of the start of the cost accounting period, the contractor is not required to file until the end of the 90 days.
- c. 48 CFR section 9903.201-7 (FAR Appendix) describes the cognizant Federal agency responsibilities.
 - (1) The requirements of part 9903 shall, to the maximum extent practicable, be administered by the cognizant Federal agency responsible for a particular contractor organization or location, usually the Federal agency responsible for negotiating indirect cost rates on behalf of the Government.
 - (2) The cognizant Federal agency should take the lead role in administering the requirements of Part 9903 and coordinating CAS administrative actions with all affected Federal agencies. When multiple CAS-covered contracts or more than one Federal agency are involved, agencies should discourage Contracting/Grants Officers from individually administering CAS on a contract-by-contract basis. Coordinated administrative actions will provide greater assurances that individual contractors follow their cost accounting practices consistently under all their CAS-covered contracts and that changes in cost accounting practices or CAS noncompliance issues are resolved, equitably, in a uniform overall manner.

2. *Audit Objectives - CAS and Disclosure Statements*

- a. Determine whether the NPO's accounting practices, for direct and indirect costs, are compliant with CAS, based on its required CAS coverage (full or modified).
- b. Determine whether the NPO's Disclosure Statement (including amendments) is current, accurate, complete, and properly filed with the cognizant Federal Administrative Officer in accordance with 48 CFR section 9903.202-5.
- c. Determine whether the NPO's actual accounting practices are consistent with its disclosed practices.

3. *Suggested Internal Control Audit Procedures – CAS and Disclosure Statements*

- a. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
- b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
- c. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures - CAS and Disclosure Statements*

- a. Determine whether the NPO has any CAS-covered contract or subcontracts. If so, determine which type of CAS coverage is applicable (full or modified) and if a Disclosure Statement is required to be submitted to the cognizant Federal agency.
- b. Test the NPO's actual accounting practices for direct and indirect costs are compliant with applicable CAS.
- c. If a Disclosure Statement is required, obtain a copy and any amendments. Review these to ensure the disclosures are current, accurate, compliant with CAS, and approved by the cognizant Federal agency.
- d. Test whether the NPO's actual accounting practices are consistent with the disclosed practices.

Allowable Costs – Special Requirements – Internal Service, Central Service, Pension, or Similar Activities or Funds

1. *Compliance Requirement*

NPOs using internal service, central service, pension, or similar activities or funds must follow the applicable cost principles found in A-122.

2. *Audit Objectives*

Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c). Determine whether charges are made from internal service, central service, pension, or similar activities or funds, are in accordance with A-122.

3. *Suggested Internal Control Audit Procedures*

- a. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
- b. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
- c. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

4. *Suggested Compliance Audit Procedures*

Perform the following procedures as applicable:

- a. For activities accounted for in separate funds, ascertain that: (1) retained earnings/fund balances (including reserves) were computed in accordance with the applicable cost principles; (2) working capital reserves were not excessive in amount (generally not greater than 60 days for cash expenses for normal operations incurred for the period exclusive of depreciation, capital costs, and debt principal costs); and (3) refunds were made to the Federal Government for its share of any amounts transferred or borrowed from internal service, central

service, pension, insurance, or other similar activities or funds for purposes other than to meet the operating liabilities, including interest on debt, of the fund.

- b. Test that all users of services are billed in a consistent manner.
- c. Test that billing rates exclude unallowable costs in accordance with A-122.
- d. Test, where activities are not accounted for in separate funds, that billing rates (or charges) are developed based on actual costs and were adjusted to eliminate profits.
- e. For organizations that have self-insurance and a certain type of fringe benefit programs (e.g., pension funds), ascertain if independent actuarial studies appropriate for such activities are performed at least biennially and that current period costs were allocated based on an appropriate study which is not over two years old.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

LIST OF SELECTED ITEMS OF COST CONTAINED IN OMB COST PRINCIPLES CIRCULARS

The following exhibit provides a listing of selected items of costs contained in each of the OMB cost principles circulars. The exhibit lists the selected items of costs along with a cursory description of its allowability. The reader is strongly cautioned not to rely exclusively on this summary exhibit but to place primary reliance on the referenced circular text.

Several cost items are unique to one type of entity and not to other entities (e.g., commencement & convocation costs are only applicable to universities). The numbers in parentheses refer to the cost item in the applicable circulars.

Selected Items of Cost			Exhibit 1
Selected Cost Item	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov'ts	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non-Profit Organizations
Accounting	(1)-Allowable	Not specifically addressed	Not specifically addressed
Advertising & Public Relations	(2) B Allowable with restrictions	(1) B Allowable with restrictions	(1)-Allowable with restrictions
Advisory Councils	(3)-Allowable with restrictions	Not specifically addressed	Not specifically addressed
Alcoholic Beverages	(4)-Unallowable	(2)-Unallowable	(2)-Unallowable
Alumni/ae Activities	Not specifically addressed	(3)-Unallowable	Not specifically addressed
Audit Services	(5)-Allowable with restrictions and as addressed in OMB Circular A-133	Allowable with restrictions as addressed in OMB Circular A-133	Allowable with restrictions as addressed in OMB Circular A-1
Automatic electronic data processing	(6)-Allowable with restrictions	Not specifically addressed	Not specifically addressed
Bad Debts	(7)-Unallowable unless provided in program regulations	(4)-Unallowable	(3)-Unallowable
Bonding Costs	(8)-Allowable	Not specifically addressed	(5)-Allowable with restrictions
Budgeting	(9)-Allowable	Not specifically addressed	Not specifically addressed
Civil Defense (local)	Not specifically addressed	(5)-Allowable with restrictions	Not specifically addressed
Commencement & Convocations	Not specifically addressed	(6)-Unallowable with exceptions	Not specifically addressed
Communications	(15)-Allowable	(7)-Allowable	(6)-Allowable

Selected Items of Cost			Exhibit 1
Selected Cost Item	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov'ts	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non-Profit Organizations
Compensation - Institution furnished Automobile	Not specifically addressed	(8.g)- Unallowable that portion of costs attributed to personal use	(7.g)-Unallowable as overhead costs Unallowable that portion of costs attributed to personal use
Compensation for Personal Services	(11)-Unique criteria for support	(8)-Unique criteria for support	(7)-Unique criteria for support
Contingencies	(12)-Unallowable with qualifiers	(9)-Unallowable with qualifiers	(8)-Unallowable with qualifiers
Deans of faculty and graduate schools	Not addressed	(10)-Allowable	Not addressed
Defense & Prosecution of Criminal & Civil Proceedings	(14)-Allowable with restrictions	(11)-Allowable with restrictions	(10)-Allowable with restrictions
Depreciation and use allowances	(15)-Allowable with specifications	(12)-Allowable with specifications	(11)-Allowable with specification
Disbursing Services	(16)-Allowable	Not specifically addressed	Not specifically addressed
Donations & Contributions	(13)-Unallowable	(13)-Unallowable with exception	(9,12)-Unallowable
Employee morale, health, and welfare costs	(17)-Allowable with restrictions	(14)-Allowable with restrictions	(13)-Allowable with restrictions
Entertainment	(18)-Unallowable	(15)-Unallowable	(14)-Unallowable with qualifier
Equipment and other capital expenditures	(19)-Allowability based on specific requirements	(16)-Allowability based on specific requirements	(15)-Allowability based on specific requirements
Fines and Penalties	(20)-Unallowable with exception	(18)-Unallowable with exception	(16)-Unallowable with exception

Selected Items of Cost			Exhibit 1
Selected Cost Item	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov'ts	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non-Profit Organizations
Gains/Profits and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs	(22)-Allowable with restrictions	(33)-Allowable with restrictions	(40)-Allowable with restrictions
General Government Expenses	(23)-Unallowable with exceptions	Not specifically addressed	Not specifically addressed
Goods or Services for Personal Use	Not specifically addressed	(19)-Unallowable	(18)-Unallowable
Housing & Personal Living Expenses	Not specifically addressed	(20)-Unallowable	(19)-Unallowable as overhead costs
Idle Facilities and Idle capacity	(24)-Allowable with restrictions	Not specifically addressed	(20)-Facilities unallowable with exceptions; capacity allowable with restrictions
Insurance & Indemnification	(25)-Allowable with restrictions	(21)-Allowable with restrictions	(22)-Allowable with restrictions
Interest, Fund Raising & Investment	(21,26)-Allowable with restrictions	(22)-Allowable with restrictions	(23)-Allowable with restrictions
Labor relations costs	Not specifically addressed	(23)-Allowable	(24)-Allowable
Lobbying/Executive Lobbying Costs	(27)-Unallowable (certain exceptions at State/Local level)	(17,24)-Unallowable	(21)-Unallowable
Losses on Other Sponsored Programs/Under recovery of Costs on Federal Agreements	(42)-Unallowable	(25)-Unallowable	(26)-Unallowable

Selected Items of Cost			Exhibit 1
Selected Cost Item	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov'ts	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non-Profit Organizations
Maintenance, operations and repairs	(28)-Allowable with restrictions	(26)-Allowable with restrictions	(27)-Allowable with restrictions
Materials and supplies	(29)-Allowable	(27)-Allowable	(28)-Allowable
Meetings and conferences	Not specifically addressed	Not specifically addressed	(29)-Allowable
Memberships, Subscriptions, & Professional Activities	(30)-Allowable for civic, community & social organizations with Federal Approval	(28)-Unallowable for civic, community & social organizations	(30)-Unallowable for civic, community & social organizations
Motor Pools	(31)-Allowable	Not specifically addressed	Not specifically addressed
Organizational Costs	Not specifically addressed	Not specifically addressed	(31)-Allowable with prior approval
Overtime, extra-pay shift, and multi-shift premiums	Not specifically addressed	Not specifically addressed	(32)-Allowable with prior approval of the awarding agency with exceptions for approval
Page charges in professional journals	Not specifically addressed	Not specifically addressed	(33)-Allowable with restrictions
Participant support costs	Not specifically addressed	Not specifically addressed	(34)-Allowable with prior approval of the awarding agency
Patents	Not specifically addressed	(29)-Allowable with restrictions	(35)-Allowable with restrictions
Pension plans	(11e)-Allowable with restrictions	(8f)-Allowable with restrictions	(7h)-Allowable with restrictions
Plant Security Costs	Not specifically addressed	(30)-Allowable with restrictions	(37)-Allowable with restrictions
Pre-Agreement/Preaward Costs	(32)-Allowable with restrictions	(31)-Unallowable unless approved by the sponsoring agency	(38)-Allowable with restrictions

Selected Items of Cost			Exhibit 1
Selected Cost Item	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov'ts	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non-Profit Organizations
Professional Services Costs	(33)-Allowable with restrictions	(32)-Allowable with restrictions	(39)-Allowable with restrictions
Proposal Costs	(34)-Allowable with restrictions	(34)-Allowable with restrictions	Not specifically addressed
Publication & Printing	(35)-Allowable	Not specifically addressed	(41)-Allowable with restrictions
Rearrangements and alterations	(36)-Allowable (ordinary and normal); Allowable with prior approval (special)	(35)-Allowable (Ordinary and normal); Allowable with prior approval (special)	(42)-Allowable (Ordinary and normal); Allowable with prior approval (special)
Reconversion Costs	(37)-Allowable with restrictions	(36)-Allowable with restrictions	(43)-Allowable with restrictions
Recruiting Costs	(2)-Allowable with restrictions	(37 [.b])-Allowable with restrictions	(44)-Allowable with restrictions
Relocation Costs	Not specifically addressed	(37.d)-Allowable with restrictions	(45)-Allowable with restrictions
Rental cost of buildings and equipment	(38)-Allowable with restrictions	(38)-Allowable with restrictions	(46)-Allowable with restrictions
Royalties and other costs for use of patents	Not specifically addressed	(39)-Allowable with restrictions	(47)-Allowable with restrictions
Sabbatical leave costs	Not specifically addressed	(40)-Allowable with restrictions	Not specifically addressed
Scholarship and Student Aid Costs	Not specifically addressed	(41)-Allowable with restrictions	Not specifically addressed
Selling & Marketing	Not specifically addressed	(42)-Unallowable	(48)-Unallowable
Severance Pay	(11.g)- Allowable with restrictions	(43)-Allowable with restrictions	(49)-Allowable with restrictions
Specialized Services Facilities	Not specifically addressed	(44)-Allowable with restrictions	(50)-Allowable with restrictions

Selected Items of Cost			Exhibit 1
Selected Cost Item	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov'ts	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non-Profit Organizations
Student Activity Costs	Not specifically addressed	(45)-Unallowable unless specifically provided for in the sponsored agreements	Not specifically addressed
Substantial Relocation - Interest Provision	(26)-Possible adjustment if relocated within useful life	(22)-Possible adjustment if relocated within 20 years	(23)-Possible adjustment if relocated within 20 years
Taxes	(39)-Allowable with restrictions	(46)-Allowable with restrictions	(51)-Allowable with restrictions
Termination costs	Not specifically addressed	(49)-Allowable with restrictions	(52)-Allowable with restrictions
Training and education costs	(40)-Allowable for employee development	(8.f)-Allowable	(53)-Allowable with limitations
Transportation Costs	Not specifically addressed	(47)-Allowable with restrictions	(54)-Allowable
Travel Costs	(41)-Allowable with restrictions	(48,50)-Allowable with restrictions	(55)-Allowable with restrictions
Trustees (travel expense)	Not specifically addressed	(50)-Allowable with restrictions	(56)-Allowable with restrictions
Under recovery of Costs on Federal Agreements	(42)	(25)	(26)

C. CASH MANAGEMENT

Compliance Requirements

When entities are funded on a reimbursement basis, program costs must be paid for by entity funds before reimbursement is requested from the Federal Government. When funds are advanced, recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement. When advance payment procedures are used, recipients must establish similar procedures for subrecipients.

Pass-through entities must establish reasonable procedures to ensure receipt of reports on subrecipients' cash balances and cash disbursements in sufficient time to enable the pass-through entities to submit complete and accurate cash transactions reports to the Federal awarding agency or pass-through entity. Pass-through entities must monitor cash drawdowns by their subrecipients to assure that subrecipients conform substantially to the same standards of timing and amount as apply to the pass-through entity.

Interest earned on advances by local government grantees and subgrantees is required to be submitted promptly, but at least quarterly, to the Federal agency. Up to \$100 per year may be kept for administrative expenses. Interest earned by non-State non-profit entities on Federal fund balances in excess of \$250 is required to be remitted to Department of Health and Human Services, Payment Management System, P.O. Box 6021, Rockville, MD 20852.

Treasury regulations at 31 CFR part 205, which implement the Cash Management Improvement Act of 1990 (CMIA), as amended (Pub. L. No. 101-453; 31 USC 6501 *et seq.*), require State recipients to enter into agreements that prescribe specific methods of drawing down Federal funds (funding techniques) for selected large programs. The agreements also specify the terms and conditions in which an interest liability would be incurred. Programs not covered by a Treasury-State Agreement are subject to procedures prescribed by Treasury in Subpart B of 31 CFR part 205 (Subpart B).

The requirements for cash management are contained in the OMB Circular 102 (Paragraph 2.a.), the A-102 Common Rule (§__.21), OMB Circular A-110 (§__.22), Treasury regulations at 31 CFR part 205, Federal awarding agency regulations, and the terms and conditions of the award.

Availability of Other Information

The U.S. Treasury, Financial Management Service maintains a Cash Management Improvement Act page on the Internet (<http://www.fms.treas.gov/cmia/>).

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §__.500(c).

2. Determine whether the recipient/subrecipient followed procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury, or pass-through entity, and their disbursement.
3. Determine whether States have complied with the terms and conditions of the Treasury-State Agreement or Subpart B procedures prescribed by Treasury.
4. Determine whether the pass-through entity implemented procedures to assure that subrecipients conformed substantially to the same timing requirements that apply to the pass-through entity.
5. Determine whether interest earned on advances was reported/remitted as required.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for cash management and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

Note: The following procedures are intended to be applied to each program determined to be major. However, due to the nature of cash management and the system of cash management in place in a particular entity, it may be appropriate and more efficient to perform these procedures for all programs collectively rather than separately for each program.

States

1. For programs tested as major for States, verify which of those programs are covered by the Treasury-State Agreement in accordance with the materiality thresholds in 31 CFR section 205.5, Table A).
2. For those programs identified in procedure 1, determine the funding techniques used for those programs. For those funding techniques that require clearance patterns to schedule the transfer of funds to the State, review documentation supporting the clearance pattern

and verify that the clearance pattern conforms to the requirements for developing and maintaining clearance patterns as specified in the Treasury-State Agreement (31 CFR sections 205.12, 205.20, and 205.22).

3. Select a sample of Federal cash draws and verify that:
 - a. The timing of the Federal cash draws was in compliance with the applicable funding techniques specified in the Treasury-State Agreement or Subpart B procedures, whichever is applicable (31 CFR sections 205.11 and 205.33).
 - b. To the extent available, program income, rebates, refunds, and other income and receipts were disbursed before requesting additional Federal cash draws as required by the A-102 Common Rule (§____.21) and OMB Circular A-110 (§____.22).
4. Where applicable, select a sample of reimbursement requests and trace to supporting documentation showing that the costs for which reimbursement was requested were paid prior to the date of the reimbursement request (31 CFR section 205.12(b)(5)).
5. Review the calculation of the interest obligation owed to or by the Federal Government, reported on the annual report submitted by the State to ascertain that the calculation was in accordance with Treasury regulations and the terms of the Treasury-State Agreement or Subpart B procedures. Trace amounts used in the calculation to supporting documentation.

States and Other Recipients

6. For those programs where Federal cash draws are passed through to subrecipients:
 - a. Select a representative sample of subrecipients and ascertain the procedures implemented to assure that subrecipients minimize the time elapsing between the transfer of Federal funds from the recipient and the pay out of funds for program purposes (A-102 Common Rule §____.37(a)(4)).
 - b. Select a representative sample of Federal cash draws by subrecipients and ascertain that they conformed to the procedures.

Other Recipients and Subrecipients

7. For those programs that received advances of Federal funds, ascertain the procedures established with the Federal agency or pass-through entity to minimize the time between the transfer of Federal funds and the pay out of funds for program purposes.
8. Select a sample of Federal cash draws and verify that:

- a. Established procedures to minimize the time elapsing between drawdown and disbursement were followed.
 - b. To the extent available, program income, rebates, refunds, and other income and receipts were disbursed before requesting additional cash payments as required by the A-102 Common Rule (§____.21) and OMB Circular A-110 (§____.22).
9. Where applicable, select a sample of reimbursement requests and trace to supporting documentation showing that the costs for which reimbursement was requested were paid prior to the date of the reimbursement request.
10. Review records to determine if interest was earned on Federal cash draws. If so, review evidence to ascertain whether it was returned to the appropriate agency.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

D. DAVIS-BACON ACT

Compliance Requirements

When required by the Davis-Bacon Act, the Department of Labor's (DOL) governmentwide implementation of the Davis-Bacon Act, or by Federal program legislation, all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2000 financed by Federal assistance funds must be paid wages not less than those established for the locality of the project (prevailing wage rates) by the DOL (40 USC 276a to 276a-7).

Non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis-Bacon Act and the DOL regulations (29 CFR part 5, "Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction"). This includes a requirement for the contractor or subcontractor to submit to the non-Federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls) (29 CFR sections 5.5 and 5.6). This reporting is often done using Optional Form WH-347, which includes the required statement of compliance (OMB No. 1215-0149).

The requirements for Davis-Bacon are also contained in the A-102 Common Rule (§____.36(i)(5) and OMB Circular A-110 (Appendix A Contract Provisions).

Availability of Other Information

The U.S. Department of Labor, Employment Standards Administration, maintains a Davis-Bacon and Related Acts Internet page (<http://www.dol.gov/esa/programs/dbra/index.htm>). Optional Form WH-347 and instructions are available on this Internet page.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §____.500(c).
2. Determine whether the non-Federal entity notified contractors and subcontractors of the requirements to comply with the Davis-Bacon Act and obtained copies of certified payrolls.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.

2. Plan the testing of internal control to support a low assessed level of control risk for Davis-Bacon Act and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

1. Select a sample of construction contracts and subcontracts greater than \$2000 that are covered by the Davis-Bacon Act and perform the following procedures:
 - a. Verify that the required prevailing wage rate clauses were included.
 - b. Verify that the contractor or subcontractor submitted weekly the required certified payrolls.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

E. ELIGIBILITY

Compliance Requirements

The specific requirements for eligibility are unique to each Federal program and are found in the laws, regulations, and the provisions of contract or grant agreements pertaining to the program. For programs listed in the Compliance Supplement, these specific requirements are in Part 4 - Agency Program Requirements or Part 5 - Clusters of Programs, as applicable. This compliance requirement specifies the criteria for determining the individuals, groups of individuals, or subrecipients that can participate in the program and the amounts for which they qualify.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
2. Determine whether required eligibility determinations were made, (including obtaining any required documentation/verifications), that individual program participants or groups of participants (including area of service delivery) were determined to be eligible, and that only eligible individuals or groups of individuals (including area of service delivery) participated in the program.
3. Determine whether subawards were made only to eligible subrecipients.
4. Determine whether amounts provided to or on behalf of eligibles were calculated in accordance with program requirements.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for eligibility and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

1. *Eligibility for Individuals*

- a. For some Federal programs with a large number of people receiving benefits, the non-Federal entity may use a computer system for processing individual eligibility determinations and delivery of benefits. Often these computer systems are complex and will be separate from the non-Federal entity's regular financial accounting system. Typical functions a computer system for eligibility may perform are:
- Perform calculations to assist in determining who is eligible and the amount of benefits
 - Pay benefits (e.g., write checks)
 - Maintain eligibility records, including information about each individual and benefits paid to or on behalf of the individual (regular payments, refunds, and adjustments)
 - Track the period of time an individual is eligible and stop benefits at the end of a predetermined period unless, there is a redetermination of eligibility
 - Perform matches with other computer data bases to verify eligibility (e.g., matches to verify earnings or identify individuals who are deceased)
 - Control who is authorized to approve benefits for eligibles (e.g., an employee may be approving benefits on-line and this process may be controlled by passwords or other access controls)
 - Produce exception reports indicating likely errors that need follow-up (e.g., when benefits exceed a certain amount, would not be appropriate for a particular classification of individuals, or are paid more frequently than normal)

Because of the diversity of computer systems, both hardware and software, it is not practical for this Supplement to provide suggested audit procedures to address each system. However, generally accepted auditing standards provide guidance for the auditor when computer processing relates to accounting information that can materially effect the financial statements being audited. Similarly, when eligibility is material to a major program, and a computer system is integral to eligibility compliance, the auditor should follow this guidance and consider the non-Federal entity's computer processing. The auditor should perform audit procedures relative to the computer system for eligibility as necessary to support the opinion on compliance for the major program. Due to the nature and controls of computer systems, the auditor may choose to perform

these tests of the computer systems as part of testing the internal controls for eligibility.

b. *Split Eligibility Determination Functions*

- (1) *Background* - Some non-Federal entities pay the Federal benefits to the eligible participants but arrange with another entity to perform part or all of the eligibility determination. For example, a State arranges with local government social services agencies to perform the “intake function” (e.g., the meeting with the social services client to determine income and categorical eligibility) while the State maintains the computer systems supporting the eligibility determination process and actually pays the benefits to the participants. The State is fully responsible for Federal compliance for the eligibility determination as the benefits are paid by the State and State shows the benefits paid as Federal awards expended on the State’s Schedule of Expenditures of Federal Awards. Therefore, the auditor of the State is responsible for meeting the internal control and compliance audit objectives for eligibility. This may require the auditor of the State to perform or arrange for additional procedures to ensure compliant eligibility determinations when another entity performs part of the eligibility determination functions.
- (2) Ensure that eligibility testing includes all benefit payments regardless of whether another entity, by arrangement, performs part of the eligibility determination functions.

c. Perform procedures to ascertain if the non-Federal entity’s records/database includes all individuals receiving benefits during the audit period (e.g., that the population of individuals receiving benefits is complete).

d. Select a sample of individuals receiving benefits and perform tests to ascertain if

- (1) The required eligibility determinations and redeterminations, (including obtaining any required documentation/verifications) were performed and the individual was determined to be eligible. Specific individuals were eligible in accordance with the compliance requirements of the program. (Note that some programs have both initial and continuing eligibility requirements and the auditor should design and perform appropriate tests for both. Also, some programs require periodic redeterminations of eligibility, which should also be tested.)
- (2) Benefits paid to or on behalf of the individuals were calculated correctly and in compliance with the requirements of the program.
- (3) Benefits were discontinued when the period of eligibility expired.

- e. In some programs, the non-Federal entity is required to use a quality control process to obtain assurances about eligibility. Review the quality control process and perform tests to ascertain if it is operating to effectively meet the objectives of the process and in compliance with applicable program requirements.

2. *Eligibility for Group of Individuals or Area of Service Delivery*

- a. In some cases, the non-Federal entity may be required to perform procedures to determine whether a population or area of service delivery is eligible. Test information used in determining eligibility and ascertain if the population or area of service delivery was eligible.
- b. Perform tests to ascertain if:
 - (1) The population or area served was eligible.
 - (2) The benefits paid to or on behalf of the individuals or area of service delivery were calculated correctly.

3. *Eligibility for Subrecipients*

- a. If the determination of eligibility is based upon an approved application or plan, obtain a copy of this document and identify the applicable eligibility requirements.
- b. Select a sample of the awards to subrecipients and perform procedures to verify that the subrecipients were eligible and amounts awarded were within funding limits.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

F. EQUIPMENT AND REAL PROPERTY MANAGEMENT

Compliance Requirements

Equipment Management

Title to equipment acquired by a non-Federal entity with Federal awards vests with the non-Federal entity. Equipment means tangible nonexpendable property, including exempt property, charged directly to the award having a useful life of more than one year and an acquisition cost of \$5000 or more per unit. However, consistent with a non-Federal entity's policy, lower limits may be established.

A State shall use, manage, and dispose of equipment acquired under a Federal grant in accordance with State laws and procedures. Subrecipients of States who are local governments or Indian tribes shall use State laws and procedures for equipment acquired under a subgrant from a State.

Local governments and Indian tribes shall follow the A-102 Common Rule for equipment acquired under Federal awards received directly from a Federal awarding agency. Institutions of higher education, hospitals, and other non-profit organizations shall follow the provisions of OMB Circular A-110. Basically the A-102 Common Rule and OMB Circular A-110 require that equipment be used in the program for which it was acquired or, when appropriate, other Federal programs. Equipment records shall be maintained, a physical inventory of equipment shall be taken at least once every two years and reconciled to the equipment records, an appropriate control system shall be used to safeguard equipment, and equipment shall be adequately maintained. When equipment with a current per unit fair market value of \$5000 or more is no longer needed for a Federal program, it may be retained or sold with the Federal agency having a right to a proportionate (percent of Federal participation in the cost of the original project) amount of the current fair market value. Proper sales procedures shall be used that provide for competition to the extent practicable and result in the highest possible return.

The requirements for equipment are contained in the A-102 Common Rule (§____.32), OMB Circular A-110 (§____.34), Federal awarding agency program regulations, and the terms and conditions of the award.

Real Property Management

Title to real property acquired by non-Federal entities with Federal awards vests with the non-Federal entity. Real property shall be used for the originally authorized purpose as long as needed for that purpose. For non-Federal entities covered by OMB Circular A-110 and with written approval from the Federal awarding agency, the real property may be used in other federally sponsored projects or programs that have purposes consistent with those authorized for support by the Federal awarding agency. The non-Federal entity may not dispose of or encumber the title to real property without the prior consent of the awarding agency.

When real property is no longer needed for the federally supported programs or projects, the non-Federal entity shall request disposition instructions from the awarding agency. (For purposes of this compliance requirement, the awarding agency for recipients under OMB Circular A-110 or the A-102 Common Rule and subrecipients under OMB Circular A-110 is the Federal agency providing the funding. The awarding agency for subrecipients under the A-102 Common Rule is the pass-through entity.) When real property is sold, sales procedures should provide for competition to the extent practicable and result in the highest possible return. If sold, non-Federal entities are normally required to remit to the awarding agency the Federal portion (based on the Federal participation in the project) of net sales proceeds. If retained, the non-Federal entity shall normally compensate the awarding agency for the Federal portion of the current fair market value of the property. Disposition instructions may also provide for transfer of title in which case, the non-Federal entity is entitled to compensation for its percentage share of the current fair market value.

The requirements for real property are contained in the A-102 Common Rule (§____.31), OMB Circular A-110 (§____.32), Federal awarding agency regulations, and the terms and conditions of the award.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §____.500(c).
2. Determine whether the non-Federal entity maintains proper records for equipment and adequately safeguards and maintains equipment.
3. Determine whether disposition or encumbrance of any equipment or real property acquired under Federal awards is in accordance with Federal requirements and that the awarding agency was compensated for its share of any property sold or converted to non-Federal use.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for equipment and real property management and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §____.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.

3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

(Procedure 1 only applies to subrecipients of States that are local governments or Indian tribal governments. Procedure 2 only applies to States and to subrecipients of States that are local governments or Indian tribal governments.)

1. Obtain entity's policies and procedures for equipment management and ascertain if they comply with the State's policies and procedures.
2. Select a sample of equipment transactions and test for compliance with the State's policies and procedures for management and disposition of equipment.

(Procedures 3-4 only apply to institutions of higher education, hospitals, and other non-profit organizations; and Federal awards received directly from a Federal awarding agency by a local government or an Indian tribal government.)

3. *Inventory Management of Equipment*

- a. Inquire if a required physical inventory of equipment acquired under Federal awards was taken within the last two years. Test whether any differences between the physical inventory and equipment records were resolved.
- b. Identify equipment acquired under Federal awards during the audit period and trace selected purchases to the property records. Verify that the property records contain the following information about the equipment: description (including serial number or other identification number), source, who holds title, acquisition date and cost, percentage of Federal participation in the cost, location, condition, and any ultimate disposition data including, the date of disposal and sales price or method used to determine current fair market value.
- c. Select a sample of equipment identified as acquired under Federal awards from the property records and physically inspect the equipment including whether the equipment is appropriately safeguarded and maintained.

4. *Disposition of Equipment*

- a. Determine the amount of equipment dispositions for the audit period and perform procedures to verify that dispositions were properly classified between equipment acquired under Federal awards and equipment otherwise acquired.
- b. For dispositions of equipment acquired under Federal awards, perform procedures to verify that the dispositions were properly reflected in the property records.

- c. For dispositions of equipment acquired under Federal awards with a current per-unit fair market value of \$5000 or more, test whether the awarding agency was reimbursed for the appropriate Federal share.

(Procedure 5 applies to States, local governments, Indian tribal governments and non-profit organizations regardless of whether funding is received as a recipient or subrecipient.)

5. *Disposition of Real Property*

- a. Determine real property dispositions for the audit period and ascertain such real property acquired with Federal awards.
- b. For dispositions of real property acquired under Federal awards, perform procedures to verify that the non-Federal entity followed the instructions of the awarding agency, which will normally require reimbursement to the awarding agency for the Federal portion of net sales or fair market value at the time of disposition, as applicable.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

G. MATCHING, LEVEL OF EFFORT, EARMARKING

Compliance Requirements

The specific requirements for matching, level of effort, and earmarking are unique to each Federal program and are found in the laws, regulations, and the provisions of contract or grant agreements pertaining to the program. For programs listed in this Supplement, these specific requirements are in Part 4 - Agency Program Requirements or Part 5 - Clusters of Programs, as applicable.

However, for matching, the A-102 Common Rule (§____.24) and OMB Circular A-110 (§____.23) provide detailed criteria for acceptable costs and contributions. The following is a list of the basic criteria for acceptable matching:

- Are verifiable from the non-Federal entity's records.
- Are not included as contributions for any other federally assisted project or program, unless specifically allowed by Federal program laws and regulations.
- Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.
- Are allowed under the applicable cost principles.
- Are not paid by the Federal Government under another award, except where authorized by Federal statute to be allowable for cost sharing or matching.
- Are provided for in the approved budget when required by the Federal awarding agency.
- Conform to other applicable provisions of the A-102 Common Rule and OMB Circular A-110 and the laws, regulations, and provisions of contract or grant agreements applicable to the program.

Matching, level of effort and earmarking are defined as follows:

1. *Matching* or cost sharing includes requirements to provide contributions (usually non-Federal) of a specified amount or percentage to match Federal awards. Matching may be in the form of allowable costs incurred or in-kind contributions (including third-party in-kind contributions).
2. *Level of effort* includes requirements for (a) a specified level of service to be provided from period to period, (b) a specified level of expenditures from non-Federal or Federal sources for specified activities to be maintained from period to period, and (c) Federal funds to supplement and not supplant non-Federal funding of services.

3. *Earmarking* includes requirements that specify the minimum and/or maximum amount or percentage of the program's funding that must/may be used for specified activities, including funds provided to subrecipients. Earmarking may also be specified in relation to the types of participants covered.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
2. *Matching* - Determine whether the minimum amount or percentage of contributions or matching funds was provided.
3. *Level of Effort* - Determine whether specified service or expenditure levels were maintained.
4. *Earmarking* - Determine whether minimum or maximum limits for specified purposes or types of participants were met.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for matching, level of effort, earmarking and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

1. **Matching**
 - a. Perform tests to verify that the required matching contributions were met.
 - b. Ascertain the sources of matching contributions and perform tests to verify that they were from an allowable source.

- c. Test records to corroborate that the values placed on in-kind contributions (including third party in-kind contributions) are in accordance with the OMB cost principles circulars, the A-102 Common Rule, OMB Circular A-110, program regulations, and the terms of the award.
- d. Test transactions used to match for compliance with the allowable costs/cost principles requirement. This test may be performed in conjunction with the testing of the requirements related to allowable costs/cost principles.

2.1 **Level of Effort** - *Maintenance of Effort*

- a. Identify the required level of effort and perform tests to verify that the level of effort requirement was met.
- b. Perform test to verify that only allowable categories of expenditures or other effort indicators (e.g., hours, number of people served) were included in the computation and that the categories were consistent from year to year. For example, in some programs, capital expenditures may not be included in the computation.
- c. Perform procedures to verify that the amounts used in the computation were derived from the books and records from which the audited financial statements were prepared.
- d. Perform procedures to verify that non-monetary effort indicators were supported by official records.

2.2 **Level of Effort** - *Supplement Not Supplant*

- a. Ascertain if the entity used Federal funds to provide services which they were required to make available under Federal, State, or local law and were also made available by funds subject to a supplement not supplant requirement.
- b. Ascertain if the entity used Federal funds to provide services which were provided with non-Federal funds in the prior year.
 - (1) Identify the federally funded services.
 - (2) Perform procedures to determine whether the Federal program funded services that were previously provided with non-Federal funds.
 - (3) Perform procedures to ascertain if the total level of services applicable to the requirement increased in proportion to the level of Federal contribution.

3. **Earmarking**

- a. Identify the applicable percentage or dollar requirements for earmarking.
- b. Perform procedures to verify that the amounts recorded in the financial records met the requirements (e.g., when a minimum amount is required to be spent for a specified type of service, perform procedures to verify that the financial records show that at least the minimum amount for this type of service was charged to the program; or, when the amount spent on a specified type of service may not exceed a maximum amount, perform procedures to verify that the financial records show no more than this maximum amount for the specified type of service was charged to the program).
- c. When earmarking requirements specify a minimum percentage or amount, select a sample of transactions supporting the specified amount or percentage and perform tests to verify proper classification to meet the minimum percentage or amount.
- d. When the earmarking requirements specify a maximum percentage or amount, review the financial records to identify transactions for the specified activity which were improperly classified in another account (e.g., if only 10 percent may be spent for administrative costs, review accounts for other than administrative costs to identify administrative costs which were improperly classified elsewhere and cause the maximum percentage or amount to be exceeded).
- e. When earmarking requirements prescribe the minimum number or percentage of specified types of participants that can be served, select a sample of participants that are counted toward meeting the minimum requirement and perform tests to verify that they were properly classified.
- f. When earmarking requirements prescribe the maximum number or percentage of specified types of participants that can be served, select a sample of other participants and perform tests to verify that they were not of the specified type.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

H. PERIOD OF AVAILABILITY OF FEDERAL FUNDS

Compliance Requirements

Federal awards may specify a time period during which the non-Federal entity may use the Federal funds. Where a funding period is specified, a non-Federal entity may charge to the award only costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the Federal awarding agency. Also, if authorized by the Federal program, unobligated balances may be carried over and charged for obligations of the subsequent funding period. Obligations means the amounts of orders placed, contracts and subgrants awarded, goods and services received, and similar transactions during a given period that will require payment by the non-Federal entity during the same or a future period (A-102 Common Rule, §____.23; OMB Circular A-110, §____.28).

Non-Federal entities subject to the A-102 Common Rule shall liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation) to coincide with the submission of the annual Financial Status report (SF-269). The Federal agency may extend this deadline upon request (A-102 Common Rule, §____.23).

An example used by a program to determine when an obligation occurs (is made) is found under Part 4, Department of Education, CFDA 84.000 (Cross-Cutting Section).

Audit Objective

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §____.500(c).
2. Determine whether Federal funds were obligated within the period of availability and obligations were liquidated within the required time period.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for period of availability of Federal funds and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §____.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.

3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

1. Review the award documents and regulations pertaining to the program and determine any award-specific requirements related to the period of availability and document the availability period.
2. Test a sample of transactions charged to the Federal award after the end of the period of availability and verify that the underlying obligations occurred within the period of availability and that the liquidation (payment) was made within the allowed time period.
3. Test a sample of transactions that were recorded during the period of availability and verify that the underlying obligations occurred within the period of availability.
4. Select a sample of adjustments to the Federal funds and verify that these adjustments were for transactions that occurred during the period of availability.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

I. PROCUREMENT AND SUSPENSION AND DEBARMENT

Compliance Requirements

Procurement

States, and governmental subrecipients of States, shall use the same State policies and procedures used for procurements from non-Federal funds. They also shall ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations.

Local governments and Indian tribal governments which are not subrecipients of States will use their own procurement procedures provided that they conform to applicable Federal law and regulations and standards identified in the A-102 Common Rule.

Institutions of higher education, hospitals, and other non-profit organizations shall use procurement procedures that conform to applicable Federal law and regulations and standards identified in OMB Circular A-110. All non-Federal entities shall follow Federal laws and implementing regulations applicable to procurements, as noted in Federal agency implementation of the A-102 Common Rule and OMB Circular A-110.

Requirements for procurement are contained in the A-102 Common Rule (§____.36), OMB Circular A-110 (§____.40 through §____.48), Federal awarding agency regulations, and the terms of the award. The specific references for the A-102 Common Rule and OMB Circular A-110, respectively are given for each procedure. (The first number listed refers to the A-102 Common Rule and the second refers to A-110.)

Suspension and Debarment

Non-Federal 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. Under rules in effect prior to November 26, 2003, covered transactions included procurement contracts for goods or services equal to or in excess of \$100,000. A change in the nonprocurement suspension and debarment rule took effect on November 26, 2003. As of that date only 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 specified criteria are considered “covered transactions.” §__.220 of the governmentwide nonprocurement debarment and suspension common rule contains those additional limited circumstances. All nonprocurement transactions (i.e., subawards to subrecipients) are considered covered transactions—this was the case before November 26, 2003, and was not changed by the revised rules.

Under rules in effect prior to November 26, 2003, contractors receiving individual awards for \$100,000 or more and all subrecipients must certify that the organization and its principals are not suspended or debarred. Effective November 26, 2003, 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 is not suspended or debarred or otherwise excluded. This verification may be accomplished by checking the *Excluded Parties List System (EPLS)* maintained by the General Services Administration (GSA), collecting a certification from the entity, or adding a clause or condition to the covered transaction with that entity (§__.300).. The information contained in the EPLS is available in printed and electronic formats. The printed version is published monthly. Copies may be obtained by purchasing a yearly subscription from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by calling the Government Printing Office Inquiry and Order Desk at (202) 783-3238. The electronic version can be accessed on the Internet (<http://epls.arnet.gov>).

Requirements for suspension and debarment are contained in the Federal agencies' codification of the governmentwide nonprocurement debarment and suspension common rule (see Appendix II for CFR cites), which implements Executive Orders 12549 and 12689, Debarment and Suspension, and the terms of the award.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §__.500(c).
2. Determine whether procurements were made in compliance with the provisions of the A-102 Common Rule, OMB Circular A-110, and other procurement requirements specific to an award.
3. Determine whether the non-Federal entity obtained the required certifications for covered contracts and subawards.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for procurement and suspension and debarment and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §__.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

(Procedures 1 - 4 apply only to institutions of higher education, hospitals, and other non-profit organizations; and Federal awards received directly from a Federal awarding agency by a local government or an Indian tribal government.)

1. Obtain entity's procurement policies. Verify that the policies comply with applicable Federal requirements (§____.36(b)(1) and §____.43).
2. Ascertain if the entity has a policy to use statutorily or administratively imposed in-State or local geographical preferences in the evaluation of bids or proposals. If yes, verify that these limitations were not applied to Federal procurements except where applicable Federal statutes expressly mandate or encourage geographic preference (§____.36(c)(2) and §____.43).
3. Examine procurement policies and procedures and verify the following:
 - a. Written selection procedures require that solicitations incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured, identify all requirements that the offerors must fulfill, and include all other factors to be used in evaluating bids or proposals (§____.36(c)(3) and §____.44(a)(3)).
 - b. There is a written policy pertaining to ethical conduct (§____.36(b)(3) and §____.42).
4. Select a sample of procurements and perform the following:
 - a. Examine contract files and verify that they document the significant history of the procurement, including the rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis of contract price (§____.36(b)(9) and §____.46).
 - b. Verify that procurements provide full and open competition (§____.36(c)(1) and §____.43).
 - c. Examine documentation in support of the rationale to limit competition in those cases where competition was limited and ascertain if the limitation was justified (§____.36(b)(1) and (d)(4); and §____.43 and §____.44(e)).
 - d. Verify that contract files exist and ascertain if appropriate cost or price analysis was performed in connection with procurement actions, including contract modifications and that this analysis supported the procurement action (§____.36(f) and §____.45).

- e. Verify that the Federal awarding agency approved procurements exceeding \$100,000 when such approval was required. Procurements (1) awarded by noncompetitive negotiation, (2) awarded when only a single bid or offer was received, (3) awarded to other than the apparent low bidder, or (4) specifying a “brand name” product (§____.36(g)(1) and §____.44(e)), may require prior Federal awarding agency approval.
- f. Verify compliance with other procurement requirements specific to an award.

(Procedure 5 only applies to States and Federal awards subgranted by the State to a local government or Indian tribal government.)

- 5. Test a sample of procurements to ascertain if the State’s laws and procedures were followed and that the policies and procedures used were the same as for non-Federal funds.

(Procedure 6 applies to all non-Federal entities)

- 6. Test a sample of procurements and subawards and, depending on the timing of the transaction (i.e., before, on, or after November 26, 2003) ascertain if the required suspension and debarment certifications were received or determinations were made for subawards and covered contracts. Alternatively, the auditor may test a sample of procurements and subawards to *the EPLS*, issued by GSA and ascertain if contracts or subawards were awarded to suspended or debarred parties.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

J. PROGRAM INCOME

Compliance Requirements

Program income is gross income received that is directly generated by the federally funded project during the grant period. If authorized by Federal regulations or the grant agreement, costs incident to the generation of program income may be deducted from gross income to determine program income. Program income includes, but is not limited to, income from fees for services performed, the use or rental of real or personal property acquired with grant funds, the sale of commodities or items fabricated under a grant agreement, and payments of principal and interest on loans made with grant funds. Except as otherwise provided in the Federal awarding agency regulations or terms and conditions of the award, program income does not include interest on grant funds (covered under “Cash Management”), rebates, credits, discounts, refunds, etc. (covered under “Allowable Costs/Cost Principles”), or interest earned on any of them (covered under “Cash Management”). Program income does not include the proceeds from the sale of equipment or real property (covered under “Equipment and Real Property Management”).

Program income may be used in one of three methods: deducted from outlays, added to the project budget, or used to meet matching requirements. Unless specified in the Federal awarding agency regulations or the terms and conditions of the award, program income shall be deducted from program outlays. However, for research and development activities by institutions of higher education, hospitals, and other non-profit organizations, the default method is to add program income to the project budget. Unless Federal awarding agency regulations or the terms and conditions of the award specify otherwise, non-Federal entities have no obligation to the Federal Government regarding program income earned after the end of the grant period.

The requirements for program income are found in the A-102 Common Rule (§____.21(payment) and §____.25), OMB Circular A-110 (§____.2 (program income definition), §____.22(payment), and §____.24), Federal awarding agency laws, program regulations, and the provisions of the contract or grant agreements pertaining to the program.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §____.500(c).
2. Determine whether program income is correctly determined, recorded, and used in accordance with the program requirements, A-102 Common Rule, and OMB Circular A-110, as applicable.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for program income and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

1. *Identify Program Income*
 - a. Review the laws, regulations, and the provisions of contract or grant agreements applicable to the program and ascertain if program income was anticipated. If so, ascertain the requirements for determining or assessing the amount of program income (e.g., a scale for determining user fees, prohibition of assessing fees against certain groups of individuals, etc.), and the requirements for recording and using program income.
 - b. Inquire of management and review accounting records to ascertain if program income was received.
2. *Determining or Assessing Program Income* - Perform tests to verify that program income was properly determined or calculated in accordance with stated criteria, and that program income was only collected from allowable sources.
3. *Recording of Program Income* - Perform tests to verify that all program income was properly recorded in the accounting records.
4. *Use of Program Income* - Perform tests to ascertain if program income was used in accordance with the program requirements, the A-102 Common Rule, and OMB Circular A-110.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

K. REAL PROPERTY ACQUISITION AND RELOCATION ASSISTANCE

Compliance Requirements

The Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended, (URA) provides for uniform and equitable treatment of persons displaced by Federally-assisted programs from their homes, businesses, or farms. Property acquired must be appraised by qualified independent appraisers. All appraisals must be examined by a review appraiser to assure acceptability. After acceptance, the review appraiser certifies the recommended or approved value of the property for establishment of the offer of just compensation to the owner. Federal requirements govern the determination of payments for replacement housing assistance, rental assistance, and down payment assistance for individuals displaced by federally funded projects. The regulations also cover the payment of moving-related expenses and reestablishment expenses incurred by displaced businesses and farm operations.

Governmentwide requirements for real property acquisition and relocation assistance are contained in Department of Transportation's single governmentwide rule at 49 CFR part 24, Uniform Relocation Assistance and Real Property Acquisition Regulations for Federal and Federally-Assisted Programs.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
2. Determine whether the non-Federal entity complied with the real property acquisition, appraisal, negotiation, and relocation requirements.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for real property acquisition and relocation assistance and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.

3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

1. Inquire of management and review the records of Federal programs to ascertain if the non-Federal entity administers Federally-assisted programs that involve the acquisition of real property or the displacement of households or businesses.

2. *Property Acquisitions*

For a sample of acquisitions:

- a. *Appraisal* - Test records to ascertain if: (1) the just compensation amount offered the property owner was determined by an appraisal process; (2) the appraisal(s) was examined by a review appraiser; and, (3) the review appraiser prepared a signed statement which explains the basis for adjusting comparable sales to reach the review appraiser's determination of the fair market value.
 - b. *Negotiations* - Test supporting documentation to ascertain if: (1) a written offer of the appraised value was made to the property owner; and (2) a written justification was prepared if the purchase price for the property exceeded the amount offered and that the documentation (e.g., recent court awards, estimated trial costs, valuation problems) supports such administrative settlement as being reasonable, prudent, and in the public interest.
 - c. *Residential Relocations* - Test supporting documentation to ascertain if the non-Federal entity made available to the displaced persons one or more comparable replacement dwellings.
3. *Replacement Housing Payments* - For a sample, test the non-Federal entity's records to ascertain if there is documentation that supports the following:
 - a. The owner occupied the displacement dwelling for at least 180 days immediately prior to initiation of negotiations.
 - b. The non-Federal entity examined at least three comparable replacement dwellings available for sale and computed the payment on the basis of the price of the dwelling most representative of the displacement dwelling.
 - c. The asking price for the comparable dwelling was adjusted, to the extent justified by local market data, to recognize local area selling price reductions.

- d. The allowance for increased mortgage cost “buy down” amount was computed based on the remaining principal balance, the interest rate, and the remaining term of the old mortgage on the displacement dwelling.
 - e. The non-Federal entity prepared written justification on the need to employ last resort housing provisions, if the total replacement housing payment exceeded \$22,500.
4. *Rental or Downpayment Assistance* - For a sample, test the non-Federal entity’s records to ascertain if there is documentation that supports the following:
- a. The displacee occupied the displacement dwelling for at least 90 days immediately prior to initiation of negotiations.
 - b. The displacee rented, or purchased, and occupied a decent, safe, and sanitary replacement dwelling within one year.
 - c. The non-Federal entity prepared written justification if the payment exceeded \$5,250.
5. *Business Relocations* - For a sample of business relocations:
- a. *Moving Expenses* - Test that payments for moving and related expenses were for actual costs incurred or that fixed payments, in lieu of actual costs, were limited to a maximum of \$20,000 and computed based on the average annual net earnings of the business, as evidenced by income tax returns, certified financial statements, or other reliable evidence.
 - b. *Business Reestablishment Expense* - Verify that (1) the displacee was eligible as a farm operation, a non-profit organization, or a small business to receive reestablishment assistance, and (2) the payment was for actual costs incurred and did not exceed \$10,000.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

L. REPORTING

Compliance Requirements

Financial Reporting

Recipients should use the standard financial reporting forms or such other forms as may be authorized by OMB (approval is indicated by an OMB paperwork control number on the form). These other forms may include financial, performance, and special reporting. Each recipient must report program outlays and program income on a cash or accrual basis, as prescribed by the Federal awarding agency. If the Federal awarding agency requires accrual information and the recipient's accounting records are not normally maintained on the accrual basis, the recipient is not required to convert its accounting system to an accrual basis but may develop such accrual information through analysis. The awarding agency may accept identical information from the recipient in machine-readable format, computer printouts, or electronic outputs in lieu of the prescribed formats.

The reporting requirements for subrecipients are as specified by the pass-through entity. In many cases, these will be the same as or similar to the following requirements for recipients.

The standard financial reporting forms are as follows:

1. *Financial Status Report (FSR) (SF-269 (OMB No. 0348-0039) or SF-269A (OMB No. 0348-0038))*. Recipients use the FSR to report the status of funds for all non-construction projects and for construction projects when the FSR is required in lieu of the SF-271.
2. *Request for Advance or Reimbursement (SF-270 (OMB No. 0348-0004))*. Recipients use the SF-270 to request Treasury advance payments and reimbursements under non-construction programs.
3. *Outlay Report and Request for Reimbursement for Construction Programs (SF-271 (OMB No. 0348-0002))*. Recipients use the SF-271 to request funds for construction projects unless advances or the SF-270 is used.
4. *Federal Cash Transactions Report (SF-272 (OMB No. 0348-0003) or SF-272-A (OMB No. 0348-0003))*. Recipients use the SF-272 when payment is by advances or reimbursements. The Federal awarding agency may waive the requirement for an SF-272 when electronic payment mechanisms provide adequate data.

Electronic versions of these standard forms are located on OMB's Internet home page (http://www.whitehouse.gov/omb/grants/grants_forms.html).

Reporting Under the Payment Management System

Many recipients utilize the Payment Management System (PMS) operated by the Division of Payment Management (DPM) within the Department of Health and Human Services. After a Federal agency awards a grant, DPM is responsible for controlling payments to the recipient; receiving collections for unexpended funds, duplicate payments, audit disallowances, and interest earned on Federal funds; accounting for disbursement information provided by the recipient; and reporting data equivalent to the SF-272, *Federal Cash Transactions Report*, to the recipient and the Federal agency.

Federal awarding agencies enter authorization amounts in PMS to allow recipients to draw Federal funds. There are three methods by which recipients can request funds: (1) the PMS 270 cash request, (2) SMARTLINK II, or (3) CASHLINE systems. SMARTLINK II enables recipients to request Federal funds through computer link with DPM, while CASHLINE allows funds to be requested via a touch-tone telephone. Once a quarter, using the authorization amounts provided by the Federal agency, payments requested by recipients, cash collection activity, and disbursement information provided by recipients, DPM generates PSC-272 reports.

The PSC 272 is a series of reports consisting of:

1. PSC 272, *Federal Cash Transactions Report, Status of Federal Cash (OMB No. 0937-0200)*. This report provides a total accountability of all Federal cash received by the recipient. It is partially prepared by DPM based on data reported to DPM, and is completed and certified by the recipient.
2. PSC 272-A, *Federal Cash Transactions Report (OMB No. 0937-0200)*. This report is a continuation of the PMS-272 and is used by the recipient to report cash disbursements back to DPM.
3. PSC 272-B, *Statement of Cash Accountability (OMB No. 0937-0200)*. This report is furnished for the recipient's information and shows how the recipient's cash accountability was derived by DPM.
4. PSC 272-C, *Error Correction Document (OMB No. 0937-0200)*. This report can be used by the recipient to report data reconciliation problems for awards on the PSC 272-A or the Advances to Payee portion in the PSC 272-B.
5. PSC 272-E, *Major Program Statement (OMB No. 0937-0200)*. This report is furnished to States, Indian tribes, and cross-serviced organizations for their information only. This report lists individual payments during the quarter among the various programs, and provides a cash accountability for all advances received through PMS by major program. All information provided is pre-printed by DPM.
6. PSC 272-F, *Authorizations for Future Periods (OMB No. 0937-0200)*. This report is provided for information only and requires no action by the recipient. It represents all awards posted in the PMS database that have effective dates in future reporting periods.

7. PSC 272-G, *Inactive Documents Report (OMB No. 0937-0200)*. This report lists all awards posted in the PMS database that have become inactive or fully disbursed during the current period or a previous period. In the event that disbursement adjustments are required, they should be reported via the PSC 272-A.

The reports are either mailed to the recipient or electronically downloaded by the recipient using DPM's Electronic 272 System. Recipients should verify the reported amounts. If discrepancies are noted, the report is annotated (or the PSC 272-C is completed) and returned to DPM. The recipient uses the PSC 272-A to report the amount of disbursements made; then signs, dates, and returns the report to DPM. Recipients may report disbursements data electronically using the Electronic 272 process. PSC 272 reporting requirements do not apply to block grant programs; however, DPM does provide block grant recipients with a PSC 272-E, *Major Program Statement*, quarterly. This report is provided solely for information and no action is required by the recipient.

Performance Reporting

Recipients shall submit performance reports at least annually but not more frequently than quarterly. Performance reports generally contain, for each award, brief information on each of the following:

1. A comparison of actual accomplishments with the goals and objectives established for the period.
2. Reasons why established goals were not met, if appropriate.
3. Other pertinent information including, when appropriate, analysis and explanation of cost overruns or high unit costs.

Special Reporting

Non-Federal entities may be required to submit other reporting which may be used by the Federal agency for such purposes as allocating program funding.

Compliance testing of performance and special reporting are only required for data that are quantifiable and meet the following criteria:

1. Have a direct and material effect on the program.
2. Are capable of evaluation against objective criteria stated in the laws, regulations, contract or grant agreements pertaining to the program.

Performance and special reporting data specified in Part 4, Compliance Requirements, meet the above criteria.

Reporting requirements are contained in the following documents:

- a. A-102 Common Rule - Financial reporting, §____.41; Performance reporting, §____.40(b).
- b. OMB Circular A-110 - Financial reporting, §____.52; Performance reporting, §____.51.
- c. The laws, regulations, and the provisions of contract or grant agreements pertaining to the program.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §____.500(c).
2. Determine whether required reports for Federal awards include all activity of the reporting period, are supported by applicable accounting or performance records, and are fairly presented in accordance with program requirements.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for reporting and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §____.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

Note: For recipients using PMS to draw Federal funds, the auditor should consider the following steps numbered 1 through 5 as they pertain to the PSC 272, PSC 272-A, PSC 272-B, and PSC 272-E, regardless of the source of the data included in the PMS reports. Although certain data is supplied by the Federal awarding agency (i.e., award authorization amounts) and certain amounts are provided by DPM, the auditor should ensure that such amounts are in agreement with the recipient's records and are otherwise accurate.

1. Review applicable laws, regulations, and the provisions of contract or grant agreements pertaining to the program for reporting requirements. Determine the types and frequency of required reports. Obtain and review Federal awarding agency, or pass-through entity in the case of a subrecipient, instructions for completing the reports.
 - a. For financial reports, ascertain the accounting basis used in reporting the data (e.g., cash or accrual).
 - b. For performance and special reports, determine the criteria and methodology used in compiling and reporting the data.
2. Perform appropriate analytical procedures and ascertain the reason for any unexpected differences. Examples of analytical procedures include:
 - a. Comparing current period reports to prior period reports.
 - b. Comparing anticipated results to the data included in the reports.
 - c. Comparing information obtained during the audit of the financial statements to the reports.

Note: The results of the analytical procedures should be considered in determining the nature, timing, and extent of the other audit procedures for reporting.

3. Select a sample of each of the following report types:
 - a. Financial reports
 - (1) Ascertain if the financial reports were prepared in accordance with the required accounting basis.
 - (2) Trace the amounts reported to accounting records that support the audited financial statements and the schedule of expenditures of Federal awards and verify agreement or perform alternative procedures to verify the accuracy and completeness of the reports and that they agree with the accounting records.
 - (3) For any discrepancies noted in PSC-272 reports, review subsequent PSC-272 reports to ascertain if the discrepancies were appropriately resolved with the Department of Health and Human Services' Division of Payment Management.
 - b. Performance and special reports
 - (1) Trace the data to records that accumulate and summarize data.

- (2) Perform tests of the underlying data to verify that the data were accumulated and summarized in accordance with the required or stated criteria and methodology, including the accuracy and completeness of the reports.
- c. When intervening computations or calculations are required between the records and the reports, trace reported data elements to supporting worksheets or other documentation that link reports to the data.
 - d. Test mathematical accuracy of reports and supporting worksheets.
4. Test the selected reports for completeness.
 - a. For financial reports, review accounting records and ascertain if all applicable accounts were included in the sampled reports (e.g., program income, expenditure credits, loans, interest earned on Federal funds, and reserve funds).
 - b. For performance and special reports, review the supporting records and ascertain if all applicable data elements were included in the sampled reports.
5. Obtain written representation from management that the reports provided to the auditor are true copies of the reports submitted or electronically transmitted to the Federal awarding agency, the Department of Health and Human Services' Division of Payment Management for recipients using the Payment Management System, or pass-through entity in the case of a subrecipient.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

M. SUBRECIPIENT MONITORING

Compliance Requirements

A pass-through entity is responsible for:

- *Award Identification* - At the time of the award, identifying to the subrecipient the Federal award information (e.g., CFDA title and number, award name, name of Federal agency) and applicable compliance requirements.
- *During-the-Award Monitoring* - Monitoring the subrecipient's use of Federal awards through reporting, site visits, regular contact, or other means to provide reasonable assurance that the subrecipient administers Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- *Subrecipient Audits* - (1) Ensuring that subrecipients expending \$300,000 (\$500,000 for fiscal years ending after December 31, 2003 as provided in OMB Circular A-133, as revised) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of OMB Circular A-133 (the revised circular is available on the Internet at <http://www.whitehouse.gov/omb/circulars/a133/a133.html>) and that the required audits are completed within 9 months of the end of the subrecipient's audit period, (2) issuing a management decision on audit findings within 6 months after receipt of the subrecipient's audit report, and (3) ensuring that the subrecipient takes timely and appropriate corrective action on all audit findings. In cases of continued inability or unwillingness of a subrecipient to have the required audits, the pass-through entity shall take appropriate action using sanctions.
- *Pass-Through Entity Impact* - Evaluating the impact of subrecipient activities on the pass-through entity's ability to comply with applicable Federal regulations.

During-the-Award Monitoring

Following are examples of factors that may affect the nature, timing, and extent of during-the-award monitoring:

- *Program complexity* - Programs with complex compliance requirements have a higher risk of non-compliance.
- *Percentage passed through* - The larger the percentage of program awards passed through the greater the need for subrecipient monitoring.
- *Amount of awards* - Larger dollar awards are of greater risk.

- *Subrecipient risk* - Subrecipients may be evaluated as higher risk or lower risk to determine the need for closer monitoring. Generally, new subrecipients would require closer monitoring. For existing subrecipients, based on results of during-the-award monitoring and subrecipient audits, a subrecipient may warrant closer monitoring (e.g., the subrecipient has (1) a history of non-compliance as either a recipient or subrecipient, (2) new personnel, or (3) new or substantially changed systems).

Monitoring activities normally occur throughout the year and may take various forms, such as:

- *Reporting* - Reviewing financial and performance reports submitted by the subrecipient.
- *Site Visits* - Performing site visits at the subrecipient to review financial and programmatic records and observe operations.
- *Regular Contact* - Regular contacts with subrecipients and appropriate inquiries concerning program activities.

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 costs of agreed-upon procedures engagements is an allowable cost to the pass-through entity if the agreed-upon procedures are performed for subrecipients below the A-133 threshold for audit (currently at \$300,000 and increases to \$500,000 for fiscal years ending after December 31, 2003) for the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and reporting (OMB Circular A-133 (§__.230(b)(2)).

Source of Governing Requirements

The requirements for subrecipient monitoring are contained in the 31 USC 7502(f)(2)(B) (Single Audit Act Amendments of 1996 (Pub. L. 104-156)), OMB Circular A-133 (§__.225 and §__.400(d)), A-102 Common Rule (§__.37 and §__.40(a)), and OMB Circular A-110 (§__.51(a)), Federal awarding agency program regulations, and the terms and conditions of the award.

Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).
2. Determine whether the pass-through entity properly identified Federal award information and compliance requirements to the subrecipient, and approved only allowable activities in the award documents.
3. Determine whether the pass-through entity monitored subrecipient activities to provide reasonable assurance that the subrecipient administers Federal awards in compliance with Federal requirements.
4. Determine whether the pass-through entity ensured required audits are performed, issued a management decision on audit findings within 6 months after receipt of the subrecipient's audit report, and ensures that the subrecipient takes timely and appropriate corrective action on all audit findings.
5. Determine whether in cases of continued inability or unwillingness of a subrecipient to have the required audits, the pass-through entity took appropriate action using sanctions.
6. Determine whether the pass-through entity evaluates the impact of subrecipient activities on the pass-through entity.

Suggested Audit Procedures - Internal Control

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for subrecipient monitoring and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in §___.500(c)(3) of OMB Circular A-133, including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Suggested Audit Procedures - Compliance

(Note: The auditor may consider coordinating the tests related to subrecipients performed as part of Cash Management (tests of cash reports submitted by subrecipients), Eligibility (tests that

subawards were made only to eligible subrecipients), and Procurement (tests of ensuring that a subrecipient is not suspended or debarred) with the testing of Subrecipient Monitoring.)

1. Gain an understanding of the pass-through entity's subrecipient procedures through a review of the pass-through entity's subrecipient monitoring policies and procedures (e.g., annual monitoring plan) and discussions with staff. This should include an understanding of the scope, frequency, and timeliness of monitoring activities and the number, size, and complexity of awards to subrecipients.
2. Test award documents and agreements to ascertain if: (a) at the time of award the pass-through entity made subrecipients aware of the award information (e.g., CFDA title and number, amount of award, award name, name of Federal agency) and requirements imposed by laws, regulations and the provisions of contract or grant agreements; and (b) the activities approved in the award documents were allowable.
3. Review the pass-through entity's documentation of during-the-award monitoring to ascertain if the pass-through entity's monitoring provided reasonable assurance that subrecipients used Federal awards for authorized purposes, complied with laws, regulations, and the provisions of contracts and grant agreements, and achieved performance goals.
4. Review the pass-through entity's follow-up to ensure corrective action on deficiencies noted in during-the-award monitoring.
5. Verify that the pass-through entity:
 - a. Ensured that the required subrecipient audits were completed. For subrecipients that are not required to submit a copy of the reporting package to a pass-through entity because there were "no audit findings" (i.e., because the schedule of findings and questioned costs did not disclose audit findings relating to the Federal awards that the pass-through entity provided and the summary schedule of prior audit findings did not report the status of audit findings relating to Federal awards that the pass-through entity provided, as prescribed in OMB Circular A-133 §__320(e)), the pass-through entity may use the information in the Federal Audit Clearinghouse (FAC) database (available on the Internet at <http://harvester.census.gov/sac>) as evidence to verify that the subrecipient had "no audit findings" and that the required audit was performed. This FAC verification would be in lieu of reviewing submissions by the subrecipient to the pass-through entity when there are no audit findings.
 - b. Issued management decisions on audit findings within 6 months after receipt of the subrecipient's audit report.
 - c. Ensured that subrecipients took appropriate and timely corrective action on all audit findings.

6. Verify that in cases of continued inability or unwillingness of a subrecipient to have the required audits, the pass-through entity took appropriate action using sanctions.
7. Verify that the effects of subrecipient noncompliance are properly reflected in the pass-through entity's records.
8. Verify that the pass-through entity monitored the activities of subrecipients not subject to OMB Circular A-133, using techniques such as those discussed in the "Compliance Requirements" provisions of this section with the exception that these subrecipients are not required to have audits under OMB Circular A-133.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.

N. SPECIAL TESTS AND PROVISIONS

Compliance Requirements

The specific requirements for Special Tests and Provisions are unique to each Federal program and are found in the laws, regulations, and the provisions of contract or grant agreements pertaining to the program. For programs listed in this Supplement, the compliance requirements, audit objectives, and suggested audit procedures for Special Tests and Provisions are in Part 4 - Agency Program Requirements or Part 5 - Clusters of Programs. For programs not listed in this Supplement, the auditor shall review the program's contract and grant agreements and referenced laws and regulations to identify the compliance requirements and develop the audit objectives and audit procedures for Special Tests and Provisions which could have a direct and material effect on a major program. The auditor should also inquire of the non-Federal entity to help identify and understand any Special Tests and Provisions.

Additionally, for both programs included and not included in this Supplement, the auditor shall identify any additional compliance requirements which are not based in law or regulation (e.g., were agreed to as part of audit resolution of prior audit findings) which could be material to a major program. Reasonable procedures to identify such compliance requirements would be inquiry of non-Federal entity management and review of the contract and grant agreements pertaining to the program. Any such requirements which may have a direct and material on a major program shall be included in the audit.

Internal Control

The following audit objective and suggested audit procedures should be considered in tests of special tests and provisions in addition to those provided in Part 4 - Agency Program Requirements; Part 5 - Clusters of Programs; and in accordance with Part 7 - Guidance for Auditing Programs Not Included in This Compliance Supplement:

Audit Objective

Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 § ____.500(c).

Suggested Audit Procedures

1. Using the guidance provided in Part 6 - Internal Control, perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for special tests and provisions and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in § ____.500(c)(3) of OMB Circular A-133,

including assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.

3. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

Note: The suggested audit procedures above for internal control and compliance testing may be accomplished using dual-purpose testing.