

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 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 volume 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 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 grants or

payment programs are exempted from the A-102 Common Rule. Appendix I to this Compliance Supplement lists 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. 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 referred to similar to the A-102 Common Rule references. However, unlike the A-102 Common Rule, agencies with OMB approval, 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 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.

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.

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, payments for services not received, and any payments that does not account for credit for applicable discounts.

Auditor's 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 the Compliance Supplement, these specific requirements are 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.

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

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 the Job Training Partnership Act, see 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 (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.

- **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 which 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 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 organization relationship, programs administered, and breadth of services offered by some grantees and not others. Exhibit 1, Selected Items of Costs, lists the treatment of the selected costs items by the 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 that can be used by the cognizant agency for indirect cost negotiation: predetermined, fixed, and provisional/final.

- Predetermined rates are 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 are 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 are temporary rates used for funding and billing indirect costs, pending the establishment of a final rate for a period.

Award specific indirect cost rates are sometimes negotiated which are different than 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 Principle Circular

The following sections are organized by applicable OMB Cost Principle 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 Principle Circulars.

OMB Circular A-87
"Cost Principles for State, Local, and Indian Tribal Governments"

In order to recover indirect or administrative costs, State, local and Indian tribal governments must prepare cost allocation plans (CAPs) and/or indirect cost rate proposals (IDCRPs). States, major local governments and Indian tribal governments must submit CAPs and IDCRPs to the cognizant agency for cost negotiation and approval. Other organizations, such as smaller local governments, must prepare the appropriate CAPs and IDCRPs, and maintain them on file for review. These other organizations may use the allocation methods maintained on file for cost recovery.

There are three types of plans/proposals submitted by States, local governments, and Indian tribal governments:

1. *State/Local-Wide Central Service CAPs* - These CAPs provide the documentation to identify, accumulate and allocate, or develop billing rates based on the allowable costs of services provided by a governmental unit on a centralized basis to its departments and agencies. These central service costs may be allocated or billed to users.

Allocated central services costs (referred to as Section I costs) are allocated to benefitting operating departments or agencies based 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 are typically included in the benefitting department or agency's indirect cost pool.

Billed central service costs (referred to as Section II costs) are billed to benefitting departments, 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, insurance and fringe benefits. Section II costs may be direct charged to Federal awards and be included in the department or agency's indirect cost pool.

2. *IDCRPs* - These indirect cost rate proposals provides the documentation prepared by a State/local governmental department or agency, to substantiate its request for the establishment of an indirect cost rate. The indirect costs include (a) the indirect costs originating in the department or agency carrying out Federal awards, and (b) the costs of central governmental services distributed through the State/local-wide central service CAP that are not otherwise treated as direct costs. The IDCRPs 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.
3. *Public Assistance CAPs (PACAPs)* - These CAPs provide a narrative description of the procedures that will be used in identifying, measuring and allocating all administrative costs (direct and indirect) to all of the programs administered or supervised by State

public assistance agencies. The requirements for the development, documentation, submission, negotiation and approval of PACAPs are in 45 CFR Part 95, Subpart E. Examples of public assistance programs include: Temporary Assistance for Needy Families (TANF), Medicaid, Food Stamps, Child Support Enforcement, Adoption Assistance and Foster Care.

Special Compliance Requirements for State, Local, and Indian Tribal Governments

State/Local-Wide Central Service CAPs - There are two special compliance requirements relating to the billed central services costs (Section II costs):

1. OMB Circular A-87 requires the adjustments of billed central services when there is a difference between the revenue generated by each billed service and the actual allowable costs. 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). Adjustments to allocated central services will not be permitted where the total amount of the adjustment for a particular service exceeds \$500,000.
2. OMB Circular A-87 requires that 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.

Public Assistance CAPs (PACAPs) - Since PACAPs are of a narrative nature, the auditor needs to verify that the State and/or local public assistance agencies are in compliance with the approved cost allocation plan.

Availability of Other Information for State, Local, and Indian Tribal Governments

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); and the *Review Guide for States and Local Governments State/Local-Wide Central Service Cost Allocation Plans and Indirect Cost Rates*, which are available on the Internet at <http://rates.psc.gov>.

Audit Objectives (Both Direct and Indirect Costs) - for State, Local, and Indian Tribal Governments

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).

Determine whether the organization complied with the provisions of OMB Circular A-87 as follows:

2. Direct charges to Federal awards were for allowable costs.

3. Charges to cost pools used in calculating indirect cost rates were for allowable costs.
4. Charges to cost pools allocated to Federal awards through CAPs were for allowable costs.
5. The methods of allocating the costs are in accordance with the applicable cost principles and produce an equitable and consistent distribution of costs (e.g., cost allocation bases include all allowable and unallowable base costs to which allowable indirect costs are allocable and the cost allocation methodology complies with the applicable cost principles and provides equitable and consistent allocation of indirect costs to benefitting cost objectives).
6. Indirect cost rates were applied in accordance with approved rate agreements, or special award provisions or limitations, if different from those stated in negotiated rate agreements. Associated billings were the result of applying the appropriate rate to the proper base amount(s).
7. Cost allocations were in accordance with CAPs approved by the cognizant agency or, in cases where such plans are not subject to approval, in accordance with the plan on file.

Suggested Internal Control Audit Procedures - for State, Local, and Indian Tribal Governments

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 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.
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 Compliance Audit Procedures (Both Direct and Indirect Costs) - for State, Local, and Indian Tribal Governments

General

1. The following procedures apply to direct charges to Federal awards as well as to 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. If the auditor identifies unallowable costs, the auditor should be aware that "directly associated costs" may 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.

Test a sample of transactions for conformance with the following criteria contained in the "Basic Guidelines" section of OMB Circular A-87 (Attachment A, Section C).

- a. Authorized or not prohibited under State or local laws or regulations.
- b. Approved by the Federal awarding agency, if required.
- c. Conform with the allowability of costs provisions of applicable cost principles, or limitations in the program agreement, program regulations, or program statute.
- d. Conform with the allocability provisions of applicable cost principles.
- e. Represent charges for actual costs, not budgeted or projected amounts.
- f. With respect to fringe benefit allocations, charges, or rates, such allocations, charges, or rates are based on the benefits received by different classes of employees within the organization.
- g. Applied uniformly to Federal and non-Federal activities.
- h. Given consistent accounting treatment. 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.
- I. Calculated in conformity with generally accepted accounting principles, or another comprehensive basis of accounting, when required under the applicable cost principles. Costs for post-employment benefits must be funded to be allowable.
- j. Not included as a cost or used to meet cost sharing requirements of other Federally-supported activities of the current or a prior period.
- k. 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.
- l. Not included as both a direct billing and as a component of indirect costs, e.g., excluded from cost pools included in CAPs and/or IDCRCs, if charged directly to Federal awards.
- m. 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 applicable cost principles. Documentation may be in an electronic form.

Internal service, central service, pension, or similar activities or funds

2. When material charges are made from internal service, central service, pension, or similar activities or funds, the auditor should verify that the charges from these activities or funds are in accordance with the applicable cost principles. The auditor should consider procedures, such as:
 - a. For activities accounted for in separate funds, ascertain if: (1) retained earnings/fund balances (including reserves) were computed in accordance with the applicable cost principles; (2) working capital was 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 or central service 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 applicable cost principles.
 - 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.

IDCRPs and CAPs (Testing of the proposals/plans)

3. The IDCRP is based upon costs that often precede the year in which the IDCRP is prepared and the resulting Indirect Cost Rate Agreement (IDCRA) is used to charge indirect costs. There is a timing consideration in that the audit (which covers the applicable cost pools) may be completed before the IDCRP is submitted.

When the IDCRA is the basis for material charges 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 are some acceptable options the auditor may use to obtain this assurance:

- Perform interim testing of the costs charged to cost pools (e.g., determine from management the cost pools that management expects to include in the IDCRCR and test the costs charged to those pools for compliance with OMB Circular A-87). As part of the subsequent year's audit, complete testing and verify management's representation against the submitted IDCRCR.
- Test costs charged to the cost pools for the IDCRCR's underlying base year. This would require testing of the prior year's transactions.
- Wait until the year in which charges from the IDCRA are material to a major program and test costs charged to cost pools used to prepare the IDCRCR. This is a much more difficult approach because it may require going back two years to audit the cost charged to cost pools of the base year.

The costs allocated through CAPs (including PACAPs) may include current year and prior year costs, therefore, the auditor should test the costs charged to cost pools in the supporting CAPs and the methods of allocating costs from CAPs in each year when these costs are material to a major program.

The auditor should consider the following procedures for IDCRCRs and CAPs:

- a. Test the cost pools, which form the basis of the IDCRCR and CAP and the resulting charges to Federal awards to ascertain if they include only allowable costs in accordance with the applicable cost principles. Suggested audit procedure number 1 provides guidance for specific tests.
- b. 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:
 - (1) Test statistical data (e.g., square footage, case counts, salaries and wages) to ascertain if the proposed allocation or rate bases are reasonable, updated as necessary, and do not contain any material omissions.
 - (2) Review time studies or time and effort reports (where and if used) to ascertain if they are mathematically and statistically 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.

For PACAPs, 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 time studies, determine whether the time studies are implemented and operated in accordance with the methodologies described in the approved CAP. Review the adequacy of the controls governing the conduct and evaluation of the study, determine that the sample observations were properly selected and

performed, the documentation of the observations were properly completed, and that the results of the study were correctly accumulated and applied.

- (3) Review the allocation methodology for consistency and test the appropriateness of methods used to make changes.

IDCRAs and CAPs (Testing of charges based upon plans)

4. Perform the following procedures, as applicable, to test the application of charges to Federal awards based upon an IDCRA and a CAP.
 - a. Ascertain if material indirect costs or centralized or administrative services costs were allocated or charged to a major program. If not, the following suggested audit procedures b through e do not apply.
 - b. Obtain and read the current IDCRA and/or CAP and determine the terms in effect.

Indirect Cost Rate Agreements

- c. 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).

Public Assistance CAPs

- d. Verify that the methods of charging costs to Federal awards are in accordance with the approved PACAP and the provisions of the approval documents issued by the cognizant Federal agency.

State/Local-Wide Central Service CAPs

- e. Ascertain if the amounts used for reimbursement of central service costs for Federal awards were in accordance with the approved CAPs or plans on file, when approval is not required.

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"

At colleges and universities, indirect costs are accounted for through Facilities & Administration Proposals (F&A). F&A costs, for the purpose of OMB Circular A-21, means 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 OMB Circular A-21 and as currently used in Appendices A and B of OMB Circular A-21. As described in OMB Circular 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; library expenses; and student administration expenses.

In order to recover indirect costs, educational institutions must prepare indirect cost rate proposals (IDCRPs) in accordance with the guidelines provided in OMB Circular A-21. Institutions of higher education must submit IDCRPs to the cognizant agency for indirect cost negotiation for approval.

The indirect cost proposals prepared by institutions of higher education are based on the most current financial data supported by the organization's accounting system and audited financial statements. These indirect cost proposals can be used to either establish predetermined or fixed indirect cost rates, or to establish or finalize provisional rates.

Special Compliance Requirements for Institutions of Higher Education

Disclosure Statements

OMB Circular A-21 requires institutions of higher education (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 six 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 cost accounting standard covered contract in accordance with 48 CFR section 9903.202-1.

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.

Large Research Facilities Construction Costs

OMB Circular A-21 requires that for large research facilities (those with construction costs of more than \$10 million) of which 40 percent or more of total assignable space is expected for Federal use, an institution must maintain an adequate review and approval process to ensure that construction costs are reasonable. The review process shall address and document relevant factors affecting construction costs, such as:

- Life cycle costs
- Unique research needs
- Special building needs
- Building site preparation
- Environmental consideration
- Federal construction code requirements
- Competitive procurement practices

The approval process shall include review and approval of the projects by the institution's Board of Trustees or other independent entities.

OMB Circular A-21 also requires that for research facilities costing more than \$25 million, of which 50 percent or more of total assignable space is expected for Federal use, the institution must document the review steps performed to assure that construction costs are reasonable. The review should include an analysis of construction costs and a comparison of these costs with relevant construction data, including the National Science Foundation data for research facilities based on its biennial survey, "Science and Engineering Facilities at Colleges and Universities."

Standard Format for Long Form Proposals

For F&A rate proposals submitted on or after July 1, 2001, institutions of higher education shall use the standard format shown in OMB Circular A-21, Appendix C to submit their F&A rate proposal 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 institutions of higher education which use the simplified method for calculating F&A rates, as described in OMB Circular A-21, section H.

Availability of Other Information for Institutions of Higher Education

University Long Form Facilities & Administrative Cost Proposals

Additional information on indirect cost rates is found in the Department of Health and Human Services (HHS) publications: *Review Guide for Long-Form University Facilities & Administrative Cost Proposals*, which are available on the Internet at <http://rates.psc.gov>.

Audit Objectives (Both Direct and Indirect Costs) for Institutions of Higher Education

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).

Determine whether the organization complied with the provisions of the applicable OMB cost principles circular (OMB Circulars A-21) and CASB Standards as follows:

2. Direct charges to Federal awards were for allowable costs.
3. Charges to cost pools used in calculating indirect cost rates were for allowable costs.

4. The methods of allocating the costs are in accordance with the applicable cost principles or CASB Standards and produce an equitable and consistent distribution of costs (e.g., cost allocation bases include all allowable and unallowable base costs to which allowable indirect costs are allocable and the cost allocation methodology complies with the applicable cost principles and provides equitable and consistent allocation of indirect costs to benefitting cost objectives).
5. Indirect cost rates were applied in accordance with approved rate agreements, or special award provisions or limitations, if different from those stated in negotiated rate agreements. Associated billings were the result of applying the approved rate to the proper base amount.
6. Cost accounting practice disclosures, described in the 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.
7. The institution's review of large research facilities under construction was documented as required.

Suggested Internal Control Audit Procedures - for Institutions of Higher Education

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 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.
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 Compliance Audit Procedures (Both Direct and Indirect Costs) - for Institutions of Higher Education

General

1. The following procedures apply to direct charges to Federal awards as well as to 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. If the auditor identifies unallowable costs, the auditor should be aware that "directly associated costs" may 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.

Test a sample of transactions for conformance with the following criteria contained in the "Basic Considerations" section of OMB Circular A-21.

- a. Approved by the Federal awarding agency, if required.
- b. Conform with the allowability of costs provisions of applicable cost principles, or limitations in the program agreement, program regulations, or program statute.
- c. Conform with the allocability provisions of applicable cost principles or CASB Standards.
- d. Represent charges for actual costs, not budgeted or projected amounts.
- e. With respect to fringe benefit allocations, charges, or rates, such allocations, charges, or rates are based on the benefits received by different classes of employees within the organization.
- f. Applied uniformly to Federal and non-Federal activities.
- g. 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.
- h. Calculated in conformity with CASB Standards, generally accepted accounting principles, or another comprehensive basis of accounting, when required under the applicable cost principles or CASB Standards. Costs for post-employment benefits must be funded to be allowable.
- I. Not included as a cost or used to meet cost sharing requirements of other Federally-supported activities of the current or a prior period.
- j. 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.
- k. Not included as both a direct billing and as a component of indirect costs, e.g., excluded from cost pools included in IDCRRPs, if charged directly to Federal awards.
- l. 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 applicable cost principles. Documentation may be in an electronic form.

Internal service, central service, pension, or similar activities or funds

2. When material charges are made from internal service, central service, pension, or similar activities or funds, the auditor should verify that the charges from these activities or funds are in accordance with the applicable cost principles. The auditor should consider procedures, such as:
 - a. For activities accounted for in separate funds, ascertain if: (1) retained earnings/fund balances (including reserves) were computed in accordance with the applicable cost principles; (2) working capital was 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 applicable cost principles.
 - 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.

IDCRP (Testing of the proposal)

3. The IDCRP is based upon costs charged to cost pools representing costs of a base year. The base year often precedes the year in which the IDCRP is prepared and the year the resulting Indirect Cost Rate Agreement (IDCRA) is used to charge indirect costs. For example, a non-Federal entity may submit an IDCRP in January 1998, based upon costs incurred and charged to cost pools during fiscal year ending June 30, 1997 (1997), the base year. The resulting IDCRA negotiated during the year ending June 30, 1998 (1998) would be used as the basis for charging indirect costs to Federal awards in the year ended June 30, 1999 (1999). For this example, the term IDCRA will also include an IDCRP which is not required to be submitted to the Federal agency for indirect cost negotiation but is retained on file and is used to charge indirect costs to Federal awards the same as an approved plan resulting in an IDCRA.

An audit timing consideration is that the audit for 1997 (which covers the applicable cost pools) may be completed before the IDCRA is submitted. Therefore, as part of the 1997 audit, the auditor cannot complete testing of the IDCRA. Also, if the auditor waits to test the IDCRA until 1999 (the year when this IDCRA is first used to charge Federal awards), the auditor would be testing 1997 records, which would then be two years old.

Continuing this example, when the IDCRA is the basis for material charges to a major program in 1999, the auditor for 1999 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 are some acceptable options the auditor may use to obtain this assurance:

- Perform interim testing of the costs charged to cost pools (e.g., determine from management the cost pools that management expects to include in the IDCRA and test the costs charged to those pools for compliance with the cost principles circulars) during the 1997 audit. As part of the 1998 audit, complete testing and verify management's representation against the IDCRA finally submitted in 1998.
- Test costs charged to the cost pools underlying the IDCRA during the audit of 1998, the year immediately following the base year. This would require testing of 1997 transactions.
- Wait until 1999, the year in which charges from the IDCRA are material to a major program and test costs charged to cost pools (1997) used to prepare the IDCRA. This is a much more difficult approach because it requires going back two years to audit the cost charged to cost pools of the base year.

Advantages of the first two methods are that the testing of the costs charged to the cost pools occurs closer to the time when the transactions occur (which makes the testing easier to perform) and should there be audit exceptions, corrective action may be taken earlier to minimize questioned costs (which makes audit exceptions easier to resolve). When material indirect costs are charged to any Type A program (determined in accordance with OMB Circular A-133), auditors are strongly encouraged to use one of the first two methods. This is because under the risk-based approach, described in OMB Circular A-133, all Type A programs are required to be considered major programs at least once in every three years and the IDCRA is usually used to charge Federal awards for at least three years.

When the auditee submits the IDCRA, the auditee provides written assurances to the Federal government that the plan includes only allowable costs. Accordingly, any material unallowable costs reflected in the IDCRA should be reported as an audit finding in the year in which they are first found by audit.

An IDCRA may result in an IDCRA that covers only one year, but most often results in a multi-year IDCRA. When an IDCRA has been tested in a prior year and this testing provides the auditor appropriate audit assurance, in subsequent years the auditor is only required to perform tests to ascertain if there have been material changes to the cost accounting practices, including

practices that would affect either the cost pools or the allocation base and, if so, that the cognizant agency for indirect cost negotiation has been informed.

The auditor should take appropriate steps to coordinate testing of costs charged to cost pools supporting an IDCPR with the auditee and, as appropriate, with the cognizant agency for indirect cost negotiation. The auditor should consider consulting with the auditee in the base year and the year in which the IDCPR is submitted to determine the best (e.g., most efficient) alternative under the circumstances.

The following procedures are applicable when material charges are made to a major program based upon an IDCPR:

- a. Ascertain if the IDCPR has been tested in a prior year.
 - (1) When the testing performed in a prior year provides appropriate audit assurance, further review of the IDCPR is not required unless there have been material changes to cost accounting practices supporting the IDCPR. To ascertain if there have been material changes, the auditor should inquire of auditee management as to whether any changes have been made to the cost accounting practices and the likely effect of these changes.
 - (2) When the auditor believes the changes in cost accounting practices are material, and the auditee is required to file the IDCPR with a cognizant agency for indirect cost negotiation, the auditor should ascertain if the cognizant agency for indirect cost negotiation has been appropriately notified of the changes in cost accounting practices. For non-Federal entities that are required to file a DS-2, this testing is performed in Step 5 "DS-2 Requirements."

When prior testing of the IDCPR does not provide appropriate audit assurance (e.g., was not performed).

- b. Test the cost pools which form the basis of the IDCPR and the resulting charges to Federal awards to ascertain if they include only allowable costs in accordance with the cost principles or CASB Standards, as applicable. Suggested audit procedure number 1 provides guidance for specific tests.
- c. Test the methods of allocating the costs to ascertain if they are in accordance with the provisions of the cost principles or CASB Standards, as applicable, and produce an equitable distribution of costs. Appropriate detailed tests may include:
 - (1) Test statistical data (e.g., square footage, case counts, salaries and wages) to ascertain if the proposed allocation or rate bases are reasonable, updated as necessary, and do not contain any material omissions.
 - (2) Review time studies or time and effort reports (where and if used) to ascertain if they are mathematically and statistically 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.

- (3) Review the allocation methodology for consistency and test the appropriateness of methods used to make changes.

IDCRA (Testing of charges based upon an agreement)

4. Perform the following procedures to test the application of charges to Federal awards based upon an IDCRA.
 - a. Ascertain if material indirect costs or centralized or administrative services costs were allocated or charged to a major program. If not, the following suggested audit procedures b and c do not apply.
 - b. Obtain and read the current IDCRA and determine the terms in effect.
 - c. 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).

DS-2 Requirements (For applicable non-Federal entities)

5. Perform the following procedures for DS-2, as applicable:
 - a. Read the DS-2 and its amendments and ascertain if the disclosures agree with the policies prescribed in the institution's policies and procedures documents.
 - b. Test that the disclosures agree with actual practices for the period covered by audit, including whether the practices were consistent throughout the period.

Large Research Facilities Construction Costs (For applicable educational institutions)

6. Perform the following procedures related to large research facilities:
 - a. Ascertain if the institution had large research facilities as defined in OMB Circular A-21 under construction. If not, the following suggested audit procedures b and c do not apply.
 - b. For large research facilities under construction of which 40 percent or more of total assignable space is expected for Federal use, review the institution's approval process that should include board minutes or other documentation to

ascertain if the institution's Board of Trustees or other independent entity reviewed and approved these construction projects.

- c. For research facilities under construction costing more than \$25 million of which 50 percent or more of total assignable space is expected for Federal use, ascertain if the institution documented the review steps performed to assure that construction costs are reasonable.

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"

Indirect cost proposals prepared by non-profit Organizations (NPOs) are based on the most current financial data supported by the organization's accounting system and audited financial statements. These indirect cost proposals can be used to either establish predetermined or fixed indirect cost rates, or to establish or finalize provisional rates.

There are three major categories of indirect costs for NPOs:

- **Depreciation and Use Allowance** - The expenses under this heading are the portion of the costs of the organization's buildings, capital improvements to land and buildings, and equipment which are computed in accordance with OMB Circular A-122, Attachment B, section 11. Interest on debt associated with certain buildings, equipment, and capital improvements are computed in accordance with OMB Circular A-122, Attachment B section 23.
- **Operation & Maintenance** - The expenses under this heading are those that have been incurred for the administration, operation, maintenance, preservation, and protection of the organization's physical plant.
- **General & Administrative** - The expenses under this heading are those that have been incurred for the overall general executive and administration offices of the organization and other expenses of a general nature, which do not relate solely to any major function of the organization.

Determination of Indirect Cost Rates - NPOs can select one of three different methods to calculate the indirect cost rate.

- **Simplified Method** (OMB Circular A-122, Attachment A, section D.2) - 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 which 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.

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 OMB Circular, Attachment A, section C.3. The rate in each case shall be stated as the percentage which the amount of the particular indirect cost category (i.e., Facilities or Administration) is of the distribution base identified with that category.

- **Multiple Allocation Base Method** (OMB Circular A-122, Attachment A, section D.3) - 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 subparagraph b. Each grouping shall then be allocated individually to benefitting functions by means of a base which best measures the relative benefits. The default allocation bases by cost pool are described in subparagraph c.

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 OMB Circular A-122, Attachment A, section C.3.

Except where a special indirect cost rate is required in accordance with OMB Circular A-122, Attachment A, section 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.

Indirect costs shall be distributed to applicable sponsored awards and other benefitting activities within each major function on the basis of Modified Total Direct Cost (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.

- **Direct Allocation Method** (OMB Circular A-122, Attachment A, section D.4) - Some non-profit organizations 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.

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. This method is compatible with the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations issued jointly by the National

Health Council, Inc., the National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America.

Under this method, indirect costs consist exclusively of general administration and general expenses. In all other respects, the organization's indirect cost rates shall be computed in the same manner as that described in OMB Circular A-122, Attachment A section D.2.

Special Compliance Requirements for Non-Profit Organizations

Unallowable Direct Costs (OMB Circular A-122, Attachment A, section B.3 and B. 4)

The costs of certain activities are not allowable as charges to Federal awards (see, for example, fundraising costs in OMB Circular A-122, Attachment B, section 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.

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. Some examples of these types of activities include:

- Maintenance of membership rolls, subscriptions, publications, and related functions.
- Providing services and information to members, legislative or administrative bodies, or the public.
- Promotion, lobbying, and other forms of public relations.
- Meetings and conferences except those held to conduct the general administration of the organization.
- Maintenance, protection, and investment of special funds not used in operation of the organization.
- Administration of group benefits on behalf of members or clients, including life and hospital insurance, annuity or retirement plans, financial aid, etc.

Availability of Other Information for Non-Profit Organizations Indirect Cost Rate Determination

Additional information on indirect cost rate determination for non-profit organizations is found in the Department of Labor publication *Indirect Cost Rate Determination Guide* which is available on the Internet at www2.dol.gov/oasam/programs/guide.htm.

Audit Objectives (Both Direct and Indirect Costs) for Non-Profit Organizations

1. Obtain an understanding of internal control, assess risk, and test internal control as required by OMB Circular A-133 §___.500(c).

Determine whether the organization complied with the provisions of the applicable OMB cost principles circular (OMB Circular A-122) and CASB Standards (if applicable) as follows:

2. Direct charges to Federal awards were for allowable costs.
3. Charges to indirect cost pools used in calculating indirect cost rates were for allowable costs.
4. The methods of allocating the costs are in accordance with the applicable cost principles or CASB Standards and produce an equitable and consistent distribution of costs (e.g., cost allocation bases include all allowable and unallowable base costs to which allowable indirect costs are allocable and the cost allocation methodology complies with the applicable cost principles and provides equitable and consistent allocation of indirect costs to benefitting cost objectives).
5. Indirect cost rates were applied in accordance with approved rate agreements, or special award provisions or limitations, if different from those stated in negotiated rate agreements. Associated billings were the result of applying the approved rate to the proper base amount.
6. For non-profits that do not have an indirect cost rate agreement negotiated with their cognizant agency, cost allocations are consistent with the indirect cost proposal submitted to their cognizant agency.
7. For non-profit organizations that do not have a negotiated rate agreement or a rate approved by the award terms and conditions for use on that particular award, costs directly allocated to the award are adequately documented, supported, and meet all other restrictions of OMB Circular A-122 (e.g., necessary, reasonable, and allowable).
8. Cost accounting practice disclosures, described in the DS-1 (including amendments), represent actual practice consistently applied. This objective only applies to non-Federal entities that are required to submit the DS-1.

Suggested Audit Procedures - Internal Control (for Non-Profit Organizations)

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 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.

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 (Both Direct and Indirect Costs) - Compliance (for Non-Profit Organizations)

General

1. The following procedures apply to direct charges to Federal awards as well as to 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. If the auditor identifies unallowable costs, the auditor should be aware that "directly associated costs" may 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.

Test a sample of transactions for conformance with the following criteria contained in the "Basic Considerations" section of OMB Circular A-122.

- a. Approved by the Federal awarding agency, if required.
- b. Conform with the allowability of costs provisions of applicable cost principles, or limitations in the program agreement, program regulations, or program statute.
- c. Conform with the allocability provisions of applicable cost principles or CASB Standards.
- d. Represent charges for actual costs, not budgeted or projected amounts.
- e. With respect to fringe benefit allocations, charges, or rates, such allocations, charges, or rates are based on the benefits received by different classes of employees within the organization.
- f. Applied uniformly to Federal and non-Federal activities.
- g. 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.

- h. Calculated in conformity with CASB Standards, generally accepted accounting principles, or another comprehensive basis of accounting, when required under the applicable cost principles or CASB Standards. Costs for post-employment benefits must be funded to be allowable.
- I. Not included as a cost or used to meet cost sharing requirements of other Federally-supported activities of the current or a prior period.
- j. 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.
- k. Not included as both a direct billing and as a component of indirect costs, e.g., excluded from cost pools included in IDCRRPs, if charged directly to Federal awards.
- l. 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 applicable cost principles. Documentation may be in an electronic form.

Internal service, central service, pension, or similar activities or funds

- 2. When material charges are made from internal service, central service, pension, or similar activities or funds, the auditor should verify that the charges from these activities or funds are in accordance with the applicable cost principles. The auditor should consider procedures, such as:
 - a. For activities accounted for in separate funds, ascertain if: (1) retained earnings/fund balances (including reserves) were computed in accordance with the applicable cost principles; (2) working capital was 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 applicable cost principles.
 - 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.

IDCRP (Testing of the proposal)

3. The IDCRP is based upon costs charged to cost pools representing costs of a base year. The base year often precedes the year in which the IDCRP is prepared and the year the resulting Indirect Cost Rate Agreement (IDCRA) is used to charge indirect costs. For example, a non-Federal entity may submit an IDCRP in January 1998, based upon costs incurred and charged to cost pools during fiscal year ending June 30, 1997 (1997), the base year. The resulting IDCRA negotiated during the year ending June 30, 1998 (1998) would be used as the basis for charging indirect costs to Federal awards in the year ended June 30, 1999 (1999). For this example, the term IDCRA will also include an IDCRP which is not required to be submitted to the Federal agency for indirect cost negotiation but is retained on file and is used to charge indirect costs to Federal awards the same as an approved plan resulting in an IDCRA.

An audit timing consideration is that the audit for 1997 (which covers the applicable cost pools) may be completed before the IDCRP is submitted. Therefore, as part of the 1997 audit, the auditor cannot complete testing of the IDCRP. Also, if the auditor waits to test the IDCRP until 1999 (the year when this IDCRP is first used to charge Federal awards), the auditor would be testing 1997 records, which would then be two years old.

Continuing this example, when the Indirect Cost Rate Agreement or the Indirect Cost Proposal which has been submitted to the cognizant federal agency is the basis for material charges to a major program in 1999, the auditor for 1999 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 are some acceptable options the auditor may use to obtain this assurance:

- Perform interim testing of the costs charged to cost pools (e.g., determine from management the cost pools that management expects to include in the IDCRP and test the costs charged to those pools for compliance with the cost principles circulars) during the 1997 audit. As part of the 1998 audit, complete testing and verify management's representation against the IDCRP finally submitted in 1998.
- Test costs charged to the cost pools underlying the IDCRP during the audit of 1998, the year immediately following the base year. This would require testing of 1997 transactions.
- Wait until 1999, the year in which charges from the IDCRA are material to a major program and test costs charged to cost pools (1997) used to prepare the IDCRP. This is a much more difficult approach because it requires going back two years to audit the cost charged to cost pools of the base year.

Advantages of the first two methods are that the testing of the costs charged to the cost pools occurs closer to the time when the transactions occur (which makes the testing easier to perform) and should there be audit exceptions, corrective action may be taken earlier to minimize questioned costs (which makes audit exceptions easier to resolve). When material indirect costs are charged to any Type A program (determined in accordance with OMB Circular A-133), auditors are strongly encouraged to use one of the first two methods. This is because under the risk-based approach, described in OMB Circular A-133, all Type A programs are required to be considered major programs at least once in every three years and the IDCRA is usually used to charge Federal awards for at least three years.

When the auditee submits the IDCRP, the auditee provides written assurances to the Federal government that the plan includes only allowable costs. Accordingly, any material unallowable costs reflected in the IDCRP should be reported as an audit finding in the year in which they are first found by audit.

An IDCRP may result in an IDCRA that covers only one year, but most often results in a multi-year IDCRA. At other times the indirect cost proposal may not result in an IDC Rate Agreement but was still used as the basis for charging indirect costs to the award. When an IDCRP has been tested in a prior year and this testing provides the auditor appropriate audit assurance, in subsequent years the auditor is only required to perform tests to ascertain if there have been material changes to the cost accounting practices, including practices that would affect either the cost pools or the allocation base and, if so, that the cognizant agency for indirect cost negotiation has been informed.

The auditor should take appropriate steps to coordinate testing of costs charged to cost pools supporting an IDCRP with the auditee and, as appropriate, with the cognizant agency for indirect cost negotiation. The auditor should consider consulting with the auditee in the base year and the year in which the IDCRP is submitted to determine the best (e.g., most efficient) alternative under the circumstances.

The following procedures are applicable when material charges are made to a major program based upon an IDCRP:

- a. Ascertain if the IDCRP has been tested in a prior year.
 - (1) When the testing performed in a prior year provides appropriate audit assurance, further review of the IDCRP is not required unless there have been material changes to cost accounting practices supporting the IDCRP. To ascertain if there have been material changes, the auditor should inquire of auditee management as to whether any changes have been made to the cost accounting practices and the likely effect of these changes.
 - (2) When the auditor believes the changes in cost accounting practices are material, and the auditee is required to file the IDCRP with a cognizant agency for indirect cost negotiation, the auditor should ascertain if the

cognizant agency for indirect cost negotiation has been appropriately notified of the changes in cost accounting practices. For non-Federal entities that are required to file a DS-1, this testing is performed in Step 5 "DS-1 Requirements."

When prior testing of the IDCRCP does not provide appropriate audit assurance (e.g., was not performed).

- b. Test the cost pools which form the basis of the IDCRCP and the resulting charges to Federal awards to ascertain if they include only allowable costs in accordance with the cost principles or CASB Standards, as applicable. Suggested audit procedure number 1 provides guidance for specific tests.
- c. Test the methods of allocating the costs to ascertain if they are in accordance with the provisions of the cost principles or CASB Standards, as applicable, and produce an equitable distribution of costs. Appropriate detailed tests may include:
 - (1) Test statistical data (e.g., square footage, case counts, salaries and wages) to ascertain if the proposed allocation or rate bases are reasonable, updated as necessary, and do not contain any material omissions.
 - (2) Review time studies or time and effort reports (where and if used) to ascertain if they are mathematically and statistically 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.
 - (3) Review the allocation methodology for consistency and test the appropriateness of methods used to make changes.

Indirect Cost Rate Agreements (Testing of charges based upon an Agreement)

- 4. Perform the following procedures to test the application of charges to Federal awards based upon an IDCRA.
 - a. Ascertain if material indirect costs or centralized or administrative services costs were allocated or charged to a major program. If not, the following suggested audit procedures b through d do not apply.
 - b. Obtain and read the current IDCRA and/or IDCRCP and determine the terms in effect.
 - c. Ascertain whether the indirect cost rate agreement or indirect cost proposal uses a (1) pre-determined rate, (2) fixed rate (3) final rate, (4) provisional rate, or (5) award specific rate. For definitions of these rates see OMB A-122 Paragraph E (b) through (e).

1. If a fixed rate agreement has been negotiated or submitted to the cognizant agency for negotiation, determine that the difference between the funds claimed 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.
 2. If the Indirect Cost Rate Agreement is for an award specific rate, ascertain that the award specific rate is only being used for the approved award.
- d. 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).

DS-1 Requirements (For applicable non-Federal entities)

5. Perform the following procedures for DS-1, as applicable:
 - a. Read the DS-1 and its amendments and ascertain if the disclosures agree with the policies prescribed in the institution's policies and procedures documents.
 - b. Test that the disclosures agree with actual practices for the period covered by audit, including whether the practices were consistent throughout the period.

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

LIST OF SELECTED ITEMS OF COSTS CONTAINED IN OMB COST PRINCIPLES CIRCULARS

The following exhibit provides a listing of selected items of costs contained in each of the OMB cost principle 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 Costs			Exhibit 1
Selected Cost Items	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov't	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) – Allowable with restrictions	(1) – 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

Selected Items of Costs			Exhibit 1
Selected Cost Items	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov't	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non Profit Organizations
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
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

Selected Items of Costs			Exhibit 1
Selected Cost Items	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov't	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non Profit Organizations
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
Gains/Profits and losses on disposition of depreciable property and other capital assets and substantial relocation	(22)-Allowable with restrictions	(33)-Allowable with restrictions	(40)-Allowable with restrictions

Selected Items of Costs			Exhibit 1
Selected Cost Items of Federal programs	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov't	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non Profit Organizations
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 Costs			Exhibit 1
Selected Cost Items	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov't	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

Selected Items of Costs			Exhibit 1
Selected Cost Items	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov't	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non Profit Organizations
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
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

Selected Items of Costs			Exhibit 1
Selected Cost Items	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov't	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non Profit Organizations
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
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

Selected Items of Costs			Exhibit 1
Selected Cost Items	OMB Circular A-87, Attachment B State, Local, & Indian Tribal Gov't	OMB Circular A-21, Section J Educational Institutions	OMB Circular A-122, Attachment B Non Profit Organizations
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 nonprofit 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) (Pub. L. No. 101-453; 31 USC 6501 *et seq.*), require State recipients to enter into agreements which 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 Appendix A to subpart A of 31 CFR part 205 (31 CFR section 205.4).
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 205.8 and 205.9(b)(4)).
3. Select a sample of Federal cash draws and verify that:
 - a. The timing of the Federal cash draws were in compliance with the applicable funding techniques specified in the Treasury-State Agreement or Subpart B procedures, whichever is applicable (31 CFR sections 205.7 and 205.20).
 - 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 205.7(c)(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 which 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 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 (www.dol.gov/dol/esa/public/programs/dbra/index.html). 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 which 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) and that individual program participants or groups of participants (including area of service delivery) were determined to be eligible. 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 which 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 the Compliance 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. 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 the:
- (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 which acquired it 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 in excess of \$5000, 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. *Dispositions 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 in excess of \$5000, 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. *Dispositions 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 the Compliance 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. Covered transactions include procurement contracts for goods or services equal to or in excess of \$100,000 and all nonprocurement transactions (e.g., subawards to subrecipients).

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. The non-Federal entities may rely upon the certification unless it knows that the certification is erroneous. Non-Federal entities may, but are not required to, check for suspended and debarred parties which are listed in the *List of Parties Excluded From Federal Procurement or Nonprocurement Programs*, issued by the General Services Administration (GSA). The information contained on the list 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://www.arnet.gov/epl>). Please note that the user will be required

to record their name and organization for purposes of the Computer Matching and Privacy Act of 1988.

Requirements for suspension and debarment are contained in the Federal agencies' codification of the governmentwide 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 awarding Federal 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 ascertain if the required suspension and debarment certifications were received for subawards and covered contracts. Alternatively, the auditor may test a sample of procurements and subawards to *the List of Parties Excluded From Federal Procurement or Nonprocurement Programs*, issued by the GSA and ascertain if contracts 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 \$5250.
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 open-ended entitlement programs (Appendix 1) require quarterly reports.)

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 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 the OMB's Internet home page (<http://www.whitehouse.gov/OMB>).

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 Transaction Report*, to the recipient and 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 PMS 272 reports.

The PMS 272 is a series of reports consisting of:

1. PMS 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. PMS 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. PMS 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. PMS 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 PMS 272-A or the Advances to Payee portion in the PMS 272-B.
5. PMS 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. PMS 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. PMS 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 PMS 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 PMS 272-C is completed) and returned to DPM. The recipient uses the PMS 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. PMS 272 reporting requirements do not apply to block grant programs; however, DPM does provide block grant recipients with a PMS 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 PMS 272, PMS 272-A, PMS 272-B, and PMS 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 PMS-272 reports, review subsequent PMS-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 site visits 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* - Ensuring required audits are completed within nine months of the end of the subrecipient's audit period, issuing a management decision on audit findings within six months after receipt of the subrecipient's audit report, and 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 example factors which 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, using techniques such as site visits and closer monitoring for new subrecipients and subrecipients that are otherwise considered higher risk (e.g., based on past history of non-compliance, new personnel, new or substantially changed systems).

Monitoring activities normally occur through-out 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.
- *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) 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. No. 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 six 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 suspension and debarment certifications) 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 receives audit reports from subrecipients required to have an audit in accordance with OMB Circular A-133, issues management decisions on audit findings within six months after receipt of the subrecipient's audit report, and ensures that subrecipients takes 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

1. 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.