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Not-for-profit organizations audit manual, Volume 2

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Not-for-Profit Organizations Audit Manual

*Not-for-Profit
Organizations
Audit Manual*

VOLUME 2

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***Not-for-Profit
Organizations
Audit Manual***

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Audit Manual***

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**AICPA INTEGRATED PRACTICE SYSTEM
NOT-FOR-PROFIT ORGANIZATIONS AUDIT MANUAL**

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CHAPTER 10

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CHAPTER 10

CONSULTING SERVICES

10.000 INTRODUCTION

10.001 The AICPA's Statement on Standards for Consulting Services No. 1, *Consulting Services: Definitions and Standards* (SSCS No.1), incorporates the standards that the accountant *must* follow for consultation engagements. SSCS No. 1 defines consulting services as, "professional services that employ the practitioner's technical skills, education, observations, experiences, and knowledge of the consulting process." Consulting services may include one or more of the following: consultations, advisory services, implementation services, transaction services, staff and other support services, and product services.

10.002 Auditors of a not-for-profit organization are ideally positioned to assist clients by providing consulting services covering many facets of their financial systems, financial reporting, grant compliance and reporting, and tax exemption matters.

10.003 Through the normal course of an audit engagement, the auditor will already have gained an understanding of the organization's structure, operations, accounting system, program activities, fund raising activities, and will already be familiar with funders, staff and board members. Most likely, the auditor will have a better understanding than the client of generally accepted accounting principles and provisions of the Internal Revenue Code relating to tax exemption and unrelated business income tax. And by virtue of his or her testing procedures during the conduct of the audit, the auditor is probably as familiar with key components of the internal control structure as any client personnel.

10.004 From the client's point of view, there can be some significant advantages to using the auditor as a consultant for certain projects. Obviously, the client does not have to orient the consultant and avoids the cost of the consultant getting to know the client's situation. Furthermore, because the services are performed by the auditor, the client can rest assured that the results of the consulting project will not lead to audit issues later on.

10.005 From the auditor's point of view, some real benefits grow from providing consulting services to an audit client. Since these services would probably be provided by more experienced audit staff, the billing rates may exceed average audit realization rates. There is usually considerable flexibility in scheduling these services, so they can be used to fill staff time in slow periods. By performing consulting services, an auditor frequently identifies client systems, activities or issues that could affect the nature, extent and timing of audit procedures, which may facilitate initial audit planning and audit fee estimation. Furthermore, assisting a client with issues that are significant to its management or operations can enhance the auditor's credibility and client rapport, which should solidify client loyalty and result in client retention.

10.006 This chapter is intended to highlight certain consulting services that an auditor can provide to not-for-profit clients. Specifically, the following paragraphs discuss:

- Assisting the organization in properly implementing the requirements of SFAS Nos. 116, *Accounting for Contributions Received and Contributions Made*, and 117, *Financial Statements of Not-For-Profit Organizations*.
- Advising the organization about choosing new general ledger software.

10.100 ADAPTING POLICIES AND PROCEDURES TO IMPLEMENT SFAS NOS. 116 AND 117

10.101 SFAS Nos. 116 and 117, when implemented by an organization, will necessitate considerable changes to the organization's accounting system. Those changes will include some or all of the following:

1. review of a number of accounting policies
2. additional internal control procedures
3. possible changes to current internal control procedures
4. additional financial statement disclosures
5. possible changes to current financial statement disclosures
6. the addition of a statement of cash flows to the organization's financial statements
7. the probable change of format of the current balance sheet and statement of activity
8. the addition (for some organizations) of functional expense reporting

10.102 As an organization's auditor, you are the ideal consultant to assist your client in properly implementing the requirements of these new pronouncements. Some of the many reasons you are the right consultant are:

1. You already know the organization's current accounting policies, internal control procedures, and financial statements.
2. You already know the organization's mix of funding sources and the extent to which it receives promises to give (pledges), restricted contributions, or donated services.
3. You already understand the organization's programs and "supporting services" and you already understand enough about the organization's circumstances to help it choose allocation methods and statistics for functional expense reporting.

4. You have already developed a working relationship with the management and staff of the organization and they already respect your professional assistance.

10.103 Remember that many policies and internal control measures will have to be established *at the beginning of the year* in which SFAS Nos. 116 and 117 become effective for an organization in order for reliable accounting information to be accumulated during the year. You should begin your analyses of your clients early so that your assistance will be available to them when, or before, they need it.

10.104 As you begin to plan the recommendations that you will make to an organization, you might want to start by reviewing the completed Internal Control Questionnaire (ICQ) at Chapter 6, section 6.100 (which includes the requirements of SFAS Nos. 116 and 117) and the Test of Controls Programs at Section 6.300. If you haven't yet completed the ICQ, you may want to complete it now. This will allow you to make a preliminary assessment of improvements that will have to be made when the organization adopts the new SFASs.

10.105 The following discussion is meant to guide you through your analysis of the organization's systems so that you can better plan your engagement and make your recommendations comprehensive and effective.

Promises to Give

10.106 SFAS No. 116 makes a number of far-reaching changes in the accounting for promises to give (commonly referred to as pledges prior to the adoption of SFAS No. 116). Those new rules are discussed in Chapter 2, section 2.227. Prior to adoption of SFAS No. 116, some organizations may have recognized only pledges that were enforceable while others may not have recognized pledges at all. Under SFAS No. 116, all organizations must carefully monitor and record pledges.

10.107 You can assist your clients in implementing SFAS No. 116 by helping them develop (or adapt their current) policies and procedures and by giving their staff the education necessary to adequately identify and account for promises received. Your offer to the organization could include the following points:

1. You can train staff, volunteers and board members to "recognize" when a donor has made a promise, so that its fulfillment can be monitored. You can also recommend procedures so that everyone will know whom to inform of any promises they receive.
2. You can educate those staff or volunteers in a position to solicit or receive promises to also understand the difference between conditional and unconditional and restricted and unrestricted promises. For example, staff or volunteers should recognize that statements such as "I promise \$1,000 if you raise another \$1,000 before June 30, 19X4" and "I promise \$1,000 if you provide shelter for ten new families before June 30, 19X4" are conditional. They should also understand that a statement such as "I promise \$500 for feeding the homeless" represents a restricted promise. Further, you can train staff and volunteers about how to prompt potential donors to word their promises so that the donors' intentions will not be misunderstood. If the organization intends to solicit funds restricted for a specific purpose, staff or volunteers should word solicitations accordingly. For instance, a pledge form may be worded as "Our organization needs money this year to

renovate our educational facilities. Will you promise \$200 to meet this need?" to solicit funds restricted for this specific purpose.

3. You can assist the organization's accounting staff in developing a "promises receivable subsidiary ledger." This subsidiary, of course, could be a computerized file, a tickler file, a card file, or any other physical means to track the receipt and fulfillment of promises, but it should be auditable and should be subject to adequate segregation of duties. Furthermore, since SFAS No. 116 requires disclosure of maturities of promises receivable, the subsidiary ledger should contain the expected date of receipt for each promise and the organization must have a procedure to summarize these maturity dates for financial statement disclosure.
4. You can advise the organization of procedures to ensure that promises received are posted to the subsidiary ledger, that related cash receipts relieve the subsidiary ledger, and that it is reconciled to the general ledger periodically. If at all possible, the responsibilities of recording cash receipts, depositing cash receipts, and reconciling the promises receivable subsidiary ledger to the general ledger should be assigned to different individuals.
5. You can help the organization design a method of documenting *conditional* pledges received (which are not recognized as revenue or receivables until such conditions are met), sort them according to similar characteristics, and prepare the required financial statement disclosures. Examples of conditional promises having similar characteristics include those conditioned upon the raising of matching gifts or upon establishment of a new program. Furthermore, you can assist the organization in establishing procedures to closely monitor the fulfillment of donor conditions so the revenue and receivables associated with the promises to give are properly recorded on a timely basis as the conditions are met.
6. You can help the organization to develop a policy and train staff as to the difference between receipt of an advance on a promise to give and receipt of a contribution. There should also be a policy that a second knowledgeable and responsible person approve this classification for all amounts received larger than a certain amount.
7. You can help the organization to develop procedures to ensure that the promises receivable subsidiary ledger will also indicate whether each promise is restricted, and if so, whether it is temporarily restricted or permanently restricted. This decision, also, should be approved by a second person for promises larger than a certain amount.
8. You can also recommend procedures to ensure that long-term promises are properly discounted and that the periodic amortization (accretions) of the receivable amounts are recorded as additional contributions.

Contribution Recognition and Measurement

10.108 SFAS No. 116 contains several provisions that will greatly affect the recognition and measurement of contributions. These provisions impact not only the timing of contribution recognition (such as the immediate recognition of even restricted contributions) but also whether certain contributions (such as donated services) are recognized at all.

10.109 Your clients need your immediate consultations to assist them in implementing the new revenue recognition guidance. You can be of tremendous value to them in the following ways:

1. You can train the staff to identify donated services that meet the SFAS No. 116 criteria for recognition (see Chapter 2, section 2.244) and help the organization develop a policy for valuing, and procedures to document, such services. For instance, if board members volunteer to work in program activities, then the organization should have policies stating:
 - a. that only time volunteered for non-board duties will be considered for recognition;
 - b. only their services for program activities that require specialized skills and otherwise meet the criteria of paragraph 9 of SFAS No. 116 will be recognized;
 - c. that, when recognized, volunteers' time will be valued at the amount the organization would otherwise have had to pay for those services (not the amount that the volunteer normally earns for their time in their professions); and
 - d. that volunteer time should be reported in a prescribed manner (such as a time sheet or other document) by a given time or date.
2. You can educate the organization's employees and volunteers to identify donated materials and facilities that qualify for recognition under SFAS No. 116 (See Chapter 2, section 2.238) and recommend policies and procedures to ensure that those transactions are valued and documented properly.
3. You can train the organization's staff to identify the bargain element, if any, of the purchase of goods or services, and assist the organization in developing a policy and procedures to ensure the proper recording and valuation of these bargain elements. For example, an organization's policy might state:
 - a. that purchases made in arm's length transactions (such as from sales catalogs or at auction) have no contribution element, even if the price paid was a bargain.
 - b. that purchases made at prices not available to other buyers, or at prices available only to not-for-profit organizations, would contain a contribution element equal to the difference between the price actually paid and the amount at which the item or service would have been priced for other buyers.
4. You can recommend methods to be used in the discounting of long-term promise receivables to present value and establish procedures to ensure that periodic amortizations of the discount are recognized as additional contributions.

Disclosure Requirements

10.110 Your knowledge of SFAS No. 116 and your understanding of the organization's current internal control system will allow you to make effective recommendations as to how your client can best ensure that it maintains and documents information needed for the following required disclosures:

1. The amounts of unconditional promises receivable in less than one year, in one to five years, and in more than five years;
2. The amount of the allowance for uncollectible promises receivable;
3. The amount of conditional promises received;
4. A description and amount for each group of conditional promises having similar characteristics, such as amounts of promises conditioned on establishing new programs, completing a new building, or raising matching gifts by a specified date;
5. The fair value of donated services received but not recognized as contributions, if it is practical (this disclosure is encouraged but not required by SFAS No. 116, paragraph 10); and
6. Information about collection items required to be disclosed by organizations that do not capitalize their collections, and by organizations that capitalize their collection items only prospectively.

Policies To Be Established

10.111 You can assist your clients in ensuring that nothing "falls through the cracks" when SFAS Nos. 116 and 117 become effective for them by asking the following questions:

10.112 *Should the organization establish a policy that restricted contributions whose restrictions are met in the same period as the contribution is received be reported as unrestricted revenue instead of as restricted revenue? (SFAS No. 116, par. 14 and SFAS No. 117, par. 21)*

Such a policy would not affect an organization's statements of financial position or cash flows, but it could have a significant effect on the statement of activities. Expenses incurred to fulfill a donor's restrictions would be reported as unrestricted expenses whether or not such a policy is adopted. *Without* such a policy, the organization would be required to record the initial entry as a restricted contribution, then would reclassify it to unrestricted when the restriction is met. *With* such a policy, the contribution would be recorded directly into unrestricted revenues. While the latter results in simpler recordkeeping, some organizations may prefer the former method because it better reflects their ability to meet donors' restrictions.

An organization, however, should evaluate the costs and benefits that would be required to identify, track, and report expenses that fulfill donor restrictions in the same period in which the organization receives the contribution.

10.113 *Should the organization establish a policy that stipulates the time period that donations of long-lived assets can be used?*

Such a policy will affect whether the donated asset is recorded as unrestricted or temporarily restricted support. With such a policy, the donated item would be reported as an increase in temporarily restricted

net assets. Without such a policy, the donated asset would be reported as an increase in unrestricted net assets.

Therefore, the decision of whether to adopt such a policy depends on whether the organization wants to minimize unrestricted net assets.

10.114 *Should the organization establish a policy to disclose the fair value of contributed services received but not recognized as revenue? (SFAS No. 116, par. 10)*

An organization may want to establish a policy to disclose the fair value of contributed services not recognized as revenue in order to give users of the financial statements more complete information about the efforts needed to run the organization. This disclosure made consistently could help users make determinations regarding funding additional jobs, and could help the organization solicit additional contributed services or other contributions. However, an organization should consider the costs and benefits of establishing a system to identify, value, and accumulate information that would be needed for such disclosures.

10.115 *For organizations holding collections (works of art, historical treasures, and similar assets) that meet the criteria in paragraph 11 of SFAS No. 116, should the organization establish a policy to:*

- a. capitalize its collection items? (SFAS No. 116, par. 11)*
- b. capitalize its collections prospectively? (SFAS No. 116, par. 12)*
- c. capitalize its collections retroactively? (SFAS No. 116, par. 12)*

Organizations often believe that reporting collections as assets would give financial statement users a distorted sense of financial security, because large amounts of unencumbered assets would be reported and therefore unrestricted net assets would be unrealistically inflated. Since such organizations usually hold their collections for other than investment purposes or to convert collection items into cash for operating purposes, they typically decide not to capitalize their collections. Further, collection items are often difficult, if not impossible, to value (such as moon rocks or dinosaur bones) and that any recorded value for those items would be meaningless. Again, the costs and benefits of establishing a system to identify, value, and accumulate information that would be needed for such disclosures would have to be considered.

10.116 *Should the organization adopt SFAS No. 116 earlier than required? (SFAS No. 116, par. 28)*

The most probable reasons that an organization would prefer early adoption would be to make its financial statements more attractive for fundraising purposes or to meet the requirements of a funder.

The most probable reason that an organization would prefer to delay adoption would be to avoid recognizing restricted revenue whose restrictions have not been fulfilled (this reason may apply to organizations that follow SOP 78-10) or to delay the costs of implementing required changes (such as recognizing certain donated services, tracking satisfaction of conditional pledges, or revising its accounting system to record and report functional expenses).

10.117 *In its statement of activities, should the organization elect to classify items within a class as operating and nonoperating, expendable and nonexpendable, earned and unearned, recurring and nonrecurring, or in other ways? (SFAS No. 117, par. 23)*

Consideration of financial statement format and classification options should take into account funder requirements, if any, and anticipated difficulty that funders, creditors, or board members may have either with the organization's former format or with formats permitted under SFAS No. 117. The chart of accounts should be modified to reflect the financial statement presentation that is elected. In addition, the organization should evaluate the needs of the financial statement users in determining an appropriate financial statement format.

An organization may elect certain classifications or subtotals if it believes they will be helpful to users (funders, creditors, regulators, or board members).

10.118 *Should organizations that are not voluntary health and welfare organizations present expenses by natural classification (required for voluntary health and welfare organizations, optional for all others)? (SFAS No. 117, par. 26)*

Most organizations will find it beneficial to classify transactions both functionally and by natural classification in their accounting systems in order to administer budgets, report to funders when required, and, for most organizations exempt under section 501(c)(3), to complete Form 990. Therefore, this information should be provided by the accounting systems of most not-for-profit organizations. The decision of whether to display expenses both functionally and by natural classification in external financial statements will depend on issues such as whether the statements are being submitted to fulfill the requirements of a funder, and whether the organization wishes to maintain the confidentiality of certain natural classifications of expenses, such as salaries.

10.119 *Which of the following formats of liquidity disclosure should the organization adopt? (SFAS No. 117, par. 12)*

- a. *Sequencing assets according to their nearness of conversion to cash and sequencing liabilities according to their nearness to maturity and resulting use of cash.*
- b. *Classifying assets and liabilities as current and noncurrent.*
- c. *Disclosing necessary information about liquidity or maturity of assets and liabilities including restrictions on the use of particular assets.*

Most organizations will not have to change their reporting practices in order to meet the liquidity disclosure requirement, since their current statements of financial position probably already meet at least one of the methods required.

10.120 *Should the organization establish a policy for reporting investment expenses net of investment revenue (with the amount of expenses disclosed), instead of presenting such amounts gross? (SFAS No. 117, par. 24)*

Organizations whose investment expenses are relatively immaterial will probably decide to report investment revenue net of the expenses. Organizations whose investment expenses are material will

probably decide to report investment revenues and expenses separately to better illustrate the level of activity.

Transition Issues

10.121 You can help your client work through the following transition issues that arise upon adoption of SFAS No. 116:

1. You can assist the organization in determining whether to adopt SFAS No. 116 retroactively (by restating opening net assets for the earliest year presented or for the year SFAS No. 116 is first applied if no prior years are presented) as permitted by paragraph 30 of SFAS No. 116. Organizations will most likely want to avoid the costs of restating prior year financial statements, but their funders may require them to restate to enhance comparability. If the organization decides to apply SFAS No. 116 retroactively by restating opening net assets, then you can assist the organization in the following adjustments:
 - a. Organizations that have followed the policy of deferring restricted contributions until the restrictions were met may need to restate prior year ending liabilities and "fund balances" so that beginning balances comply with SFAS No. 116 as to recognition of restricted contributions.
 - b. If the prior year ending pledge receivable balance included some pledges which would be considered "conditional" under SFAS No. 116, the balance might need to be reduced.
 - c. If the prior year ending pledge receivable balance included long-term pledges which were not valued at fair value (which might be at "present value"), the balance might need to be reduced.
 - d. If the prior year ending pledge receivable balance excluded certain "pledges" that were judged to be unenforceable, the balance might need to be increased.
2. If the organization restates opening net assets, you can help an organization consider whether it wants to exercise the option offered by paragraph 30 of SFAS No. 116 to apply the provisions of the pronouncement's paragraph 17 prospectively for the recognition of expirations of restrictions. Applying the provisions of paragraph 17 prospectively avoids the cost of determining the effect of this accounting change and avoids some revenue recognition.
3. If an organization decides not to restate opening net assets (rejecting the option provided by paragraph 30 of SFAS No. 116), then you can help the organization compute the "cumulative effect of a change in accounting principle" described in paragraph 29 of SFAS No. 116 (in accordance with APB No. 20), which would encompass the same items listed in item 1 above.
4. You can assist organizations that maintain collections that meet the criteria in SFAS No. 116 in their decision of whether or not to capitalize their collection items retroactively.

5. If an organization has not previously reported expenses functionally:
- a. You can recommend which functions it should present. Choose functions that are either:
 1. necessary for reporting to funders or regulators, or
 2. broadly descriptive of its services, such as adult services, services to children, or public education.

As the exposure draft of the AICPA audit and accounting guide, *Not-For-Profit Organizations*, (which is not authoritative) points out, SFAS No. 14, *Financial Reporting for Segments of a Business Enterprise*, might be helpful in determining what constitutes a major program, although SFAS No. 14 exempts not-for-profit organizations from its scope.

- b. You can assist in the redesigning of their chart of accounts, if necessary.

For instance, if the current chart of accounts is organized by "fund," so that revenue restricted for a particular purpose and expenses incurred for that purpose are coded and accounted for in a particular restricted "fund," it may be difficult to combine all expenses for reporting purposes into the *unrestricted* class of net assets and report revenue in the *restricted* class of net assets.

Likewise, if the current chart of accounts identifies expenses only by natural classification, the organization will need to determine how it will accumulate its expenses by function. One solution may be to add a digit or digits to the chart of accounts so that each transaction can be coded by function. Another solution may be simply to "allocate" totals at the end of each period based on a reasonable basis. This solution, however, will be inappropriate for most organizations, since different transactions, even within each natural expense classification, may need to be allocated based on differing bases or may be entirely attributable to a single function.

The chart of accounts may also need new accounts for such items as:

- a. contributed services
- b. capitalized collection items
- c. contributions of the use of facilities
- d. discount on long-term promises receivable

10.200 SELECTING GENERAL LEDGER SOFTWARE FOR NOT-FOR-PROFIT ORGANIZATIONS

10.201 Advising not-for-profit organizations about choosing new general ledger software can be a profitable engagement for you, the auditor, and can be a wise decision for your client. This may be an especially important year for advising your clients on software selection because many organizations may be faced with the task of upgrading or replacing their software to handle the accounting and reporting requirements prescribed by SFAS Nos. 116 and 117. To get you started, the following section of this chapter includes a discussion of the major factors to consider in selecting general ledger software for

nonprofit organizations as well as a listing of some popular nonprofit software packages, including highlights of some of the major benefits of each.

10.202 For most not-for-profit organizations, their unique accounting and reporting needs preclude them from using off-the-shelf general ledger software designed for commercial businesses. Most similarly sized businesses do not need the reporting flexibility or the budget tracking capabilities that many nonprofits do, and businesses need profit-related capabilities (such as "cost of goods sold" and "gross margin" calculations) that most nonprofits do not need.

10.203 Most nonprofit organizations must be able to report by multiple cost or profit centers for their funders, for internal management oversight and budget control, for GAAP, and for the Form 990. Many organizations not only need flexibility in the design of some reports (and choice of line items to present) but they may even need several "versions" (such as with different groupings of line items) for reporting to different constituents.

10.204 Furthermore, the need to report by cost centers necessitates an efficient method of allocating expenses among cost centers, and possibly re-allocating at year-end if allocations are based on estimated percentages which differ significantly from actual data. For software to improve *efficiency*, it must be able to *calculate* allocations (based on customizable percentages) in addition to being able to "handle" allocations which the organization's staff may compute manually.

10.205 In short, choosing general ledger software for not-for-profit organizations can be very challenging, but it can also represent an opportunity for significant increases in efficiency and information availability.

Your Role as a Consultant

10.206 As we will discuss below, the selection of software should begin with an analysis of the *accounting needs* to be met by the new software and should include an evaluation of the ability of potential software products to meet those needs. As the organization's auditor, you should be a natural consultant on those matters.

10.207 As auditor, you already know the cost centers which are necessitated by GAAP and IRS reporting. You already know the organization's budgeting process and internal reporting practices. And for major grants and contracts, you already know non-allowed costs, allocations methods required or prohibited, grant periods that may not coincide with the organization's fiscal year, etc.

10.208 And you can probably foresee the changing needs that software may be asked to meet in the future. For instance, as some organizations grow, they change funding sources, downsize to become more efficient, restructure to follow the demographics of their constituents, etc.

10.209 And since you will audit the financial statements produced by the system, you have a vested interest in ensuring that any new general ledger software will be able to provide you with the information that you will need for an efficient audit (such as year-to-date journals or detail general ledger transaction lists, budget comparisons, prior-year comparisons, working trial balances, and any reports that you may need for a particular cost center).

10.300 MAJOR FACTORS TO CONSIDER

10.301 Among the major factors for you to consider in advising an organization on the selection of general ledger software are the following:

- Required capabilities
- Ease of transition
- Ease of training
- Manuals and on-screen help
- Technical support
- Access to user groups
- Security and backup features
- Auditability
- Cost

10.302 Many factors which a not-for-profit organization should consider are common to any entity purchasing general ledger software. However, there are some factors which will be of unique importance to many nonprofits.

Required Capabilities

10.303 Ensuring that prospective software will meet the organization's needs will naturally be your overriding priority. Consider whether your client needs the following capabilities:

1. *Profit centers and cost centers* — All nonprofits need to track expenses (and often revenue) by a number of cost centers (not to be confused with traditional "fund accounting," which tracks not only costs, but also assets, liabilities and equities related to specific revenue). A not-for-profit organization's need to account by cost center is similar to a business entity's "departmental accounting." Software which will accommodate "departmental accounting" may very well meet this need, but it may not meet some of the unique nonprofit reporting needs discussed below.
2. *Multiple levels of profit centers and cost centers* — Many nonprofits, like many businesses, operate several cost centers (or programs) at several locations. They may need to allocate a location's costs to several programs, or a program's costs to several locations. Many organizations also have multiple grants which fund a particular location, program, or sub-program category (such as services to a particular subset of recipients). For example, an organization may receive a United Way grant funding some but not all of the programs the organization conducts in the United Way's jurisdiction, and it may also receive other grants from other United Ways in other jurisdictions for other combinations of programs in the other United Ways' jurisdictions. Software must be able to not only track programs, locations, grants, and subsets of each, but it must also be able to allocate expenses among these cost centers (see item 6 below).
3. *Budgets for every profit or cost center* — Many organizations budget "from the bottom up," meaning that they establish budgets for each subset of a program, location, or grant, and allow the total budget to be derived from the parts. The nature of many grants necessitates

close budget monitoring to ensure that the grant is neither underspent (which could require the organization to return the unspent portion of the grant to the funder) nor overspent (which the organization would have to pay for from its non-grant funds).

4. *Multiple budgets* — Often, organizations need more than the ability to compare actual operations to a single "approved budget." They may need to simultaneously monitor a "cash flow budget" for cash management purposes and a board-approved (probably accrual based) budget for control purposes. Some organizations also use the budgeting capabilities of their software to continually update a projected year-end report. (They do this by each month replacing the just-completed-month's budget amounts with the just-completed-month's actual amounts.) Such organizations, however, also need normal budget comparisons to their board-approved budget.
5. *Annual and monthly budget data* — Since many costs are seasonal, many budget line items can be reliably anticipated to be higher in some months than in other months. If budget comparison reports are to portray actual activity compared to *realistic* projections, then monthly as well as annual budget data must be captured for each line item in each cost center.
6. *Expense allocation* — Some software allows the entry of percentages by which specified transactions are to be allocated among a predetermined list of general ledger accounts. This not only saves considerable personnel cost by avoiding manual calculations, it helps minimize errors. Some organizations find it very useful to automate expense allocations (such as allocating payroll costs based on time data entered separately). For example, if the relative number of square feet of space used by each function can be input in advance, the software could calculate the amounts to debit each function when checks are written for rent, utilities, building insurance and so on.
7. *Retroactive re-allocation of expenses* — An organization might need to retroactively reallocate expenses among cost centers if it had allocated expenses throughout the year using predetermined estimated percentages. If final data differs significantly from the estimated amounts, the organization may need to retroactively reallocate based on the actual, rather than estimated, data. For example, an organization may estimate at the beginning of the year that occupancy expenses of a certain building should be split 50-50 between two functions, but at the end of the year, statistics reveal that actual usage was 40-60. It would be useful for the software to be able to undo and reallocate the items that had been allocated 50-50 during the year.
8. *Reports to meet the organization's needs:*
 - a. Many organizations need a statement of functional expenses, in matrix format with rows of natural expense categories and columns of programs, departments, locations, etc.
 - b. Some organizations need a spreadsheet type report (similar to the matrix format of a statement of functional expenses) with flexible definition of columns to be any one or combination of cost centers, such as:

- 1) columns representing locations (regardless of program)
 - 2) columns representing programs (regardless of location)
 - 3) columns representing grants within a program
 - 4) columns representing grants, each of which funds a combination of programs
- c. Many organizations need budget comparison reports for specific grants, locations, programs, etc., usually with additional columns displaying variance in dollar amounts or percentages, prior year actual figures, variance from prior year in dollar amounts or percentages, etc. Variance columns should have the flexibility to present either:
- 1) Year-to-date actual amounts compared to year-to-date budgeted amounts, with the variance providing "red flag" type warnings of line items which are over or under the amounts that had been expected to be spent for a comparable period of time, or
 - 2) Year to-date actual amounts compared to a full year budget, with the variance representing the amount left to be spent or the amount which must be spent to avoid a pay-back.
- d. Some organizations must furnish reports to funders using line items specified by the funder. These line items may require different combinations of general ledger accounts than a "typical" trial balance, internal management report, external report, or "IRS Form 990 format" report.
9. *Reports for nonstandard fiscal periods* — Some organizations must send funders reports for fiscal periods other than 12 months, for periods that do not coincide with the organization's fiscal year, or for periods that start and end in the middle of months instead of at month-ends. For example, an organization with a December 31 year-end may receive a grant with a grant period running from October 1, 19X1 through September 30, 19X2, or a period running from February 15, 19X1 through November 15, 19X1. Software should be able to provide not only "financial statements" for such periods, but also, for any particular cost center or combination of cost centers, "year-to-date" journals, check registers, detailed general ledgers, payroll reports etc. for the nonstandard period.
10. *Consolidation of several organizations* — Many organizations have companion organizations, which may currently or may in the future have to be consolidated with your client-organization. Software should be able to account for and report on the organizations on either a separate or consolidated basis. GAAP may require consolidation while the organizations' tax exemptions may result in separate IRS reporting. Likewise, funders may want to see statements only for the organization they fund, but management may need combined reports for internal purposes, such as budget monitoring or program oversight.
11. *Traditional "fund accounting"* — Fund accounting is an internal management technique not required or prohibited by SFAS No. 117. Upon adoption of SFAS No. 117, most organizations no longer need traditional "fund accounting" because they do not need to account for assets, liabilities and equity related to specific purposes. Most organizations

need only account for expenses (and perhaps revenue) related to specific purposes. For traditional fund accounting, software must be able to:

- a. produce financial statements based on all general ledger accounts with a given "fund code" (such as "17") in a given position (such as the fifth and sixth digits) of a general ledger account number;
- b. allow for interfund transactions (such as one fund paying an expense for another fund);
- c. allow, for each revenue and expense category in the general ledger, designation of "fund balance" for posting of year-end "closings"; and
- d. track interfund payables and receivables in each fund, and indicate when corresponding payables and receivables do not equal.

Naturally, the first step in determining whether software meets the reporting needs of an organization must be to determine the current and anticipated reporting needs of that organization. The goal should be to avoid letting the "tail wag the dog," that is, to avoid letting the software limit the usefulness or efficiency of the organization's accounting system.

Ease of Transition

10.304 Although this consideration is not unique to nonprofits, it is extremely important, due to the complexity of most organizations' accounting systems.

Ease of transition includes several factors, such as:

1. *the ability to "import"* from the previous accounting system information such as:
 - a. chart of accounts (including the set-up information for cost centers, funds, locations, departments, etc.)
 - b. beginning balances
 - c. report formats
 - d. employee lists and data
 - e. vendor lists and data
 - f. donor/customer lists and data
 - g. prior year(s) detail, budgets, etc.
 - h. current year detail, budgets, allocation percentages
2. *availability when needed* — usually three to four months prior to year-end, to allow for installation, training and three months of parallel operation of both the old and new systems to resolve any transition problems.

3. *degree of similarity* to old system - any major differences in the level of sophistication between the old and new systems could slow transition. Examples of significantly different features that may prove cumbersome include:
 - a. manual system changing to a computerized system;
 - b. single entry bookkeeping changing to double entry bookkeeping;
 - c. new system may perform some functions that had previously been performed by outside services, such as payroll processing;
 - d. the look, feel and logic of the new system. If similar to the old system, it will enhance not only training, but also staff and management comfort with the new system which will facilitate transition.

Ease of Training

10.305 Training on a new system can be costly in time, money and staff morale. When evaluating the ease of training of prospective new general ledger software, consider factors such as:

1. *degree of similarity* to old system, as discussed above
2. *user friendliness*
 - a. even if the new system is complex with a lot of flexibility, menus and entry screens are often designed to match an operator's intuitive approach
 - b. manuals and on-screen help, as discussed below
 - c. "bells and whistles" should include such provisions as on-screen warnings or reminders of potential problems as or before they become uncorrectable
 - d. "hot keys" or other short cuts to reduce repetitive keystrokes
3. *training classes available*, either off-site or on-site
4. *support available*, as discussed below

Manuals and On-screen Help

10.306 Manuals and on-screen help should be written in easy to understand language, with insight as to why an operator may need help, what they may have been trying to do that caused them to need help, and what steps they may or may not have tried before they reached the point of needing help.

10.307 The manuals and/or on-screen help are as important as the capabilities of the software itself, because, no matter what capabilities the software has, an operator must be able to use the software relatively unaided most of the time. Even excellent software is useless if operators cannot efficiently use its capabilities.

Technical Support

10.308 As with any software, support should be available at the hours that operators might need help, and it should be fairly easy to get through to the support staff and responses should be relatively fast.

10.309 Many organizations hope to minimize software costs by not paying for support. Often this is false economy, because, as discussed below, the cost of support is minimal compared to the cost of confusion or inefficiency.

Access to User Groups

10.310 Try to find user groups, or other ways for the organization to connect with other users. If you have more than one client using the same software, ask their permission to have other clients contact them to discuss the product. Frequently, operators are much more comfortable talking to other real users, instead of trainers or support personnel who speak computer "jargon." Organizations can share "war stories" of how they solved perceived problems and how they invented new ways to save time and money with the software. The availability of these contacts often provides a comfort level with the software that can not be obtained any other way.

Security and Backup Features

10.311 Pay particular attention to security measures and "bells and whistles" when recommending general ledger software to an organization.

10.312 Evaluate the degree of security necessary in the particular organization. For instance:

- a. If all staff members have a high degree of computer literacy, then multiple levels of passwords and lockouts may be appropriate. For instance, non-financial staff should not have access to payroll information, or unauthorized staff should not have access to board meetings.
- b. If some of the organization's personnel have a relatively low level of computer literacy, then it may be important to have on-screen warnings to require keystroke confirmation for potentially "dangerous" operations, such as deleting or changing information.

10.313 Back-up procedures, consistently followed, are essential in any computer system. However, for entities with less computer-literate personnel, *automatic* back-up capabilities become even more important. For instance, it may be beneficial:

- a. to have entries "saved" automatically every few keystrokes;
- b. to have "undelete" capabilities; and
- c. to have a permanent record of deleted/changed transactions.

10.314 For back-up procedures that are not automatic, it is essential to ensure thorough training in, dependable compliance with, and competent monitoring of those back-up procedures.

Auditability

10.315 Obviously, it is in your interest as the auditor to ensure that prospective general ledger software is totally auditable. But beyond that, audibility is also important for:

1. internal control procedures which the client will want to establish, and
2. interim in-house searches for details and problem solving.

10.316 Look for features such as:

1. the ability to print lists of deleted transactions
2. the availability of transaction registers that can be printed out long after a monthly closing is completed
3. the ability to print year-to-date detailed lists and journals, so that it is not necessary to review twelve separate monthly lists at year-end
4. easy verification that one period's beginning balances equal the previous period's ending balances
5. the ability to display any reports on the screen as well as in print

Cost

10.317 The cost of prospective software is the last factor we discuss, because, surprisingly, it may very well be the least important. Many organizations, of course, feel intense pressure to minimize such costs, but part of your responsibility as a knowledgeable consultant is to convince your client that buying inexpensive software may be a false economy.

10.318 The cost of "expensive" software is often directly related to the inclusion of the types of capabilities that you will recommend to your clients:

1. reporting flexibility
2. ability to compute allocations automatically
3. security provisions
4. on-screen warnings of dangerous situations
5. "hot keys" and other provisions to reduce keystrokes and increase efficiency
6. on-line, situation-sensitive, help screens
7. easy access to support

- 8. a manual that is easy to use and actually helpful
- 9. training
- 10. auditability

10.319 The cost of "expensive" software is also often very *inexpensive* compared to avoidable personnel costs resulting from:

- 1. manually calculating expense allocations month after month
- 2. manually preparing special format reports which inexpensive software cannot produce
- 3. reconstructing records because inexpensive software will not reprint prior months reports
- 4. incurring avoidable audit costs because year-to-date detail general ledgers or journals cannot be produced
- 5. manually preparing by hand financial reports for periods that do not coincide with the organization's fiscal year
- 6. re-entering transactions because inexpensive software does not warn about errors being made

10.400 POPULAR SOFTWARE PRODUCTS CURRENTLY AVAILABLE

10.401 To give you a starting point in helping your clients select the software programs that best meet their needs, we have assembled a list of some popular software packages (from low-end to high-end products). We've also highlighted some of the major benefits of each program. We obtained this information from literature provided by the software vendors.

The software has not been tested by the authors nor by AICPA staff. The listing is provided for informational purposes only and does not represent an endorsement of these products.

10.402 Each of the general ledger programs listed below can be fully integrated with other modules created by the respective software manufacturers. The range of other modules available varies between software companies, but generally includes Accounts Payable, Encumbrances/Purchase Orders, Accounts Receivable, Fixed Assets, and Payroll programs. Some companies offer additional modules.

10.403 Unless otherwise noted, these programs have been revised to comply with the requirements of SFAS Nos. 116 and 117.

Software Product and Main Features**AccountMate Fund Accounting**

- Source code is available to end-users for significant customization.
- Compatible with Microsoft FoxPro database and other xbase programs.
- Program includes a cash reconciliation function.

ADS ProFund

- Source code is available to end-users for significant customization.
- Interfaces with several third-party packages, including: medical billing, fund raising, membership management, utility billing, land planning, and others.
- System is date-sensitive, allowing users to enter data for a new month before closing out the previous month.

Blackbaud Fund Accounting Series

- Version to comply with SFAS Nos. 116 and 117 will be available summer 1995.
- Fully integrates with Blackbaud fund raising software.
- Capacity for large organizations.
- Versatile budgeting facility.

Vendor and Price**SourceMate Information Systems, Inc.**

20 Sunnyside Ave.
Mill Valley, CA 94941
(800) 877-8896
fax: (415) 381-6902

Price:

Fund Accounting module, \$395 (\$695 network);

Advanced Data Systems

458 Main St.
Bangor, ME 04401
(800) 779-4494
fax: (603) 563-8726

Price:

General Ledger, \$1,790 (\$1,990 network); Accounts Payable, Purchase Orders, Accounts Receivable, and Extended Features, \$995 each (\$1,095 each for network); System Manager, \$295 (\$595 for five users)

Blackbaud, Inc.

4401 Belle Oaks Dr.
Charleston, SC 29405
(800) 443-9441
fax: (803) 740-5410

Price:

General Ledger, Accounts Payable, Purchase Orders, Student Billing, and Payroll, \$2,000 each (\$2,500 each for network); Budget Management, \$1,200 (\$1,500 network); Cash Receipts, \$1,000 (\$1,200 network); Fixed Assets, \$1,500 (\$1,800 network)

Software Product and Main Features**Fund Accounting Software Series**

- Two versions are available — v.3.6 for smaller nonprofit organizations with less complex reporting requirements and v.5.3 for larger, more complex organizations. A growing organization can change from v.3.6 to v.5.3 and receive full credit for the price paid for v.3.6.
- V3.6 is fully compliant with SFAS Nos. 116 and 117; v5.3 revision to comply with SFAS Nos. 116 and 117 will be available in summer 1995.
- Both versions can be fully integrated with Donor Records (fund raising program).
- Both versions are date-sensitive, allowing users to enter data for a new month before closing out the previous month.

Fund-Plus 9.5

- Version to comply with SFAS Nos. 116 and 117 will be available in the second half of 1995.
- Organization and fund fiscal calendars may be different and each fund's fiscal calendar may be closed independently of other funds.
- All periods in the organization's fiscal calendar may remain open up to three years.
- Automatically generates recurring transactions.

Vendor and Price**Executive Data Systems, Inc.**

1640 Powers Ferry Rd.
Bldg. 27
Marietta, GA 30067
(800) 272-3374
fax: (404) 955-1975

Price:

v.3.6 General Ledger, Accounts Payable, and Donor Records, \$625 for all three; Payroll, \$425

v.5.3 General Ledger, \$850 (\$1,275 network); Multi-Fiscal Year Reporting, \$400 (\$600 network); Accounts Payable, \$600 (\$900 network); Payroll, \$750 (\$1,125 network); Donor Records \$1,250 (\$1,875 network); additional modules also available

Cougar Mountain Software

2609 Kootenai St.
Box 6886
Boise, ID 83705
(800) 388-3038
fax: (208) 375-4460

Price:

Package including General Ledger, Accounts Payable, Payroll, Check Reconciliation, Purchase Order, and LYNX, \$1,999.50 (\$2,999.50 network, \$3,999.50 UNIX/Xenix); Add-on package including Accounts Receivable, Order Entry, and Inventory, \$299.50 (\$399.50 network, \$499.50 UNIX/Xenix)

Software Product and Main Features**Fundware**

- Current release can be set up to accommodate SFAS Nos. 116 and 117 requirements; version 5.5 (available before June 1996) will automatically comply with SFAS Nos. 116 and 117.
- General Ledger module has the capacity for several organizations and chart of account structures and a large number of funds.
- Flexibility to handle commercial entities (i.e., for-profit subsidiaries).
- Fully integrates with American Fundware's Allocation Management module, which handles complex allocations.

Kenrick Fund Accounting

- Fully integrates with Kenrick fund raising software.
- Report presentation features include integrated word processing, graphing, and spreadsheet.
- Complete database for project and grant accounting.

Vendor and Price**American Fundware**

1385 S. Colorado Blvd.
Suite 400
Denver, CO 80222
(800) 551-4458

Price:

General Ledger, \$1,595; Accounts Payable, \$695; Report Writer, \$995; Purchase Order, \$695; network pricing varies based upon number of users; UNIX versions available; additional modules available.

Kenrick Technologies, Inc.

8760 Manchester Rd.
St. Louis, MO 63144
(800) 659-2022
fax: (314) 963-9432

Price:

General Ledger, \$1,295; Accounts Payable, \$895; Project/Grant Reporting, \$795; Fund Raising, \$2,495; Report Writer, \$595; network pricing varies based upon number of users; additional modules also available.

Software Product and Main Features**M.I.P. Fund Accounting**

- Report writer produces virtually unlimited number of reports (and fiscal periods of reports don't have to match the organization's fiscal period).
- General ledger module can produce instant checks, cash receipts, and 1099s.
- Fully integrates with Database Interface module.
- Ability to upgrade software every eighteen months.

Vendor and Price**Micro Information Products, Inc.**

505 E. Huntland Dr.
Suite 340
Austin, TX 78752
(800) 647-3863
fax: (512) 454-1246

Price:

General Ledger, Payroll, and Fixed Assets, \$995 for each (\$1,495 each for network); Database Interface, \$595 (\$795 network); various other modules are \$795 each (\$1,195 each for network)

CHAPTER 11

INTEGRATED PRACTICE SYSTEM NOT-FOR-PROFIT ORGANIZATIONS AUDIT MANUAL—SELF-STUDY CPE COURSE

INSTRUCTIONS

COURSE OVERVIEW:

This course is designed for accountants and auditors who want to gain an understanding of Statements of Financial Accounting Standards (SFAS) Nos. 116 and 117, *Accounting for Contributions Received and Contributions Made* and *Financial Statements of Not-for-Profit Organizations*, respectively. Accountants and auditors of not-for-profit organizations will benefit from the theoretical concepts and examples for applying the knowledge gained from the various readings and exercises provided by this course.

GOING THROUGH THE COURSE:

SFAS Nos. 116 and 117¹ are to be read in their entirety prior to proceeding with this course. Next, you should read the course materials provided, answer the review questions in each section and then compare your answers to those provided.

CPE CREDIT:

To earn a self-study "Certificate of Completion for Recommended Continuing Education Credit" for this course, complete the examination at the end of this Chapter. If you receive a grade of 75% or more on the examination, we will send you a certificate recommending four hours of CPE credit.

WARNING

This CPE course was included in the 1994 edition of the Not-for-Profit Organizations Audit Manual. If you have already received CPE credit for completion of this course, you cannot receive additional CPE credit for this course.

¹ Both SFASs can be ordered by calling the Financial Accounting Standards Board order department at (203) 847-0700.

Included with the course materials are three postcards. Each postcard will allow you to purchase one examination package (Product No. 730000) which includes the following:

- Self-Study Examination Answer Sheet
- AICPA/CPE Self-Study Course Evaluation
- Preaddressed return envelope, and
- Instruction letter.

Each postcard should be mailed with a check for \$35.00 plus \$6.00 shipping and handling fees. By purchasing this manual, up to three persons may obtain four hours of CPE credit for this course.

RESPONSIBILITY FOR KEEPING CPE RECORDS:

The widely adopted *Statement on Standards for Formal Continuing Professional Education (CPE) Programs* issued by the AICPA, places responsibility on both the individual participant and the course sponsor to maintain a record of satisfactory completion for CPE self-study courses.

You should keep the following information on each course:

- The sponsor-provided Certificate of Completion.
- Other information you feel would be helpful in reporting your CPE credit hours to the state board (e.g., any notes you have taken).

This information should be kept for an appropriate period of time to enable regular periodic reporting to jurisdictional boards of accountancy and to professional organizations requiring such reports. Some state boards request copies of this information directly from registrants. Others will contact the program sponsor to confirm those details provide by CPE participants on a registration form. Sponsors are required to keep documentation on programs for five years.

COURSE EVALUATION:

Included with your examination package will be a Course Evaluation Form, which you should complete and return with your examination answer sheet in the envelope provided. Your comments are important to us for preparing new courses.

REQUIRED READING

The reading of SFAS Nos. 116 and 117 in their entirety is required prerequisite reading for this course.

SFAS NO. 116, ACCOUNTING FOR CONTRIBUTIONS RECEIVED AND CONTRIBUTIONS MADE

In June 1993, the Financial Accounting Standards Board (FASB) issued SFAS No. 116. This Statement establishes consistent standards for all not-for-profit organizations and supersedes the guidance in the AICPA Industry Accounting Guide, *Audits of Voluntary Health and Welfare Organizations* (VHW Guide), and Statement of Position (SOP) 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations*. Statement No. 116 is effective for financial statements issued for fiscal years beginning after December 15, 1994, except for not-for-profit organizations with less than \$5 million in total assets and less than \$1 million in annual expenses. For those organizations, this Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged.

The Statement defines a contribution as "an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner." Contributions (often referred to as "support") may be in the form of gifts, grants, bequests, promises to give (pledges), or donations of services, materials or facilities.

Contribution Versus Earned Revenue

The timing of revenue recognition for contributions differs from that of earned revenues. Recognition of earned revenue is triggered by the completion of an action, either delivery of services sold or the transfer of ownership of materials sold. No such action is required for recognizing contributions because, by definition, contributions are nonreciprocal and involve no delivery of services or transfer of ownership. Recognition of contribution revenue is triggered by the transfer of an economic benefit, usually the "receipt" of either the contribution itself (cash or other economic benefit) or a pledge (a promise to make a contribution in the future).

Restrictions and Conditions

Frequently, donors stipulate how their donations are to be used by placing restrictions on them. Restrictions may be permanent, such as for the establishment of an endowment in perpetuity, or they may be temporary, such as for next year's operations or for a specific project.

A contribution or pledge may also be conditional, which means that the contribution may not be received or used by the organization until some future event has either occurred or not occurred. Paragraph 57 of Statement No. 116 distinguishes conditions from restrictions as follows:

A donor imposed restriction limits the use of donated assets; however, a condition creates a barrier that must be overcome before assets transferred or promised become contributions received or made.

The following shows examples of some donor stipulations and indicates whether they would be considered to be conditions, restrictions, or neither:

| <u>Donor Communication</u> | <u>Accounting Treatment</u> |
|--|---|
| 1. I promise to give \$100. | 1. Unrestricted, unconditional promise. |
| 2. I promise to give \$100 if there is an earthquake. | 2. Unrestricted, conditional promise. |
| 3. I promise to give \$100 for earthquake relief. | 3. Restricted, unconditional promise. |
| 4. I promise to give \$100 for earthquake relief, if there is an earthquake. | 4. Restricted, conditional promise. |

Promises that are unconditional are recognized immediately; promises that are conditional are recognized at the point that the condition is substantially met. Prior to that time, because there are barriers to be overcome by the donee before receipt can be assured, the contribution cannot be recognized.

Promises to give are recorded as unrestricted, temporarily restricted, or permanently restricted based on donor imposed restrictions. The Statement allows an organization to record temporarily restricted assets whose restrictions are fulfilled in the same reporting period as an unrestricted contribution provided the organization discloses its policy in the notes to the financial statement.

Promises to Give (Pledges)

Under SFAS No. 116, a promise to give (pledge) should be recognized at fair value (as revenue and receivable) when the pledge is received, even if the donor restricts the pledged contribution or if the pledge will not be paid to the organization until a future period.

The fair value of a pledge that is expected to be collected in less than one year is measured at net realizable value, which in most cases would be the face value of the pledge net of any estimated uncollectible amount. Many organizations have historical data from which they calculate anticipated collection rates. Such organizations use these rates to estimate the net realizable value at which to record pledges (or they may record pledges at face value and then record a contra-asset account for uncollectible pledges). If actual collections fall short or exceed the estimated net realizable value, the variance affects the next period's revenue.

For pledges anticipated to be collected after one year, SFAS No. 116 states that fair value should be based on future cash receipts, discounted at a rate "commensurate with the risks involved." For a not-for-profit organization, this rate may be the rate that the organization would have to pay to borrow funds from a bank, or some published rate or index. Judgment should be exercised by both the organization and the accountant as to the reasonableness of the rate used. Each period's accrual of the interest element of this discount should be accounted for as an additional contribution in the appropriate class of net assets.

SFAS No. 116 directs that pledges be recognized without regard to their legal enforceability. It points out that a pledge is usually a promise, and that a promise carries the social, moral, and generally, legal obligations to make the promised transfer. It reasons that recognizing only those promises that are

enforceable would result in recording transactions with the same economic substance differently because of differences in state laws.

Donated Services

The Statement indicates new criteria for the recognition of donated services by not-for-profit organizations. To be recognized as a contribution, the donated service must:

- create or enhance nonfinancial assets, or
- require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.

SFAS No. 116 does not specifically address the donation of materials and facilities other than to state that contributions should be measured at their fair values.

Collections of Works of Art and Similar Assets

For works of art, historical treasures, and similar assets contributed to an organization, SFAS No. 116 allows certain exceptions to the requirement to recognize such items at fair value. Specifically, these exceptions apply to donated items that are: (1) added to collections held for public exhibition, education, or research in furtherance of public service rather than financial gain, (2) protected, kept unencumbered, cared for and preserved, and (3) subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collection. For collection items that have not been capitalized, certain disclosures may be required. These disclosures are discussed in paragraphs 26 and 27 of SFAS No. 116.

Contributions Received — Comparison of VHW Guide, SOP 78-10 and SFAS No. 116

Illustration No. 10-1 compares the guidance for accounting for contributions established by SFAS No. 116 with the guidance under the VHW Guide and SOP 78-10.

ILLUSTRATION NO. 11-1

CONTRIBUTIONS RECEIVED

Comparison of VHW Guide, SOP 78-10 and SFAS No. 116

| | <u>VHW Guide</u> | <u>SOP 78-10</u> | <u>SFAS No. 116</u> |
|---------------------------------------|--|---|---|
| 1. Unrestricted contributions. | 1. Recognize on receipt. | 1. Recognize on receipt. | 1. Recognize on receipt. |
| 2. Restricted contributions. | 2. Recognize on receipt. | 2. Defer until restrictions are met. | 2. Recognize on receipt. |
| 3. Promise to give. | 3. Recognize on receipt of promise. | 3. Recognize on receipt of promise, only if legally enforceable. | 3a. Recognize on receipt if unconditional. b. If conditional defer until condition is fulfilled. |
| 4. Discounting of pledges receivable. | 4. Not mentioned. | 4. Not mentioned. | 4. If collection is anticipated after one year, discount and record amortization as contributions income. |
| 5. Donated material and facilities. | 5. Recognize at fair value if measurable and there is objective basis for value. | 5. Recognize at fair value if measurable and there is objective basis for value; otherwise, disclose. | 5. Recognize at fair value. |

ILLUSTRATION NO. 11-1 (Continued)

CONTRIBUTIONS RECEIVED

Comparison of VHW Guide, SOP 78-10 and SFAS No. 116

| | <u>VHW Guide</u> | <u>SOP 78-10</u> | <u>SFAS No. 116</u> |
|----------------------|--|---|--|
| 6. Donated services. | 6. May recognize if: | 6. May recognize if: | 6. Must recognize if services: |
| | a. services are a normal part of program service and would otherwise be performed by paid staff, | a. Services form an integral part of efforts of an organization, would be performed by paid staff, and organization would continue program if donated services are not available, | a. create or enhance non-financial assets |
| | | | <u>or</u> |
| | b. organization controls employment and duties of volunteers, <u>and</u> | b. organization controls employment and duties of volunteers and can influence their activities like paid staff, <u>and</u> | b. require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not donated. |
| | c. organization has a clearly measurable basis for amount. | c. organization has a clearly measurable basis for amount, <u>and</u> | c. Other services may be recognized. |
| | d. Other services may be recognized. | d. services of the organization are not principally intended for the benefit of members. | |

ILLUSTRATION NO. 11-1 (Continued)

CONTRIBUTIONS RECEIVED

Comparison of VHW Guide, SOP 78-10 and SFAS No. 116

| | <u>VHW Guide</u> | <u>SOP 78-10</u> | <u>SFAS No. 116</u> |
|-------------------------------------|--|--|---|
| | | e. Other services may not be recognized. | |
| 7. Donated services. (continued) | 7. Disclose methods of recording, evaluating, and reporting services; distinguish between those valued and not valued. | 7. Disclose methods of recording, evaluating, and reporting services; distinguish between those valued and not valued. | 7a. Disclose programs for which services were used, includ- ing nature and extent of services received and amount recognized as revenues. b. Encourages disclosure of fair value of services received but not recognized. |

Disclosure Requirements

SFAS No. 116 has several specific financial statement disclosure requirements. They are as follows:

- Recipients of unconditional promises to give should disclose the following:
 - a. The amounts of promises receivable in less than one year, in one to five years, and in more than five years.
 - b. The amount of the allowance for uncollectible promises receivable.
- Recipients of conditional promises to give should disclose the following:
 - a. The total of the amounts promised.
 - b. A description and amount for each group of promises having similar characteristics, such as promises conditioned on establishing new programs, completing a new building, or raising matching gifts by a specified date.
- Organizations must disclose their accounting policy for gifts of long-lived assets.

- Entities are encouraged to disclose if practicable the fair value of contributed services received but not recognized as revenues.
- Entities that receive contributed services should describe the programs or activities for which those services were used, including the nature and extent of contributed services received for the period and the amount recognized as revenues for the period.
- Entities that do not recognize and capitalize collections, works of art, historical treasures, and similar assets (or that capitalize collections prospectively but not retrospectively) should describe the collections, including their relative significance, and the accounting and stewardship policies for those collections. If collection items not capitalized are deaccessioned during the period, the entity also should (a) describe the items given away, damaged, destroyed, lost, or otherwise deaccessioned during the period, or (b) disclose their fair value. In addition, a line item should be shown on the face of the statement of financial position that refers to these disclosures. Also, the line item should be dated if collections are capitalized prospectively but not retroactively, for example, "Collections acquired since January 1, 1995 (Note X)."

On pages 10-10 to 10-11, you will find an exercise that tests your knowledge of contributions. This exercise consists of various donor statements that could accompany a contribution. For each statement, indicate in the space provided: (1) the nature of the contribution, that is, whether it is restricted or unrestricted **and** conditional or unconditional, (2) the event that triggers revenue recognition, and (3) whether the item should be classified as temporarily restricted, permanently restricted, or unrestricted.

After completing this exercise, turn to page 10-12 to check your answers.

EXERCISE

For each of the following examples, assume that the recipient not-for-profit organization has a December 31 year end. Insert in the appropriate columns whether the contribution is conditional or restricted, the event that triggers revenue recognition, and whether the contribution should be classified as temporarily restricted, permanently restricted or unrestricted. When you have completed the exercise compare your responses with the answers beginning on page 10-12. The first item is completed as an example of how to complete this exercise.

| <u>Donor Statement</u> | <u>Nature of Contribution (Un)conditional/ (Un)restricted</u> | <u>What event triggers revenue recognition?</u> | <u>Classification (Temporarily, Permanently Restricted or Unrestricted)</u> |
|--|---|---|---|
| 1. I promise \$100. | Unconditional and Unrestricted | The receipt of the pledge. | Unrestricted |
| 2. I promise \$100 for Program A. | | | |
| 3. I promise \$100 to Mothers Against Drunk Driving (MADD) to educate the public of the perils of drunk driving. | | | |
| 4. I promise \$100 for feeding the homeless, if you raise another \$100 by December 31. | | | |
| 5. I promise \$100, if you serve 1,000 meals to the homeless by December 31. | | | |
| 6. I give you \$1,000, but you must return \$1 for each meal short of 1,000 that you serve to the homeless by June 30, 1994. (Today is November 22.) | | | |
| 7. I promise \$1 for each meal you serve to the homeless by December 31, up to \$10,000. | | | |

EXERCISE (Continued)

| <u>Donor Statement</u> | <u>Nature of Contribution ((Un)conditional/ (Un)restricted)</u> | <u>What event triggers revenue recognition?</u> | <u>Classification (Temporarily, Permanently Restricted or Unrestricted)</u> |
|---|---|---|---|
| <p>8. I promise to give \$1,000,000 to the United Way for feeding the homeless, if it raises another \$1,000,000 by December 31. If the \$1,000,000 is not raised, no funds will be given. (Today is November 22 and there is doubt as to whether the matching funds can be raised by the deadline. If the matching funds are not raised, the organization plans to ask the donor to waive the matching requirement.)</p> | | | |
| <p>9. I promise to match each dollar you raise by December 31 for feeding the homeless, up to \$1,000,000. (Today is November 22, and the organization cannot estimate the amount that it might raise by December 31.)</p> | | | |

ANSWERS TO EXERCISE

1. This is an unrestricted, unconditional pledge that would be recorded upon receipt of the pledge. This pledge would be considered unrestricted for financial statement purposes.
2. This pledge would be considered unconditional and restricted. The organization would record the pledge when received, and reflect this amount as temporarily restricted in the financial statements. The organization could classify this pledge as unrestricted, if the restriction is met in the reporting period the contribution was received.
3. This contribution would be considered unconditional and unrestricted because the donor's statement indicating how the funds should be spent is consistent with the overall mission of MADD. Because it is intended for a specific program it is recorded when the pledge is received as classified as unrestricted.
4. This promise to give is both conditional and restricted. Paragraph 22 of SFAS No. 116 states that an organization should not record a conditional pledge until it becomes unconditional. For financial statement purposes this contribution would be considered temporarily restricted, unless the restrictions were satisfied in the same reporting period as the recording of the contribution and the organization's accounting policy is to record these types of contributions as unrestricted.
5. If the organization serves 1,000 meals by December 31 and maintains and discloses its accounting policy to record this contribution as unrestricted, the organization may consider the contribution to be unrestricted for financial statement purposes. If the 1,000 meals are not served, there is no accounting event.
6. This promise is conditional and unrestricted. This pledge would be recorded as a refundable advance; however, if the chance of failing to serve 1,000 meals by June 30 is *remote*, the promise would be considered unconditional and unrestricted. If it is *likely* that the organization will not serve 1,000 meals by June 30, the contribution would not be recorded. In this situation, the organization must assess at December 31 the meals that will be served through the June 30 deadline and record that amount as revenue.
7. As the meals are served, revenue is considered earned up to \$10,000.
8. This promise to give is both conditional and restricted, and revenue would not be recognized until the condition is met. In this situation, the organization will have to raise \$1 million by December 31, (deadline date of the donor-imposed condition) in order to record this revenue. If the monies are raised by December 31, the promise would be considered restricted unless the restrictions were satisfied in the same reporting period as the recording of these types of contributions and the organization's accounting policy is to record this as unrestricted. If at the statement of financial position date (December 31) the donor waives the matching requirement, the contribution would no longer be considered conditional, but would be considered restricted until the restriction is met.

ANSWERS TO EXERCISE (Continued)

9. This promise to give is both conditional and restricted. As the matching funds are raised, the revenue would be recorded. The funds raised are restricted unless the restrictions are satisfied in the same reporting period as the recording of the contribution and if the organization maintains and discloses its accounting policy to record these types of contributions as unrestricted.

SFAS NO. 117, FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ORGANIZATIONS

In June 1993, the FASB issued SFAS No. 117, *Financial Statements of Not-for-Profit Organizations*. This Statement establishes generally accepted accounting principles (GAAP) for all general-purpose external financial statements issued by all not-for-profit organizations. This Statement is effective for financial statements issued for fiscal years beginning after December 15, 1994, except for not-for-profit organizations with less than \$5 million in total assets and less than \$1 million in annual expenses. For those organizations, this Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged.

SFAS No. 117 establishes what comprises a complete set of financial statements and sets the minimum level of basic information required in each statement. While requiring certain basic information, the Statement does not require any specific format for any of the financial statements, but does require that all statements, at a minimum, focus on the entity as a whole. The Statement also renders unacceptable any specialized accounting and reporting principles or practices provided in AICPA Guides that are inconsistent with this Statement.

For organizations that have adopted SFAS No. 117, a complete set of financial statements consists of:

1. Statement of financial position (balance sheet)
2. Statement of activities (revenue and expenses)
3. Statement of cash flows
4. Notes to financial statements.

Statement of Financial Position

The statement of financial position should provide information about an organization's assets, liabilities, and net assets (the term "net assets" should be used instead of "fund balance") and should focus on the organization as a whole. These amounts should be further subdivided into unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The totals of each class of assets should agree with the statement of activities.

It is permissible to present amounts for different types (subcategories) of permanent or temporarily restricted net assets either on the face of the statement of financial position or in the notes to the financial statements. For example, amounts of board designations of unrestricted net assets (subcategories) may be shown either on the face of the statement of financial position or in the notes.

In order to provide relevant information about liquidity, financial flexibility, and the interrelationship of an organization's assets and liabilities, the assets and liabilities should be aggregated into reasonably homogeneous groups (such as cash and cash equivalents, accounts and notes receivable from service recipients, etc.). Information about liquidity must be provided by one or more of the following three methods:

1. sequencing assets according to their nearness of conversion to cash and sequencing liabilities according to the nearness of their maturity (and resulting use of cash), or

2. classifying assets and liabilities as current and noncurrent, as defined by Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, or
3. disclosing (in notes to financial statements) relevant information about the liquidity or maturity of assets and liabilities, including restrictions on the use of particular assets.

Statement of Activities

The statement of activities should report the change in net assets, as well as the changes in each class of net assets (unrestricted, temporarily restricted, and permanently restricted).

All unrestricted revenue should be reported as increases in the unrestricted class of net assets. Contributions that carry donor-imposed restrictions should be reported as increasing either the temporarily restricted class of net assets or the permanently restricted class of net assets.

There is one exception to the requirement that contributions with donor-imposed restrictions be reported as increases in either the temporarily or permanently restricted classes of net assets: contributions whose restrictions are met within the same reporting period may be reported as unrestricted, provided the organization discloses that policy and follows it consistently from period to period.

All expenses should be reported as decreases in the unrestricted class of net assets. This is a significant change from current practice, in which many organizations report expenses that fulfill donor restrictions as decreases in the appropriate restricted fund. Under the new guidance, expirations of restrictions on temporarily restricted net assets will be reported as reclassifications, which simultaneously increase the unrestricted class of net assets. These reclassifications in effect reimburse the unrestricted class of net assets for expenses that (a) are charged against the unrestricted class of net assets, and (b) fulfill donor-imposed restrictions and thus should decrease temporarily restricted net assets.

An organization must provide, either in the statement of activities or in the notes to the financial statements, information about expenses reported by their functional classification, such as major classes of program services or supporting activities. Organizations are encouraged, but not required, to provide information about expenses by their natural classifications as well. Only voluntary health and welfare organizations are required to report both functional and natural classifications of expense information in a matrix format in a separate statement of functional expenses.

SFAS No. 117 states that revenues and expenses are to be reported at gross amounts in the statement of activities. The only guidance given on how to apply this requirement is that transactions that are peripheral, incidental, or beyond the control of the organization may be reported at net amounts. For example, an organization that sells land and a building it no longer uses would be able to present the gain or loss associated with the sale on a net basis in the statement of activity. This sale is considered peripheral to the ongoing operations of the organization. It is presumed that the user of the financial statements would be able to derive information related to the sale based on this presentation in the statement of activities, together with relevant information provided in the statement of cash flows.

The only exception to this requirement is for investment revenues, which may be reported net of investment expenses, provided the amount of investment expense is disclosed.

Gains and losses (when recognized under policies adopted by an organization) are to be reported as increases and decreases in the unrestricted class of net assets, unless their use is limited by donor restrictions or by a law that extends a donor's restrictions. An example of a gain or loss that would be considered restricted would be the sale of a painting that had originally been donated with the restriction that if it were ever sold, the proceeds could be used only for specified purposes.

SFAS No. 117 clarifies the question of how to report the net appreciation of investments of donor-restricted endowments:

1. If donor stipulation or the state or local law, as interpreted by an organization's governing board, places permanent restrictions on all or some part of the net appreciation, that amount should be reported as an increase in the permanently restricted class of net assets.
2. Absent relevant law to the contrary, if the donor stipulated that some or all of the net appreciation should be used only for specific purposes or in specific periods, then that amount of net appreciation should be reported as an increase in the temporarily restricted class of net assets. SFAS No. 117 states that it would not be proper to report that amount as an increase in the permanently restricted class of net assets with a subsequent reclassification from the permanently restricted to the temporarily restricted class of net assets, since such appreciation was never permanently restricted.
3. Absent relevant law or donor stipulation to the contrary, all other net appreciation on investments of donor-restricted endowments should be reported as an increase directly in the unrestricted class of net assets. SFAS No. 117 states that it would not be proper to report that amount as an increase in the permanently restricted class of net assets with a subsequent reclassification from the permanently restricted class of net assets to the unrestricted class of net assets.

The net appreciation on investments of board-designated endowments are to be reported as increases in the unrestricted class of net assets if the endowment was created from unrestricted funds.

Statement of Cash Flows

SFAS No. 117 makes a statement of cash flows a required statement for not-for-profit organizations and amends SFAS No. 95, *Statement of Cash Flows* as follows:

1. requires not-for-profit organizations to present a statement of cash flows as part of a complete set of financial statements, and
2. redefines "financing activities" to include any contributions or investment income restricted by a donor for purchasing, constructing or improving long-lived assets, or for long-term investment.

Fund Accounting

Although SFAS No. 117 does not specifically address "fund accounting," it has far-reaching implications on organizations' use of the fund accounting technique.

First, SFAS No. 117 requires that external financial reporting focus on the organization as a whole in order to allow users:

-
1. to assess an organization's liquidity, financial flexibility, and ability to meet obligations,
 2. to understand how the organization's resources are being used to provide services, and
 3. to assess the organization's ability to continue to provide those services.

It presumes that the overview of the organization presented in a complete set of financial statements best allows users to meet these goals.

Secondly, SFAS No. 117 focuses financial reporting on classes of net assets differentiated by any underlying donor-imposed restrictions, instead of the traditional focus of differentiating fund balances based on how resources will be used. This change of focus emphasizes disclosure of the discretion that an organization does or does not have as to the use of its resources, thereby allowing users to better meet the goals listed above.

Fund accounting has always been a technique for tracking stewardship of resources to be used for given purposes, and this has been and continues to be an important management tool in many organizations. GAAP, for not-for-profit organizations, has in the past required a certain degree of reporting by fund, but these requirements have frequently been misconstrued to mandate the use of fund accounting in organizations' accounting systems. SFAS No. 117 leaves the use of this powerful management tool to the discretion of organizations and their managements.

ADOPTION AND IMPLEMENTATION OF SFAS NOS. 116 AND 117

The following sections summarize the policy decisions an organization must make upon adoption and implementation of SFAS Nos. 116 and 117. The auditor should maintain awareness of these issues and how the issues affect their clients.

Introduction

SFAS Nos. 116 and 117 will have an impact on an organization's accounting system, internal control system, financial statement format, and perhaps some job duties. Furthermore, there are several options identified by the Statements that an organization must evaluate and either adopt or reject. An auditor with not-for-profit-organization clients should immediately consider the possible impact of SFAS Nos. 116 and 117 on each client.

Policy Decisions Necessitated by Adoption of SFAS No. 116

- Should the organization establish a policy that restricted contributions whose restrictions are met in the same period as the contribution is received be reported as unrestricted revenue instead of as restricted revenue? (SFAS 116, par. 14 and SFAS 117, par. 21)

Practice Tip:

Such a policy would not affect an organization's statements of financial position or cash flows, but it could have a significant effect on the statement of activities. Expenses incurred to fulfill a donor's restrictions would be reported as unrestricted expenses whether or not such a policy is adopted. *Without* such a policy, the organization would be required to record the initial entry as a restricted contribution, then would reclassify it to unrestricted when the restriction is met. *With* such a policy, the contribution would be recorded directly into unrestricted revenues. While the latter results in simpler recordkeeping, some organizations may prefer the former method because it better reflects their ability to meet donors' restrictions.

An organization, however, should evaluate the costs and benefits that would be required to identify, track, and report expenses that fulfill donor restrictions in the same period in which the organization receives the contribution.

- Should organizations that retroactively adopt SFAS No. 116 elect to apply the provisions of paragraph 17 (for recognition of expirations of restrictions) prospectively? (SFAS 116, par. 30)

Practice Tip:

Retroactive adoption of paragraph 17 of SFAS No. 116 would require recognition of revenues from contributions that have been previously deferred. As a result, many organizations will elect to apply paragraph 17 *prospectively* to avoid the cost of determining the effect of this accounting change and to avoid some revenue recognition.

- Should the organization establish a policy that stipulates the time period that donations of long-lived assets can be used?

Practice Tip:

Such a policy will affect whether the donated asset is recorded as unrestricted or temporarily restricted support. With such a policy, the donated item would be reported as an increase in temporarily restricted net assets. Without such a policy, the donated asset would be reported as an increase in unrestricted net assets.

Therefore, the decision of whether to adopt such a policy depends on whether the organization wants to minimize unrestricted net assets.

- Should the organization establish a policy to disclose the fair value of contributed services received but not recognized as revenue? (SFAS 116, par. 10)

Practice Tip:

An organization may want to establish a policy to disclose the fair value of contributed services not recognized as revenue in order to give users of the financial statements more complete information about the efforts needed to run the organization. This disclosure made consistently could help users make determinations regarding funding additional jobs, and could help the organization solicit additional contributed services or other contributions. However, an organization should consider the costs and benefits of establishing a system to identify, value, and accumulate information that would be needed for such disclosures.

- For organizations holding collections (works of art, historical treasures, and similar assets) that meet the criteria in paragraph 11 of SFAS No. 116, should the organization establish a policy to:
 - a. capitalize its collection items? (SFAS 116, par. 11)
 - b. capitalize its collections prospectively? (SFAS 116, par. 12)
 - c. capitalize its collections retroactively? (SFAS 116, par. 12)

Practice Tip:

Organizations often believe that reporting collections as assets would give financial statement users a distorted sense of financial security, because large amounts of unencumbered assets would be reported and therefore unrestricted net assets would be unrealistically inflated. Since such organizations usually hold their collections for other than investment purposes or to convert collection items into cash for operating purposes, they typically decide not to capitalize their collections. Further, collection items are often difficult, if not impossible, to value (such as moon rocks or dinosaur bones) and that any recorded value for those items would be meaningless. Again, the costs and benefits of establishing a system to identify, value, and accumulate information that would be needed for such disclosures would have to be considered.

- Should the organization adopt SFAS No. 116 earlier than required? (SFAS 116, par. 28)

Practice Tip:

The most probable reasons that an organization would prefer early adoption would be to make its financial statements more attractive for fundraising purposes or to meet the requirements of a funder.

The most probable reason that an organization would prefer to delay adoption would be to avoid recognizing restricted revenue whose restrictions have not been fulfilled (this reason may apply to organizations that follow SOP 78-10) or to delay the costs of implementing required changes (such as recognizing certain donated services, tracking satisfaction of conditional pledges, or revising its accounting system to record and report functional expenses).

- Should the organization adopt SFAS No. 116 retroactively by restating opening net assets for the earliest year presented or for the year SFAS No. 116 is first applied if no prior years are presented? (SFAS 116, par. 30)

Practice Tip:

Restatement of the financial statements may be required by funders to make financial statements as comparable as possible. Organizations may prefer, however, not to elect restatement retroactivity so as to avoid the costs of restating prior years.

System Decisions Necessitated by Implementation of SFAS No. 116

- Upon adoption of SFAS No. 116, the organization should have policies to:

- a. identify conditional pledges received (and to distinguish between restrictions and pledges),
 - b. monitor fulfillment of those pledges' conditions, and
 - c. ensure proper accounting treatment of both the pledge and any advance received on the pledge, both before and after fulfillment of the conditions. (SFAS 116, pars. 7 and 75-81)
- Upon adoption of SFAS No. 116, the organization should have policies to:
 - a. identify the bargain element of any purchase of goods or services (or an exchange in which the organization receives goods or services and gives up assets of substantially lower value), and
 - b. recognize these bargain elements as contributions. (SFAS 116, par. 3)

Practice Tip:

The authors believe that when the elements of a reciprocal transaction are of unequal value (a bargain transaction), there is a contribution inherent in the transaction. If this bargain is not made available to other parties of similar transactions, the bargain element of the transaction should be recorded as a contribution by both parties to the transaction.

- Upon adoption of SFAS No. 116, the organization should have a policy for determining the value of donated facilities and a policy for recognizing these transactions as contributions. (SFAS 116, par. 5)
- Upon adoption of SFAS No. 116, the organization should have a policy to discount long-term pledge receivables to present value and to recognize the periodic amortization of the discount. (SFAS 116, par. 20)
- Upon adoption of SFAS No. 116, the organization should have a policy for accumulating the following information for required disclosures:
 - a. maturities of unconditional pledges (SFAS 116, par. 24)
 - b. for organizations that do not capitalize collections, certain collection information (SFAS 116, pars. 26-27)
 - c. information concerning contributed services (SFAS 116, par. 10)

Policy Decisions Necessitated by Adoption of SFAS No. 117

- Should the organization's balance sheet present assets and liabilities by class (optional) or just the required separation of net assets into classes? (SFAS 117, par. 156)
- What format should the organization use for its statement of activities? (SFAS 117, par. 157)

- Should the organization use the direct or indirect method for its statement of cash flows? (SFAS 95, pars. 27–28)
- In its statement of activities, should the organization elect to classify items within a class as operating and nonoperating, expendable and nonexpendable, earned and unearned, recurring and nonrecurring, or in other ways? (SFAS 117, par. 23)

Practice Tip:

Consideration of financial statement format and classification options should take into account funder requirements, if any, and anticipated difficulty that funders, creditors, or board members may have either with the organization's former format or with formats permitted under SFAS No. 117. The chart of accounts should be modified to reflect the financial statement presentation that is elected. In addition, the organization should evaluate the needs of the financial statement users in determining an appropriate financial statement format.

An organization may elect certain classifications or subtotals if it believes they will be helpful to users (funders, creditors, regulators, or board members).

- Should organizations that are not voluntary health and welfare organizations present expenses by natural classification (required for voluntary health and welfare organizations, optional for all others)? (SFAS 117, par. 26)

Practice Tip:

Most organizations will find it beneficial to classify transactions both functionally and by natural classification in their accounting systems in order to administer budgets, report to funders when required, and, for most organizations exempt under section 501(c)(3), to complete Form 990. Therefore, this information should be provided by the accounting systems of most not-for-profit organizations. The decision of whether to display expenses both functionally and by natural classification in external financial statements will depend on issues such as whether the statements are being submitted to fulfill the requirements of a funder, and whether the organization wishes to maintain the confidentiality of certain natural classifications of expenses, such as salaries.

- If the organization has not previously reported expenses by function, which functions should it present? (SFAS 117, pars. 26–28)

Usually an organization will choose functions that are either:

- a. necessary for reporting to funders or regulators, or
- b. broadly descriptive of its services, such as adult services, services to children, or public education.

- Should the organization report information about program inputs, outputs, or results? (SFAS 117, par. 27, footnote 6)

Practice Tip:

An organization may wish to report information about program inputs, outputs, or results in order to enhance the effectiveness of the financial statements as fund-raising tools or if required by funders. The costs and benefits of such reporting must be determined if such information is not required. Because including information about program inputs, outputs, or results could pose additional reporting requirements on the auditor, the cost of additional audit work that may be required should also be considered.

- Should the organization adopt SFAS No. 117 earlier than required? (SFAS 117, par. 31)

Practice Tip:

The most probable reasons that an organization would prefer early adoption would be to make its financial statements more attractive for fundraising purposes or to meet the requirements of a funder.

The most probable reason that an organization would prefer to delay adoption is to delay the costs of implementing required changes (such as recognizing certain donated services, tracking satisfaction of conditional pledges, or revising its accounting system to record and report functional expenses).

- Which of the following formats of liquidity disclosure should the organization adopt? (SFAS 117, par. 12)
 - a. Sequencing assets according to their nearness of conversion to cash and sequencing liabilities according to their nearness to maturity and resulting use of cash.
 - b. Classifying assets and liabilities as current and noncurrent.
 - c. Disclosing necessary information about liquidity or maturity of assets and liabilities including restrictions on the use of particular assets.

Practice Tip:

Most organizations will not have to change their reporting practices in order to meet the liquidity disclosure requirement, since their current statements of financial position probably already meet at least one of the methods required.

- Should the organization establish a policy for reporting investment expenses net of investment revenue (with the amount of expenses disclosed), instead of presenting such amounts gross? (SFAS 117, par. 24)

Practice Tip:

Organizations whose investment expenses are relatively immaterial will probably decide to report investment revenue net of the expenses. Organizations whose investment expenses are material will probably decide to report investment revenues and expenses separately to better illustrate the level of activity.

Systems Decisions Necessitated by Implementation of SFAS No. 117

- Upon adoption of SFAS No. 117, the organization's accounting system should be capable of handling the following issues.
 - a. The organization's ability to identify cash transactions must be sufficient to permit preparation of a statement of cash flows, including identification of nonexpendable gifts, which SFAS No. 117 defines as cash flows from financing activities.
 - b. The organization must translate the previous year's ending "fund balances" into balances for the three classes of net assets (unrestricted, temporarily restricted and permanently restricted).
 - c. The organization must be able to identify the class of net assets that is increased or decreased by each transaction during each accounting period.
 - d. The organization must be able to determine proper "reclassification" from one class of net assets to another.

Practice Tip:

The system capable of handling these issues must include not only appropriate internal accounting controls (discussed below), but also: (1) staff training so that they can understand and comply with the new pronouncements and control measures, (2) consideration of new software, (3) board orientation as to the implications on funding, fund raising, and costs related to accounting and auditing, and (4) funder/donor education as to how to use and interpret the new formats and information.

Implications for an Organization's Chart of Accounts

In order to satisfy many of the above accounting needs and reporting requirements, an organization may need to revise its chart of accounts.

For instance, if the current chart of accounts is organized by "fund," so that revenue restricted for a particular purpose and expenses incurred for that purpose are coded and accounted for in a particular restricted "fund," it may be difficult to combine all expenses for reporting purposes into the unrestricted class of net assets and report revenue in the restricted class of net assets.

Likewise, if the current chart of accounts identifies expenses only by natural classification, the organization will need to determine how it will accumulate its expenses by function. One solution may be to add a digit or digits to the chart of accounts so that each transaction can be coded by function. Another solution may be simply to "allocate" totals at the end of each period based on a reasonable basis. This solution, however, will be inappropriate for most organizations, since different transactions, even within each natural expense classification, may need to be allocated based on differing bases or may be entirely attributable to a single function.

The chart of accounts may also need new accounts for such items as:

- a. contributed services
- b. capitalized collection items
- c. contributions of the use of facilities
- d. discount on long-term pledges receivable

Implications for the Identification of Functions, Cost Centers or Funds

The new SFASs require that revenue be reported by class of net assets and expenses by function. Reporting assets and liabilities by class of net assets is optional. Likewise, reporting revenue and expenses by other groupings (operating and nonoperating, expendable and nonexpendable, earned and unearned, recurring and nonrecurring, and so on) is also optional.

Fund accounting is a management technique to analyze revenue and expenses (and often assets, liabilities, and fund balances) related to specified purposes. In many organizations, fund accounting is essential to sound management, but it is not required, prohibited, encouraged, or discouraged by SFAS Nos. 116 or 117. Organizations that find fund accounting to be advantageous may, of course, continue it.

Some organizations, in addition to or instead of using fund accounting, divide the revenue and expense portions of their chart of accounts into cost centers or profit centers. This is useful for grant reporting, reporting to regulators the specific operations within their jurisdictions, and budgeting and responsibility accounting.

This is one facet of accounting in not-for-profit organizations that is vastly more complex than accounting in most commercial entities of similar sizes. An organization may need its accounting system to track transactions by grant, function, location, restriction, fund, or fund group. Any of these classifications may overlap some or all of the others. For instance, a grant may be restricted for use in some but not all functions, or some but not all locations. An example would include the funding of an existing homebound delivery of meals to the aged program that receives additional funds to provide housekeeping services to its participants living in a certain geographic region.

Thus, for organizations that need their accounting systems to be able to produce financial statements or reports for specific grants, locations, functions, funds, or fund groups, the account codes for general ledger accounts must have a sufficient number of digits to identify not only a natural classification (such as grant revenue, salary expense, rent expense, etc.), but also the layers of grants, functions, locations, restrictions, or funds.

Some organizations are already required to report expenses functionally (all voluntary health and welfare organizations and some organizations that followed SOP 78-10). But many organizations have never classified expenses functionally, and some organizations that have reported functionally in the past (such as colleges and universities) must, under SFAS No. 117, both allocate and report their functional expenses by different criteria.

Specifically, all organizations now must classify expenses as program expenses or supporting activity expenses. Program expenses are directly related to expenditures fulfilling the purpose or mission of the organization. On the other hand, supporting activity expenses are indirect expenditures similar to general and administrative expenses of a commercial entity. SFAS No. 117 allows latitude for organizations to define their major programs for accounting purposes and to determine the degree of aggregation it will use in reporting expenses of major programs (SFAS 117, par. 59). Also, it does not specify how supporting activity expenses should be allocated to major programs.

REVIEW QUESTIONS

The following is a pretest to help you prepare for the CPE exam. Read through each question and note your answer. Upon completion of the pretest, review the answers that follow.

TRUE OR FALSE:

- | | <u>T</u> | <u>F</u> |
|--|----------|----------|
| 1. SFAS No. 116 requires organizations that follow SOP 78-10 to change their method of accounting for the receipt of restricted contributions. | | |
| 2. SFAS No. 116 requires organizations that follow the AICPA <i>Voluntary Health & Welfare Guide</i> (VHW) to change their method of accounting for the receipt of restricted contributions. | | |
| 3. SFAS No. 117 requires organizations that follow the VHW to change their financial statement presentation. | | |
| 4. Organizations that follow SOP 78-10 will now be required to present a statement of cash flows under SFAS No. 117. | | |
| 5. If two or more temporary restrictions are imposed on a contribution, SFAS No. 117 requires that the effect of the expiration of those restrictions be recognized on a pro rata basis allocated among the periods in which the restrictions expire or are otherwise met. | | |
| 6. Permanent restrictions are those restrictions that the donor, because of incapacity or death, may no longer change or waive. | | |
| 7. A temporary restriction results from the act of an organization's board of directors in expressing its intention as to the use of certain resources; it may be changed or waived at the board's discretion. | | |
| 8. SFAS No. 116 states that contributions should be recognized in financial statements when the item meets the definition of an element of a financial statement, can reasonably be estimated, has a probable chance of occurrence, and has restrictions that will expire in that accounting period. | | |
| 9. SFAS No. 116 states that an unconditional promise to give be recorded as an asset when received and as a liability when made. | | |
| 10. SFAS No. 116 requires organizations that receive contributions with temporary donor-imposed restrictions to record such contributions as restricted support, unless the organization maintains and discloses its accounting policy to record temporarily restricted contributions, whose restrictions are met in the same reporting period, as unrestricted support. | | |

REVIEW QUESTIONS (Continued)

- | | T | F |
|--|----------|----------|
| 11. In the financial statements illustrated in Appendix C of SFAS No. 117, the shaded items are those items that represent changes from the requirements of SOP 78-10. | | |
| 12. In the statement of activities illustrated in paragraph 159 of SFAS No. 117, the fact that there are no "expenses" in the "temporarily restricted" column means that no temporary restrictions were met in this accounting period. | | |
| 13. In a not-for-profit organization's statement of cash flows, the two items "cash received from contributors" and "proceeds from contributions restricted for investment in endowment" should be reported as cash flows from operating activities. | | |
| 14. Even though the prior year's statement of financial position is included in the illustration in paragraph 156 of SFAS No. 117, comparative information is not required by SFAS No. 117. | | |
| 15. SFAS No. 116 requires the disclosure of the fair value of contributed services received but not recognized as revenues. | | |
| 16. SFAS No. 116 requires disclosure of the amounts of unconditional pledges receivable to be received in less than one year, in one to five years, and in more than five years. | | |
| 17. An organization that receives contributions of works of art, historical treasures, and similar assets must capitalize them and report the contributions as revenue. | | |
| 18. SFAS No. 116 prohibits the recognition of the contribution element of a bargain purchase, because in most cases it would be too difficult to measure. | | |
| 19. SFAS No. 116 avoids the terms "grants" and "awards," since those terms are used not only to refer to contributions but also to refer to assets transferred in exchange transactions in which the grantor expects to receive commensurate value. | | |
| 20. SFAS No. 117 permits amounts for each of three classes of net assets (permanently restricted, temporarily restricted, and unrestricted) to be reported either on the face of the statement of financial position or in the notes. | | |

SUGGESTED ANSWERS

1. **True.** SOP 78-10 required organizations to defer revenue from restricted contributions until the donor-imposed restrictions were met. This resulted in the reporting of a liability usually called "deferred revenue." SFAS No. 116, however, requires that all organizations recognize restricted revenue upon receipt; that when donor-imposed restrictions are satisfied, the appropriate amount of net assets is reclassified from "temporarily restricted net assets" to "unrestricted net assets."

2. **False.** The VHW Guide required organizations to recognize revenue from restricted contributions upon receipt, just as SFAS No. 116 does.

3. **True.** The VHW Guide required organizations to present a balance sheet, statement of support, revenue and expenses, and statement of functional expenses. However, SFAS No. 117 requires that all organizations present a statement of financial position, statement of activity, and statement of cash flows; it also requires that VHW organizations present a statement of functional expenses. Thus, in addition to some format and semantic changes in the balance sheet and statement of support, revenue and expenses, VHW organizations must add a statement of cash flows.

4. **True.** SOP 78-10 required organizations to present a statement of changes in financial position; however, SFAS No. 117, requires that all organizations present a statement of cash flows.

5. **False.** If two or more restrictions are imposed on a contribution, the effect of the expiration of those restrictions is recognized in the period in which the last remaining restriction expires. (SFAS 116, footnote 5)

6. **False.** A permanent restriction is a restriction that stipulates that resources be maintained permanently, but permits the organization to use up or expend part or all of the income (or other economic benefits) derived from the donated assets. (SFAS 116, Appendix D)

7. **False.** A temporary restriction is a donor-imposed restriction that permits the organization to use up or expend the donated assets as specified and is satisfied either by the passage of time or by actions of the organization. SFAS No. 116 also states that when a board designates unrestricted funds, for example, to be used as endowment funds, the funds are still unrestricted. Identification of restricted funds in the financial statements is a result of donor-imposed requirements and does not result from internally generated decisions. (SFAS 116, Appendix D and par. 168)

8. **False.** SFAS No. 116, paragraph 73, gives four criteria that must be met in order to recognize a contribution in the financial statements: the contribution must (1) meet the definition of an "element of a financial statement," (2) be measurable, (3) be relevant to the financial statements, and (4) be verifiable. If the contribution does not meet all four criteria, it should not be recognized, although it may be disclosed.

SUGGESTED ANSWERS (Continued)

9. **True.** SFAS No. 116, paragraphs 92-100, conclude that it is not the enforceability, but the nature of a promise to give that qualifies the promise as an asset and a liability. Since legal enforceability is something that varies by state, inconsistent recognition of promises to give would exist if legal enforceability were the criterion for classification.

10. **True.** If a restricted contribution is received and satisfied in the same period, it may be recognized as unrestricted if the organization has adopted a policy to that effect.

11. **False.** The shaded items represent certain basic totals that must be reported in financial statements to comply with SFAS No. 117. Financial statement preparers should be especially aware of these shaded items when first implementing SFAS No. 117, because they represent certain required items.

12. **False.** SFAS No. 117 requires that all expenses be reported as "unrestricted" (SFAS 117, par. 20). Notice that the last three items in the revenue section of the illustrative financial statement are reclassified from the temporarily restricted to the unrestricted class of net assets.

13. **False.** SFAS No. 117 amends SFAS No. 95 to make it applicable to not-for-profit organizations. It also defines certain contributions of long-lived assets (or contributions of funds for the purchase of long-lived assets) and contributions establishing or increasing a permanent or term endowment as cash flows from financing activities.

14. **True.** SFAS No. 117 encourages, but does not require comparative financial statements. Since commercial entities are not required to present comparative financial statements, the FASB found no reason to impose a more stringent standard for not-for-profit organizations (SFAS 117, par. 70).

15. **False.** This disclosure is not required, but paragraph 10 of SFAS No. 116 encourages organizations to make this disclosure, if practicable.

16. **True.** This requirement can be found, along with others, in paragraph 24 of SFAS No. 116.

17. **False.** Paragraph 11 of SFAS No. 116 lists criteria that must be met in order to allow organizations not to recognize such contributions, however, several disclosure requirements may apply as described in paragraphs 26 and 27.

18. **False.** Paragraph 3 of SFAS No. 116 states that if an entity voluntarily transfers assets or performs services in exchange for assets of substantially lower value and no unstated rights or privileges are involved, the contribution inherent in that transaction is within the scope of SFAS No. 116. Thus, an organization should recognize the contribution inherent in a bargain purchase.

19. **True.** Many grants are in fact contracts to purchase the not-for-profit organization's services, and thus should be accounted for as reciprocal transactions, rather than as contributions.

20. **False.** The three classes of net assets must be reported on the face of the statement of financial position per paragraph 13 of SFAS No. 117. These classes are based on the existence and nature of any donor-imposed restrictions on the promises to give.

CPE EXAM

1. An entity that receives contributed services must disclose:
 - a. the activities for which these services were used, including the amount recognized as revenue.
 - b. the method used to measure the value of the revenue recognized.
 - c. the specialized skills used by those providing the services.
 - d. all of the above.

2. An expense fulfills a donor's restriction:
 - a. when stipulated time has elapsed, the stipulated purpose has been fulfilled, or both.
 - b. if unrestricted net assets are not available.
 - c. at the discretion of the organization's board of directors.
 - d. all of the above.

3. A promise to give (pledge) should be recognized as a receivable:
 - a. if the promise is unconditional.
 - b. when the promise's conditions have been satisfied or substantially met.
 - c. regardless of the legal status (enforceability) of the promise.
 - d. all of the above.

4. Recognition of contributions of works of art, historical treasures, and similar assets:
 - a. is required in all circumstances.
 - b. is required if they are held for public exhibition.
 - c. is optional under all circumstances.
 - d. none of the above.

5. Which of the following is a false statement?
 - a. The netting of revenues and expenses is never allowed in a financial statement.
 - b. Functional classifications include program services and supporting activities.
 - c. Subclassifications of items within classes of net assets is allowed within a statement of activities.
 - d. SFAS No. 117 supersedes any AICPA audit guides or Statements of Position that conflict with the Statement.

CPE EXAM (Continued)

6. A complete set of financial statements for a voluntary health and welfare organization includes:
 - a. statement of financial position, statement of activities, statement of changes in financial position, and notes to financial statements.
 - b. statement of financial position, statement of activities, statement of functional expenses, statement of cash flows, and notes to financial statements.
 - c. statement of financial position, statement of activities, statement of cash flows, and notes to financial statements.
 - d. statement of financial position, statement of activities, statement of changes in fund balances, statement of cash flows, and notes to financial statements.

7. Net assets must be classified according to:
 - a. the liability they will satisfy.
 - b. presence or absence of donor restrictions.
 - c. whether they are current or noncurrent.
 - d. the "functions" to which they relate.

8. SFAS No. 116 does not apply to:
 - a. transfers of assets that are in substance purchases of goods or services.
 - b. transfers of assets in which the reporting entity acts as an agent, trustee, or intermediary, rather than as a donor or donee.
 - c. tax exemptions, tax incentives, tax abatements or transfers of assets from governmental units to business enterprises.
 - d. all of the above.

9. Receipts of contributions that are restricted to acquiring property or establishing a permanent or term endowment are reported in the statement of cash flows as cash flows from:
 - a. donor activities.
 - b. operating activities.
 - c. financing activities.
 - d. investing activities.

CPE EXAM (Continued)

10. A statement of financial position should focus on:
- the change in net assets for the period.
 - the organization as a whole.
 - the organization's liquidity, financial flexibility, ability to meet obligations, and needs for external financing.
 - both b and c.
11. Information about expenses reported by their functional classification, such as major classes of program services and supporting activities:
- should be provided in a statement of activities or notes to financial statements.
 - helps donors, creditors, and others assess an organization's service efforts, including the costs of its services and how it uses resources.
 - both a and b.
 - neither a nor b.
12. Program services are:
- the activities that result in goods and services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission for which an organization exists.
 - activities required to fulfill donor-imposed restrictions.
 - management and general, fundraising, and membership development activities.
 - integral to proper classification of net assets.
13. Which of the following statements is true about an unconditional long-term pledge?
- It should be recognized initially at its fair value.
 - The present value of estimated future cash flows using a discount rate commensurate with the risks involved is an appropriate measure of fair value.
 - Subsequent accruals of the interest element should be accounted for as contribution income by donees and contribution expense by donors.
 - all of the above.
14. The three classes of net assets are:
- program, general and administrative, and fund raising.
 - expendable, conditional, and restricted.
 - operating funds, restricted funds, and endowment funds.
 - temporarily restricted, permanently restricted, and unrestricted.

CPE EXAM (Continued)

15. A promise to give containing stipulations that are not clearly unconditional should be presumed to be:
- unenforceable.
 - conditional.
 - temporarily restricted.
 - reciprocal.
16. A promise to give that states, "I promise to give your art museum \$1,000 if you bring a major Rembrandt exhibit to the museum by December 31, 1998" would be considered:
- unconditional and unrestricted.
 - unconditional and restricted.
 - conditional and unrestricted.
 - conditional and restricted.
17. A promise to give that states, "If there is an earthquake in San Francisco within the next two years, I promise your art museum \$1,000,000 for reparation and safeguarding of its collections" would be considered:
- unconditional and unrestricted.
 - unconditional and restricted.
 - conditional and unrestricted.
 - conditional and restricted.
18. One particular art museum normally adds several hundred paintings to its collections each year and has several million dollars budgeted for acquisitions this year. If a donor promised \$1,000,000 to this museum, provided that the museum add any painting of any value by any artist to its collections this year, then for accounting purposes:
- the pledge would be considered unrestricted, since the donor did not stipulate how the contribution should be used.
 - the pledge would be considered unconditional, since the donor's stipulations do not involve uncertain events (it is relatively certain that the museum will add at least one painting, based on its budget and its past practices).
 - the receipt of the pledge would result in the immediate recognition of \$1,000,000 receivable and revenue.
 - all of the above.

CPE EXAM (Continued)

19. Which of the following is a true statement?
- a. Prior to SFAS No. 117, not-for-profit organizations have generally provided financial statements that are consistent in form.
 - b. Classifying an item as a permanently restricted, temporarily restricted, or unrestricted net asset does not limit further subclassifications within a statement of activities.
 - c. Recognition of contribution revenue is the result of a reciprocal event or transfer of goods.
 - d. Expenses should decrease restricted, unrestricted, or permanently restricted net assets according to the source of funds for the expenditure.
20. SFAS No. 116's definition of "collection items" includes:
- a. works of art and historical treasures.
 - b. gifts, tithes, and offerings received by a church.
 - c. blood bank inventory.
 - d. all of the above.

OMB CIRCULAR A-133

***Audits of Institutions of Higher Education
and Other Nonprofit Institutions***



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

March 8, 1990

OMB Circular No. A-133

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Audits of Institutions of Higher Education and Other
Nonprofit Institutions

1. **Purpose.** Circular A-133 establishes audit requirements and defines Federal responsibilities for implementing and monitoring such requirements for institutions of higher education and other nonprofit institutions receiving Federal awards.
2. **Authority.** Circular A-133 is issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; Reorganization Plan No. 2 of 1970; and Executive Order No. 11541.
3. **Supersession.** Circular A-133 supersedes Attachment F, subparagraph 2h, of Circular A-110, "Uniform Administrative Requirements for Grants and other Agreements with Institutions of Higher Education, Hospitals, and other Nonprofit Organizations."
4. **Applicability.** The provisions of Circular A-133 apply to:
 - a. Federal departments and agencies responsible for administering programs that involve grants, cost-type contracts and other agreements with institutions of higher education and other nonprofit recipients.
 - b. Nonprofit institutions, whether they are recipients, receiving awards directly from Federal agencies, or are sub-recipients, receiving awards indirectly through other recipients.

These principles, to the extent permitted by law, constitute guidance to be applied by agencies consistent with and within the discretion, conferred by the statutes governing agency action.

5. **Requirements and Responsibilities.**

The specific requirements and responsibilities of Federal departments and agencies and institutions of higher education and other nonprofit institutions are set forth in the attachment.

6. **Effective Date.** The provisions of Circular A-133 are effective upon publication and shall apply to audits of nonprofit institutions for fiscal years that begin on or after January 1, 1990. Earlier implementation is encouraged. However, until this

Circular is implemented, the audit provisions of Attachment F to Circular A-110 shall continue to be observed.

7. Policy Review (Sunset) Date. Circular A-133 will have a policy review three years from the date of issuance.

8. Inquiries. Further information concerning Circular A-133 may be obtained by contacting the Financial Management Division, Office of Management and Budget, Washington, D.C. 20503, telephone (202) 395-3993.

A handwritten signature in black ink, appearing to read "Richard G. Darman". The signature is fluid and cursive, with a long horizontal stroke at the end.

Richard G. Darman
Director

OMB CIRCULAR A-133
AUDITS OF INSTITUTIONS OF HIGHER EDUCATION
AND OTHER NONPROFIT INSTITUTIONS

ATTACHMENT

1. Definitions. For the purposes of this Circular, the following definitions apply:

a. "Award" means financial assistance, and Federal cost-type contracts used to buy services or goods for the use of the Federal Government. It includes awards received directly from the Federal agencies or indirectly through recipients. It does not include procurement contracts to vendors under grants or contracts, used to buy goods or services. Audits of such vendors shall be covered by the terms and conditions of the contract.

b. "Cognizant agency" means the Federal agency assigned by the Office of Management and Budget to carry out the responsibilities described in paragraph 3 of this Attachment.

c. "Coordinated audit approach" means an audit wherein the independent auditor, and other Federal and non-federal auditors consider each other's work, in determining the nature, timing, and extent of his or her own auditing procedures. A coordinated audit must be conducted in accordance with Government Auditing Standards and meet the objectives and reporting requirements set forth in paragraph 12(b) and 15, respectively, of this Attachment. The objective of the coordinated audit approach is to minimize duplication of audit effort, but not to limit the scope of the audit work so as to preclude the independent auditor from meeting the objectives set forth in paragraph 12(b) or issuing the reports required in paragraph 15 in a timely manner.

d. "Federal agency" has the same meaning as the term 'agency' in Section 551(1) of Title 5, United States Code.

e. "Federal Financial Assistance."

(1) "Federal financial assistance" means assistance provided by a Federal agency to a recipient or sub-recipient to carry out a program. Such assistance may be in the form of:

- grants;
- contracts;
- cooperative agreements;
- loans;
- loan guarantees;
- property;
- interest subsidies;
- insurance;
- direct appropriations;
- other non-cash assistance.

(2) Such assistance does not include direct Federal cash assistance to individuals.

(3) Such assistance includes awards received directly from Federal agencies, or indirectly when sub-recipients receive funds identified as Federal funds by recipients.

(4) The granting agency is responsible for identifying the source of funds awarded to recipients; the recipient is responsible for identifying the source of funds awarded to sub-recipients.

f. "Generally accepted accounting principles" has the meaning specified in the Government Auditing Standards.

g. "Independent auditor" means:

(1) A Federal, State, or local government auditor who meets the standards specified in the Government Auditing Standards; or

(2) A public accountant who meets such standards.

h. "Internal control structure" means the policies and procedures established to provide reasonable assurance that:

(1) Resource use is consistent with laws, regulations, and award terms;

(2) Resources are safeguarded against waste, loss, and misuse; and

(3) Reliable data are obtained, maintained, and fairly disclosed in reports.

i. "Major program" means an individual award or a number of awards in a category of Federal assistance or support for which total expenditures are the larger of three percent of total Federal funds expended or \$100,000, on which the auditor will be required to express an opinion as to whether the major program is being administered in compliance with laws and regulations.

Each of the following categories of Federal awards shall constitute a major program where total expenditures are the larger of three percent of total Federal funds expended or \$100,000:

- Research and Development.
- Student Financial Aid.

- Individual awards not in the student aid or research and development category.

j. "Management decision" means the evaluation by the management of an establishment of the findings and recommendations included in an audit report and the issuance of a final decision by management concerning its response to such findings and recommendations, including actions concluded to be necessary.

k. "Nonprofit institution" means any corporation, trust, association, cooperative or other organization which 1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; 2) is not organized primarily for profit; and 3) uses its net proceeds to maintain, improve, and/or expand its operations. The term "nonprofit institutions" includes institutions of higher education, except those institutions that are audited as part of single audits in accordance with Circular A-128 "Audits of State and Local Governments." The term does not include hospitals which are not affiliated with an institution of higher education, or State and local governments and Indian tribes covered by Circular A-128 "Audits of State and Local Governments."

l. "Oversight" agency means the Federal agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency, unless no direct funding is received. Where there is no direct funding, the Federal agency with the predominant indirect funding will assume the general oversight responsibilities. The duties of the oversight agency are described in paragraph 4 of this Attachment.

m. "Recipient" means an organization receiving financial assistance to carry out a program directly from Federal agencies.

n. "Research and development" includes all research activities, both basic and applied, and all development activities that are supported at universities, colleges, and other nonprofit institutions. "Research" is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. "Development" is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

o. "Student Financial Aid" includes those programs of general student assistance in which institutions participate, such as those authorized by Title IV of the Higher Education Act of 1965 which is administered by the U.S. Department of Education and similar programs provided by other Federal agencies. It does not include programs which provide fellowships or similar awards

to students on a competitive basis, or for specified studies or research.

p. "Sub-recipient" means any person or government department, agency, establishment, or nonprofit organization that receives financial assistance to carry out a program through a primary recipient or other sub-recipient, but does not include an individual that is a beneficiary of such a program. A sub-recipient may also be a direct recipient of Federal awards under other agreements.

q. "Vendor" means an organization providing a recipient or sub-recipient with generally required goods or services that are related to the administrative support of the Federal assistance program.

2. Audit of Nonprofit Institutions.

a. Requirements Based on Awards Received.

(1) Nonprofit institutions that receive \$100,000 or more a year in Federal awards shall have an audit made in accordance with the provisions of this Circular. However, nonprofit institutions receiving \$100,000 or more but receiving awards under only one program have the option of having an audit of their institution prepared in accordance with the provisions of the Circular or having an audit made of the one program. For prior or subsequent years, when an institution has only loan guarantees or outstanding loans that were made previously, the institution may be required to conduct audits for those programs, in accordance with regulations of the Federal agencies providing those guarantees or loans.

(2) Nonprofit institutions that receive at least \$25,000 but less than \$100,000 a year in Federal awards shall have an audit made in accordance with this Circular or have an audit made of each Federal award, in accordance with Federal laws and regulations governing the programs in which they participate.

(3) Nonprofit institutions receiving less than \$25,000 a year in Federal awards are exempt from Federal audit requirements, but records must be available for review by appropriate officials of the Federal grantor agency or subgranting entity.

b. Oversight by Federal Agencies.

(1) To each of the larger nonprofit institutions the Office of Management and Budget (OMB) will assign a Federal agency as the cognizant agency for monitoring audits and ensuring the resolution of audit findings that affect the programs of more than one agency.

(2) Smaller institutions not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them with the most funds.

(3) Assignments to Federal cognizant agencies for carrying out responsibilities in this section are set forth in a separate supplement to this Circular.

(4) Federal Government-owned, contractor-operated facilities at institutions or laboratories operated primarily for the Government are not included in the cognizance assignments. These will remain the responsibility of the contracting agencies. The listed assignments cover all of the functions in this Circular unless otherwise indicated. The Office of Management and Budget will coordinate changes in agency assignments.

3. Cognizant Agency Responsibilities. A cognizant agency shall:

a. Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of this Circular.

b. Provide technical advice and liaison to institutions and independent auditors.

c. Obtain or make quality control reviews of selected audits made by non-Federal audit organizations, and provide the results, when appropriate, to other interested organizations.

d. Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any reported illegal acts or irregularities. A cognizant agency should also inform State or local law enforcement and prosecuting authorities, if not advised by the recipient, of any violation of law within their jurisdiction.

e. Advise the recipient of audits that have been found not to have met the requirements set forth in this Circular. In such instances, the recipient will work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

f. Coordinate, to the extent practicable, audits or reviews made for Federal agencies that are in addition to the audits made pursuant to this Circular, so that the additional

audits or reviews build upon audits performed in accordance with the Circular.

g. Ensure the resolution of audit findings that affect the programs of more than one agency.

h. Seek the views of other interested agencies before completing a coordinated program.

i. Help coordinate the audit work and reporting responsibilities among independent public accountants, State auditors, and both resident and non-resident Federal auditors to achieve the most cost-effective audit.

4. Oversight Agency Responsibilities. An oversight agency shall provide technical advice and counsel to institutions and independent auditors when requested by the recipient. The oversight agency may assume all or some of the responsibilities normally performed by a cognizant agency.

5. Recipient Responsibilities. A recipient that receives a Federal award and provides \$25,000 or more of it during its fiscal year to a sub-recipient shall:

a. Ensure that the nonprofit institution sub-recipients that receive \$25,000 or more have met the audit requirements of this Circular, and that sub-recipients subject to OMB Circular A-128 have met the audit requirements of that Circular;

b. Ensure that appropriate corrective action is taken within six months after receipt of the sub-recipient audit report in instances of noncompliance with Federal laws and regulations;

c. Consider whether sub-recipient audits necessitate adjustment of the recipient's own records; and

d. Require each sub-recipient to permit independent auditors to have access to the records and financial statements as necessary for the recipient to comply with this Circular.

6. Relation to Other Audit Requirements.

a. An audit made in accordance with this Circular shall be in lieu of any financial audit required under individual Federal awards. To the extent that an audit made in accordance with this Circular provides Federal agencies with the information and assurances they need to carry out their overall responsibilities, they shall rely upon and use such information. However, a Federal agency shall make any additional audits or reviews necessary to carry out responsibilities under Federal law and regulation. Any additional Federal audits or reviews shall be

planned and carried out in such a way as to build upon work performed by the independent auditor.

b. Audit planning by Federal audit agencies should consider the extent to which reliance can be placed upon work performed by other auditors. Such auditors include State, local, Federal, and other independent auditors, and a recipient's internal auditors. Reliance placed upon the work of other auditors should be documented and in accordance with Government Auditing Standards.

c. The provisions of this Circular do not limit the authority of Federal agencies to make or contract for audits and evaluations of Federal awards, nor do they limit the authority of any Federal agency Inspector General or other Federal official.

d. The provisions of this Circular do not authorize any institution or sub-recipient thereof to constrain Federal agencies, in any manner, from carrying out additional audits, evaluations or reviews.

e. A Federal agency that makes or contracts for audits, in addition to the audits made by recipients pursuant to this Circular, shall, consistent with other applicable laws and regulations, arrange for funding the cost of such additional audits. Such additional audits or reviews include financial, performance audits and program evaluations.

7. Frequency of Audit. Audits shall usually be performed annually but not less frequently than every two years.

8. Sanctions. No audit costs may be charged to Federal awards when audits required by this Circular have not been made or have been made but not in accordance with this Circular. In cases of continued inability or unwillingness to have a proper audit in accordance with the Circular, Federal agencies must consider appropriate sanctions including:

- withholding a percentage of awards until the audit is completed satisfactorily;
- withholding or disallowing overhead costs; or
- suspending Federal awards until the audit is made.

9. Audit Costs. The cost of audits made in accordance with the provisions of this Circular are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, determined in accordance with the provisions of Circular A-21, "Cost Principles for Universities" or Circular A-122, "Cost Principles for Nonprofit Organizations,"

FAR subpart 31, or other applicable cost principles or regulations.

10. Auditor Selection. In arranging for audit services institutions shall follow the procurement standards prescribed by Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and other Nonprofit Organizations."

11. Small and Minority Audit Firms.

a. Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of this Circular.

b. Recipients of Federal awards shall take the following steps to further this goal:

(1) Ensure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable;

(2) Make information on forthcoming opportunities available and arrange timeframes for the audit to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(3) Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(4) Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs, and in cases where this is not possible, assure that these firms are given consideration for audit subcontracting opportunities;

(5) Encourage contracting with consortiums of small audit firms as described in section (1), above, when a contract is too large for an individual small audit firm or audit firm owned and controlled by socially and economically disadvantaged individuals; and

(6) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

12. Scope of Audit and Audit Objectives.

a. The audit shall be made by an independent auditor in accordance with Government Auditing Standards developed by the Comptroller General of the United States covering financial audits. An audit under this Circular should be an organization-wide audit of the institution. However, there may be instances where Federal auditors are performing audits or are planning to perform audits at nonprofit institutions. In these cases, to minimize duplication of audit work, a coordinated audit approach may be agreed upon between the independent auditor, the recipient and the cognizant agency or the oversight agency. Those auditors who assume responsibility for any or all of the reports called for by paragraph 15 should follow guidance set forth in Government Auditing Standards in using work performed by others.

b. The auditor shall determine whether:

(1) The financial statements of the institution present fairly its financial position and the results of its operations in accordance with generally accepted accounting principles;

(2) The institution has an internal control structure to provide reasonable assurance that the institution is managing Federal awards in compliance with applicable laws and regulations, and controls that ensure compliance with the laws and regulations that could have a material impact on the financial statements; and

(3) The institution has complied with laws and regulations that may have a direct and material effect on its financial statement amounts and on each major Federal program.

13. Internal Controls Over Federal Awards; Compliance Reviews.

a. General. The independent auditor shall determine and report on whether the recipient has an internal control structure to provide reasonable assurance that it is managing Federal awards in compliance with applicable laws, regulations, and contract terms, and that it safeguards Federal funds. In performing these reviews, independent auditors should rely upon work performed by a recipient's internal auditors to the maximum extent possible. The extent of such reliance should be based upon the Government Auditing Standards.

b. Internal Control Review.

(1) In order to provide this assurance on internal controls, the auditor must obtain an understanding of the

internal control structure and assess levels of internal control risk. After obtaining an understanding of the controls, the assessment must be made whether or not the auditor intends to place reliance on the internal control structure.

(2) As part of this review, the auditor shall:

(a) Perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. Tests of controls will not be required for those areas where the internal control structure policies and procedures are likely to be ineffective in preventing or detecting noncompliance, in which case a reportable condition or a material weakness should be reported in accordance with paragraph 15 c(2) of this Circular.

(b) Review the recipient's system for monitoring sub-recipients and obtaining and acting on sub-recipient audit reports.

(c) Determine whether controls are in effect to ensure direct and indirect costs were computed and billed in accordance with the guidance provided in the general requirements section of the compliance supplement to this Circular.

c. Compliance Review.

(1) The auditor shall determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. In addition, transactions selected for non-major programs shall be tested for compliance with Federal laws and regulations that apply to such transactions.

(2) In order to determine which major programs are to be tested for compliance, recipients shall identify, in their accounts, all Federal funds received and expended and the programs under which they were received. This shall include funds received directly from Federal agencies, through other State and local governments or other recipients. To assist recipients in identifying Federal awards, Federal agencies and primary recipients shall provide the Catalog of Federal Domestic Assistance (CFDA) numbers to the recipients when making the awards.

(3) The review must include the selection of an adequate number of transactions from each major Federal financial assistance program so that the auditor obtains sufficient evidence to support the opinion on compliance required by paragraph 15c(3) of this Attachment. The selection and testing of transactions shall be based on the auditors' professional judgment considering such factors as the amount of expenditures

for the program; the newness of the program or changes in its conditions; prior experience with the program particularly as revealed in audits and other evaluations (e.g., inspections, program reviews, or system reviews required by Federal Acquisition Regulations); the extent to which the program is carried out through sub-recipients; the extent to which the program contracts for goods or services; the level to which the program is already subject to program reviews or other forms of independent oversight; the adequacy of the controls for ensuring compliance; the expectation of adherence or lack of adherence to the applicable laws and regulations; and the potential impact of adverse findings.

(4) In making the test of transactions, the auditor shall determine whether:

- the amounts reported as expenditures were for allowable services, and
- the records show that those who received services or benefits were eligible to receive them.

(5) In addition to transaction testing, the auditor shall determine whether:

- matching requirements, levels of effort and earmarking limitations were met,
- Federal financial reports and claims for advances and reimbursement contain information that is supported by books and records from which the basic financial statements have been prepared, and
- amounts claimed or used for matching were determined in accordance with 1) OMB Circular A-21, "Cost Principles for Educational Institutions"; 2) matching or cost sharing requirements in Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations"; 3) Circular A-122, "Cost Principles for Nonprofit Organizations"; 4) FAR subpart 31 cost principles; and 5) other applicable cost principles or regulations.

(6) The principal compliance requirements of the largest Federal programs may be ascertained by referring to the "Compliance Supplement for Single Audits of Educational Institutions and Other Nonprofit Organizations," and the

"Compliance Supplement for Single Audits of State and Local Governments," issued by OMB and available from the Government Printing Office. For those programs not covered in the Compliance Supplements, the auditor should ascertain compliance requirements by reviewing the statutes, regulations, and agreements governing individual programs.

(7) Transactions related to other awards that are selected in connection with examinations of financial statements and evaluations of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions.

14. Illegal Acts. If, during or in connection with the audit of a nonprofit institution, the auditor becomes aware of illegal acts, such acts shall be reported in accordance with the provisions of the Government Auditing Standards.

15. Audit Reports.

a. Audit reports must be prepared at the completion of the audit.

b. The audit report shall state that the audit was made in accordance with the provisions of this Circular.

c. The report shall be made up of at least the following three parts:

(1) The financial statements and a schedule of Federal awards and the auditor's report on the statements and the schedule. The schedule of Federal awards should identify major programs and show the total expenditures for each program. Individual major programs other than Research and Development and Student Aid should be listed by catalog number as identified in the Catalog of Federal Domestic Assistance. Expenditures for Federal programs other than major programs shall be shown under the caption "other Federal assistance." Also, the value of non-cash assistance such as loan guarantees, food commodities or donated surplus properties or the outstanding balance of loans should be disclosed in the schedule.

(2) A written report of the independent auditor's understanding of the internal control structure and the assessment of control risk. The auditor's report should include as a minimum: 1) the scope of the work in obtaining understanding of the internal control structure and in assessing the control risk, 2) the nonprofit institution's significant internal controls or control structure including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements and those that provide reasonable assurance that Federal awards are being

managed in compliance with applicable laws and regulations, and 3) the reportable conditions, including the identification of material weaknesses, identified as a result of the auditor's work in understanding and assessing the control risk. If the auditor limits his/her consideration of the internal control structure for any reason, the circumstances should be disclosed in the report.

- (3) The auditor's report on compliance containing:
 - An opinion as to whether each major Federal program was being administered in compliance with laws and regulations applicable to the matters described in paragraph 13(c)(3) of this Attachment, including compliance with laws and regulations pertaining to financial reports and claims for advances and reimbursements;
 - A statement of positive assurance on those items that were tested for compliance and negative assurance on those items not tested;
 - Material findings of noncompliance presented in their proper perspective:
 - o The size of the universe in number of items and dollars,
 - o The number and dollar amount of transactions tested by the auditors,
 - o The number and corresponding dollar amount of instances of noncompliance;
 - Where findings are specific to a particular Federal award, an identification of total amounts questioned, if any, for each Federal award, as a result of noncompliance and the auditor's recommendations for necessary corrective action.

c. The three parts of the audit report may be bound into a single document, or presented at the same time as separate documents.

d. Nonmaterial findings need not be disclosed with the compliance report but should be reported in writing to the recipient in a separate communication. The recipient, in turn, should forward the findings to the Federal grantor agencies or subgrantor sources.

e. All fraud or illegal acts or indications of such acts, including all questioned costs found as the result of these acts

that auditors become aware of, may be covered in a separate written report submitted in accordance with the Government Auditing Standards.

f. The auditor's report should disclose the status of known but uncorrected significant material findings and recommendations from prior audits that affect the current audit objective as specified in the Government Auditing Standards.

g. In addition to the audit report, the recipient shall provide a report of its comments on the findings and recommendations in the report, including a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings. If corrective action is not necessary, a statement describing the reason it is not should accompany the audit report.

h. Copies of the audit report shall be submitted in accordance with the reporting standards for financial audits contained in the Government Auditing Standards. Sub-recipient auditors shall submit copies to recipients that provided Federal awards. The report shall be due within 30 days after the completion of the audit, but the audit should be completed and the report submitted not later than 13 months after the end of the recipient's fiscal year unless a longer period is agreed to with the cognizant or oversight agency.

i. Recipients of more than \$100,000 in Federal awards shall submit one copy of the audit report within 30 days after issuance to a central clearinghouse to be designated by the Office of Management and Budget. The clearinghouse will keep completed audit reports on file.

j. Recipients shall keep audit reports, including sub-recipient reports, on file for three years from their issuance.

16. Audit Resolution.

a. As provided in paragraph 3, the cognizant agency shall be responsible for ensuring the resolution of audit findings that affect the programs of more than one Federal agency. Resolution of findings that relate to the programs of a single Federal agency will be the responsibility of the recipient and the agency. Alternate arrangements may be made on case-by-case basis by agreement among the agencies concerned.

b. A management decision shall be made within six months after receipt of the report by the Federal agencies responsible for audit resolution. Corrective action should proceed as rapidly as possible.

17. Audit Workpapers and Reports. Workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency or its designee or the General Accounting Office, at the completion of the audit.

OMB CIRCULAR A-122

Cost Principles for Nonprofit Organizations

Federal Register

Tuesday
July 8, 1980

Note: This reprint incorporates corrections published at 46 FR 17185, Tuesday, March 17, 1981.

Part III

Office of Management and Budget

Circular A-122, "Cost Principles for
Nonprofit Organizations"

OFFICE OF MANAGEMENT AND BUDGET

Circular A-122, "Cost Principles for Nonprofit Organizations"

[Note: This reprint incorporates corrections published at 48 FR 17185, Tuesday, March 17, 1981.]

AGENCY: Office of Management and Budget.

ACTION: Final Policy.

SUMMARY: This notice advises of a new OMB Circular dealing with principles for determining costs of grants, contracts, and other agreements with nonprofit organizations.

The Circular is the product of an interagency review conducted over a two-year period. Its purpose is to provide a set of cost principles to replace existing principles issued by individual agencies. These have often contained varying and conflicting requirements, and created confusion among agency administrators, auditors, and nonprofit officials. The new Circular will provide a uniform approach to the problem of determining costs, and promote efficiency and better understanding between recipients and the Federal Government.

EFFECTIVE DATE: The Circular becomes effective on issuance.

FOR FURTHER INFORMATION CONTACT: Palmer A. Marcantonio, Financial Management Branch, Office of Management and Budget, Washington, D.C. 20503, (202) 395-4773.

SUPPLEMENTARY INFORMATION: Before the Circular became final there was extensive coordination with the affected nonprofit organizations, professional associations, Federal agencies and others. All interested persons were given an opportunity to comment on the proposed Circular through informal consultations and a notice in the *Federal Register*. In response to our requests for comment, we received about 100 letters from Federal agencies, nonprofit organizations, associations, and other interested members of the public. These comments were considered in the final version of the Circular. There follows a summary of the major comments and the action taken on each.

In addition to the changes described, other changes have been made to improve the clarity and readability of the Circular. To the extent possible, we have tried to make the language of this Circular consistent with that of cost principles for educational institutions (Circular A-21), and State and local governments (Circular 74-4).

Summary of Significant Changes:

Set forth are changes that have been made in the final Circular as a result of

public comments. The more significant changes to the basic Circular and Attachment A include:

1. Paragraph 2, "Supersession" was added to the basic Circular to make it clear that this Circular supersedes cost principles issued by individual agencies.

2. Paragraph 4 of the basic Circular has been amended to make it clear that the absence of an advance agreement on any element of cost will not in itself affect the reasonableness of allocability of that element. Also, this paragraph was amended to make it clear that where an item of cost requiring prior approval is specified in the budget, approval of the budget constitutes approval of the cost.

3. Paragraph 5 of the basic Circular has been changed to remove any doubt as to which nonprofit organizations would not be covered by the Circular. Now, Appendix C to the Circular lists all exclusions.

4. Paragraph 8 was added to the basic Circular to permit Federal agencies to request exceptions from the requirements of the Circular.

5. Paragraph E.2. was added to Attachment A to cover the negotiation and approval of indirect cost rates, and to provide for cognizance arrangements.

The more significant changes to Attachment B to the Circular include:

1. Paragraph 6, *Compensation for Personal Services*, was modified to:

a. Permit Federal agencies to accept a substitute system for documenting personnel costs through means other than personnel activity reports.

b. Clarify provisions covering the allowability of costs for unemployment compensation or workers' compensation, and costs of insurance policies on the lives of trustees, officers, or other employees.

c. Make unallowable any increased costs of pension plans caused by delayed funding.

d. Delete a paragraph dealing with review and approval of compensation of individual employees.

2. Paragraph 7, *Contingencies*, was changed to make it clear that the term "contingency reserves" excludes self-insurance reserves or pension funds.

3. Paragraph 10 was modified to provide that the value of donated services used in the performance of a direct cost activity shall be allocated a share of indirect cost only when (a) the aggregate value of the service is material, (b) the services are supported by a significant amount of the indirect cost incurred by the organization, and (c) the direct cost activity is not pursued primarily for the benefit of the Federal Government. Provisions were also added to this paragraph for the

cognizant agency and the recipient to negotiate when there is no basis for determining the fair market value of the services rendered, and to permit indirect costs allocated to donated services to be charged to an agreement or used to meet cost sharing or matching requirements.

4. Paragraph 13, *Equipment and Other Capital Expenditures*, was changed. Capital equipment is now defined as having an acquisition cost of \$500 and a useful life of more than two years.

5. Paragraph 24, *Meetings, Conferences*. The prior approval requirement for charging meetings and conferences as a direct cost was deleted. A sentence was added to make it clear such costs were allowable provided they meet the criterion for the allowability of cost shown in Attachment A.

6. Paragraph 28, *Organization Costs*, was amended to provide that organization costs may be allowable when approved in writing by the awarding agency.

7. Paragraph 28, *Page Charges in Professional Journals*, was revised to provide that page charges may be allowable.

8. Paragraph 36, *Public Information Service Costs*, was modified to make public information costs allowable as direct costs with awarding agency approval.

9. Paragraph 42, *Rental Costs*, was rewritten to:

a. Make it clear that rental costs under leases which create a material equity on the leased property are allowable only up to the amount that the organization would have been allowed had it purchased the property: e.g., depreciation or use allowances, maintenance, taxes, insurance, etc.

b. Clarify the criteria for material equity leases.

10. Paragraph 50, *Travel Costs*, was amended to delete the prior approval requirement for domestic travel. In addition to the above, a number of editorial changes were made to the original document.

Suggested Changes Not Considered Necessary.

Comment. Several respondents questioned the provision that, for "less than arm's length" leases, rental costs are allowable only up to the amount that would be allowed had title to the property been vested in the grantee organization. In their opinion this rule will result in unnecessary cost to the Federal Government, since it would encourage an organization to lease space on the commercial market at a higher rate.

Response. The cost principles are designed to cover most situations; however, there are always exceptions that must be considered on a case-by-case basis. The Circular contains a provision for Federal agencies to request exceptions.

Comment. Several respondents questioned why interest is not an allowable cost, since it is an ordinary and necessary cost of doing business.

Response. It has been a longstanding policy not to recognize interest as a cost. However, this policy has recently been revised for State and local governments in Circular 74-4, with respect to the cost of office space. The revision provides that "rental" rates for publicly owned buildings may be based on actual costs, including depreciation, interest, operation and maintenance costs, and other allowable costs. This revision was under consideration for some time. It was studied extensively by OMB, the General Accounting Office and others, and considerable analysis went into its formulation. Suggestions for extending it to nonprofit organizations would have to be examined with equal care. This has not yet been done, and we were reluctant to further delay issuance of this Circular.

Comment. Several respondents questioned why public information costs were not allowable as an indirect cost.

Response. Public information costs are often direct services to an organization's other programs. They are allowable, however, as a direct charge when they are within the scope of work of a particular agreement.

Comment. One respondent suggested that smaller grantees be excluded from complying with the Circular.

Response. Similar rules for the 50 selected items of cost would be needed regardless of the size of the grantee. To the extent possible, the Circular provides simplified methods for smaller grantees.

Comment. One respondent said the requirements of the Cost Accounting Standards Board should be applied to cover contracts with nonprofit organizations.

Response. It is unlikely that the type of grantees covered by this Circular would have contracts large enough to be covered by the CASB. In the event that they do, however, the regulations of the CASB would apply.

Comment. One respondent said the allocation of indirect cost to donated services would pose a tremendous difficulty to the organization. The organization relies on a corps of approximately 8,000 committee members to carry out obligations in response to Government requests. There is no

employer relationship in the arrangements for this assistance, nor are there committee members normally reimbursed for such services. Further, it was pointed out the committee members spend many thousands of hours outside the organization's premises conducting research.

Response. It would appear that this type of committee arrangement would not be considered in the determination of the organization's indirect cost rate provided that Federal agreements do not bear an unreasonable share of indirect cost. However, the cognizant agency will be responsible for evaluating the allocation of indirect cost where there are committee-type arrangements on a case-by-case basis.

Comment. One respondent suggested that wherever possible the language in the *Federal Procurement Regulations* be used for nonprofit organizations.

Response. The language in the *Federal Procurement Regulations* was designated primarily for commercial firms, and is not necessarily well suited to nonprofit organizations. At the suggestion of the General Accounting Office, the nonprofit cost principles were written to conform as closely as possible to those of educational institutions (Circular A-21), and State and local governments (Circular 74-4).
John J. Lordan,
Chief, Financial Management Branch.

[Circular No. A-122]

June 27, 1980

To The Heads of Executive Departments and Establishments

Subject: Cost principles for nonprofit organizations.

1. *Purpose.* This Circular establishes principles for determining costs of grants, contracts and other agreements with nonprofit organizations. It does not apply to colleges and universities which are covered by Circular A-21; State, local, and federally recognized Indian tribal governments which are covered by Circular 74-4; or hospitals. The principles are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law. The principles do not attempt to prescribe the extent of cost sharing or matching on grants, contracts, or other agreements. However, such cost sharing or matching shall not be accomplished through arbitrary limitations on individual cost elements by Federal agencies. Provision for profit or other increment above cost is outside the scope of this Circular.

2. *Supersession.* This Circular supersedes cost principles issued by

individual agencies for nonprofit organization.

3. *Applicability.* a. These principles shall be used by all Federal agencies in determining the costs of work performed by nonprofit organizations under grants, cooperative agreements, cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, or settlement. All of these instruments are hereafter referred to as awards. The principles do not apply to awards under which an organization is not required to account to the Government for actual costs incurred.

b. All cost reimbursement subawards (subgrants, subcontracts, etc.) are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a nonprofit organization, this Circular shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial concerns shall apply; if a subaward is to a college or university, Circular A-21 shall apply; if a subaward is to a State, local, or federally recognized Indian tribal government, Circular 74-4 shall apply.

4. *Definitions.* a. "Nonprofit organization" means any corporation, trust, association, cooperative, or other organization which (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. For this purpose, the term "nonprofit organization" excludes (i) colleges and universities; (ii) hospitals; (iii) State, local, and federally recognized Indian tribal governments; and (iv) those nonprofit organizations which are excluded from coverage of this Circular in accordance with paragraph 5 below.

b. "Prior approval" means securing the awarding agency's permission in advance to incur cost for those items that are designated as requiring prior approval by the Circular. Generally this permission will be in writing. Where an item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost.

5. *Exclusion of some nonprofit organizations.* Some nonprofit organizations, because of their size and nature of operations, can be considered to be similar to commercial concerns for purpose of applicability of cost principles. Such nonprofit organizations shall operate under Federal cost principles applicable to commercial concerns. A listing of these

organizations is contained in Attachment C. Other organizations may be added from time to time.

8. Responsibilities. Agencies responsible for administering programs that involve awards to nonprofit organizations shall implement the provisions of this Circular. Upon request, implementing instruction shall be furnished to the Office of Management and Budget. Agencies shall designate a liaison official to serve as the agency representative on matters relating to the implementation of this Circular. The name and title of such representative shall be furnished to the Office of Management and Budget within 30 days of the date of this Circular.

7. Attachments. The principles and related policy guides are set forth in the following Attachments:

Attachment A—General Principles

Attachment B—Selected Items of Cost

Attachment C—Nonprofit

Organizations Not Subject to This Circular

8. Requests for exceptions. The Office of Management and Budget may grant exceptions to the requirements of this Circular when permissible under existing law. However, in the interest of achieving maximum uniformity, exceptions will be permitted only in highly unusual circumstances.

9. Effective Date. The provisions of this Circular are effective immediately. Implementation shall be phased in by incorporating the provisions into new awards made after the start of the organization's next fiscal year. For existing awards the new principles may be applied if an organization and the cognizant Federal agency agree. Earlier implementation, or a delay in implementation of individual provisions is also permitted by mutual agreement between an organization and the cognizant Federal agency.

10. Inquiries. Further information concerning this Circular may be obtained by contacting the Financial Management Branch, Budget Review Division, Office of Management and Budget, Washington, D.C. 20503, telephone (202) 395-4773.

James T. McIntyre, Jr.,
Director.

[Circular No. A-122]

Attachment A

General Principles

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[Circular No. A-122]

Attachment A

General Principles

A. Basic Considerations.

1. Composition of total costs. The total cost of an award is the sum of the allowable direct and allocable indirect costs less any applicable credits.

2. Factors affecting allowability of costs. To be allowable under an award, costs must meet the following general criteria:

- a. Be reasonable for the performance of the award and be allocable thereto under these principles.
- b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.
- c. Be consistent with policies and procedures that apply uniformly to both federally financed and other activities of the organization.
- d. Be accorded consistent treatment.
- e. Be determined in accordance with generally accepted accounting principles.
- f. Not be included as a cost or used to meet cost sharing or matching requirements of any other federally financed program in either the current or a prior period.
- g. Be adequately documented.

3. Reasonable costs. A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration shall be given to:

- a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.
- b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.
- c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and

clients, the public at large, and the Government.

d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

4. Allocable costs.

a. A cost is allocable to a particular cost objective, such as a grant, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Government award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

- (1) Is incurred specifically for the award.
- (2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or
- (3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

5. Applicable credits.

a. The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. Typical examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to allowable cost they shall be credited to the Government either as a cost reduction or cash refund as appropriate.

b. In some instances, the amounts received from the Federal Government to finance organizational activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the organization in determining the rates or amounts to be charged to Federal awards for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds.

(c) For rules covering program income (i.e., gross income earned from federally supported activities) see Attachment D of OMB Circular A-110.

6. Advance understandings. Under any given award the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with organizations that receive a preponderance of their support from Federal agencies. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, it is often desirable to seek a written agreement with the cognizant or awarding agency in advance of the incurrence of special or unusual costs. The absence of an advance agreement on any element of cost will not, in itself, affect the reasonableness or allocability of that element.

B. Direct Costs

1. Direct costs are those that can be identified specifically with a particular final cost objective: i.e., a particular award, project, service, or other direct activity of an organization. However, a cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstances, has been allocated to an award as an indirect cost. Costs identified specifically with awards are direct costs of the awards and are to be assigned directly thereto. Costs identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to other awards directly or indirectly.

2. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives.

3. The cost of certain activities are not allowable as charges to Federal awards (see, for example, fund raising costs in paragraph 19 of Attachment B). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct cost 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.

4. 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:

a. Maintenance of membership rolls, subscriptions, publications, and related functions.

b. Providing services and information to members, legislative or administrative bodies, or the public.

c. Promotion, lobbying, and other forms of public relations.

d. Meetings and conferences except those held to conduct the general administration of the organization.

3. Maintenance, protection, and investment of special funds not used in operation of the organization.

f. Administration of group benefits on behalf of members or clients including life and hospital insurance, annuity or retirement plans, financial aid, etc.

C. Indirect Cost.

1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct cost of minor amounts may be treated as indirect costs under the conditions described in paragraph B.2. above. After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose,

in like circumstances, has been assigned to an award as a direct cost.

2. Because of the diverse characteristics and accounting practices of nonprofit organizations, it is not possible to specify the types of costs which may be classified as indirect cost in all situations. However, typical examples of indirect cost for many nonprofit organizations may include depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive officers, personnel administration, and accounting.

D. Allocation of Indirect Costs and Determination of Indirect Cost Rates.**1. General.**

a. Where a nonprofit organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures as described in paragraph 2 below.

b. Where an organization has several major functions which benefit from its indirect costs in varying degrees, allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. The indirect costs allocated to each function are then distributed to individual awards and other activities included in that function by means of an indirect cost rate(s).

c. The determination of what constitutes an organization's major functions will depend on its purpose in being; the types of services it renders to the public, its clients, and its members; and the amount of effort it devotes to such activities as fund raising, public information and membership activities.

d. Specific methods for allocating indirect costs and computing indirect cost rates along with the conditions under which each method should be used are described in paragraphs 2 through 5 below.

e. The base period for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation to work performed in that period. The base period normally should coincide with the organization's fiscal year, but in any event, shall be so selected as to avoid inequities in the allocation of the costs.

2. Simplified allocation method.

a. Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization's total costs for the base period as either direct or indirect, and (ii) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual awards. The rate should be expressed as the percentage 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.

b. Both the direct costs and the indirect costs shall exclude capital expenditures and unallowable costs. However, unallowable costs which represent activities must be included in the direct costs under the conditions described in paragraph B.3. above.

c. The distribution base may be total direct costs (excluding capital expenditures and other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 29 of Attachment B.

d. Except where a special rate(s) is required in accordance with paragraph D.5 below, the indirect cost rate developed under the above principles is applicable to all awards at the organization. If a special rate(s) is required, appropriate modifications shall be made in order to develop the special rate(s).

3. Multiple allocation base method.

a. Where an organization's indirect costs benefit its major functions in varying degrees, such costs shall be accumulated into separate cost groupings. Each grouping shall then be allocated individually to benefiting functions by means of a base which best measures the relative benefits.

b. The 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 should constitute a pool of expenses that are of like character in terms of the functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The number of separate groupings should be held within practical limits, taking into consideration the materiality of the amounts involved and the degree of precision desired.

c. Actual conditions must be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefiting functions. When an allocation can be made by assignment of a cost grouping directly to the function benefited, the allocation shall be made in that manner. When the expenses in a grouping are more general in nature, the allocation should be made through the use of a selected base which produces results that are equitable to both the Government and the organization. In general, any cost element or cost related factor associated with the organization's work is potentially adaptable for use as an allocation base provided (i) it can readily be expressed in terms of dollars or other quantitative measures (total direct costs, direct salaries and wages, staff hours applied, square feet used, hours of usage, number of documents processed, population served, and the like) and (ii) it is common to the benefiting functions during the base period.

d. Except where a special indirect cost rate(s) is required in accordance with

paragraph D.5 below, 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.

e. The distribution base used in computing the indirect cost rate for each function may be total direct costs (excluding capital expenditures and other distorting items such as major subcontracts and subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 29, Attachment B. An indirect cost rate should be developed for each separate indirect cost pool developed. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool.

4. Direct allocation method.

a. Some nonprofit 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) fund raising, 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 in each award or other activity using a base most appropriate to the particular cost being prorated.

b. This method is acceptable provided each joint cost is prorated using a base which accurately measures the benefits provided to each award or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data. 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.

c. 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 paragraph D.2 above.

5. *Special indirect cost rates.* In some instances, a single indirect cost rate for all activities of an organization or for each major function of the organization may not be appropriate, since it would not take into account those different factors which may substantially affect the indirect costs applicable to a particular segment of work. For this purpose, a particular segment of work may be that performed under a single award or it may consist of work under a group of awards performed in a common environment. The factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills

involved, the organizational arrangements used, or any combination thereof. When a particular segment of work is performed in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to such work. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used provided it is determined that (i) the rate differs significantly from that which would have been obtained under paragraph D.2, 3, and 4 above, and (ii) the volume of work to which the rate would apply is material.

E. Negotiation and Approval of Indirect Cost Rates.

1. *Definitions.* As used in this section, the following terms have the meanings set forth below:

a. "Cognizant agency" means the Federal agency responsible for negotiating and approving indirect cost rates for a nonprofit organization on behalf of all Federal agencies.

b. "Predetermined rate" means an indirect cost rate, applicable to a specified current or future period, usually the organization's fiscal year. The rate is based on an estimate of the costs to be incurred during the period. A predetermined rate is not subject to adjustment.

c. "Fixed rate" means an indirect cost rate which has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.

d. "Final rate" means an indirect cost rate applicable to a specified past period which is based on the actual costs of the period. A final rate is not subject to adjustment.

e. "Provisional rate" or billing rate means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on awards pending the establishment of a final rate for the period.

f. "Indirect cost proposal" means the documentation prepared by an organization to substantiate its claim for the reimbursement of indirect costs. This proposal provides the basis for the review and negotiation leading to the establishment of an organization's indirect cost rate.

g. "Cost objective" means a function, organizational subdivision, contract, grant, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

2. Negotiation and approval of rates.

a. Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for the negotiation and approval of indirect cost rates and, where necessary, other rates such as fringe benefit and computer charge-out rates. Once an agency is assigned cognizance for a particular nonprofit organization, the

assignment will not be changed unless there is a major long-term shift in the dollar volume of the Federal awards to the organization. All concerned Federal agencies shall be given the opportunity to participate in the negotiation process, but after a rate has been agreed upon it will be accepted by all Federal agencies. When a Federal agency has reason to believe that special operating factors affecting its awards necessitate special indirect cost rates in accordance with paragraph D.5 above, it will, prior to the time the rates are negotiated, notify the cognizant agency.

b. A nonprofit organization which has not previously established an indirect cost rate with a Federal agency shall submit its initial indirect cost proposal to the cognizant agency. The proposal shall be submitted as soon as possible after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award.

c. Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

d. A predetermined rate may be negotiated for use on awards where there is reasonable assurance, based on past experience and reliable projection of the organization's costs, that the rate is not likely to exceed a rate based on the organization's actual costs.

e. Fixed rates may be negotiated where predetermined rates are not considered appropriate. A fixed rate, however, shall not be negotiated if (i) all or a substantial portion of the organization's awards are expected to expire before the carry-forward adjustment can be made; (ii) the mix of Government and non-government work at the organization is too erratic to permit an equitable carry-forward adjustment; or (iii) the organization's operations fluctuate significantly from year to year.

f. Provisional and final rates shall be negotiated where neither predetermined nor fixed rates are appropriate.

g. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the nonprofit organization. The cognizant agency shall distribute copies of the agreement to all concerned Federal agencies.

h. If a dispute arises in a negotiation of an indirect cost rate between the cognizant agency and the nonprofit organization, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.

i. To the extent that problems are encountered among the Federal agencies in connection with the negotiation and approval process, the Office of Management and Budget will lend assistance as required to resolve such problems in a timely manner.

[Circular No. A-122]

Attachment B

Selected Items of Cost

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[Circular No. A-122]

Attachment B

Selected Items of Cost

Paragraphs 1 through 50 provide principles to be applied in establishing the allowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather determination as to allowability in each case should be based on the treatment or principles provided for similar or related items of cost.

1. Advertising costs.

a. Advertising costs mean the costs of media services and associated costs. Media advertising includes magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

b. The only advertising costs allowable are those which are solely for (i) the recruitment of personnel when considered in conjunction with all other recruitment costs, as set forth in paragraph 40; (ii) the procurement of goods and services; (iii) the disposal of surplus materials acquired in the performance of the award except when organizations are reimbursed for disposals at a predetermined amount in accordance with Attachment N of OMB Circular A-110; or (iv) specific requirements of the award.

2. *Bad debts.* Bad debts, including losses (whether actual or estimated) arising from uncollectible accounts and other claims, related collection costs, and related legal costs, are unallowable.

3. Bid and proposal costs. (reserved)

4. Bonding costs.

a. Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the organization. They arise also in instances where the organization requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding required pursuant to the terms of the award are allowable.

c. Costs of bonding required by the organization in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

5. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage and the like, are allowable.

6. Compensation for personal services.

a. *Definition.* Compensation for personal services includes all compensation paid currently or accrued by the organization for services of employees rendered during the period of the award (except as otherwise provided in paragraph g. below). It includes, but is not limited to, salaries, wages, director's and executive committee member's fees, incentive awards, fringe benefits, pension plan costs, allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost of living differentials.

b. *Allowability.* Except as otherwise specifically provided in this paragraph, the costs of such compensation are allowable to the extent that:

(1) Total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied to both Government and non-Government activities; and

(2) Charges to awards whether treated as direct or indirect costs are determined and supported as required in this paragraph.

c. Reasonableness.

(1) When the organization is predominantly engaged in activities other than those sponsored by the Government, compensation for employees on Government-sponsored work will be considered reasonable to the extent that it is consistent with that paid for similar work in the organization's other activities.

(2) When the organization is predominantly engaged in Government-sponsored activities

and in cases where the kind of employees required for the Government activities are not found in the organization's other activities, compensation for employees on Government-sponsored work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.

d. *Special considerations in determining allowability.* Certain conditions require special consideration and possible limitations in determining costs under Federal awards where amounts or types of compensation appear unreasonable. Among such conditions are the following:

(1) Compensation to members of nonprofit organizations, trustees, directors, associates, officers, or the immediate families thereof. Determination should be made that such compensation is reasonable for the actual personal services rendered rather than a distribution of earnings in excess of costs.

(2) Any change in an organization's compensation policy resulting in a substantial increase in the organization's level of compensation, particularly when it was concurrent with an increase in the ratio of Government awards to other activities of the organization or any change in the treatment of allowability of specific types of compensation due to changes in Government policy.

e. *Unallowable costs.* Costs which are unallowable under other paragraphs of this Attachment shall not be allowable under this paragraph solely on the basis that they constitute personal compensation.

f. Fringe benefits.

(1) Fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as vacation leave, sick leave, military leave, and the like, are allowable provided such costs are absorbed by all organization activities in proportion to the relative amount of time or effort actually devoted to each.

(2) Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, workmen's compensation insurance, pension plan costs (see paragraph g. below), and the like, are allowable provided such benefits are granted in accordance with established written organization policies. Such benefits whether treated as indirect costs or as direct costs, shall be distributed to particular awards and other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards and other activities.

(3)(a) Provisions for a reserve under a self-insurance program for unemployment compensation or workers' compensation are allowable to the extent that the provisions represent reasonable estimates of the liabilities for such compensation, and the types of coverage, extent of coverage, and rates and premiums would have been allowable had insurance been purchased to cover the risks. However, provisions for self-insured liabilities which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(b) Where an organization follows a consistent policy of expensing actual payments to, or on behalf of, employees or former employees for unemployment compensation or workers' compensation, such payments are allowable in the year of payment with the prior approval of the awarding agency provided they are allocated to all activities of the organization.

(4) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibility are allowable only to the extent that the insurance represents additional compensation. The costs of such insurance when the organization is named as beneficiary are unallowable.

g. Pension plan costs.

(1) Costs of the organization's pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:

(a) Such policies meet the test of reasonableness;

(b) The methods of cost allocation are not discriminatory;

(c) The cost assigned to each fiscal year is determined in accordance with generally accepted accounting principles as prescribed in Accounting Principles Board Opinion No. 8 issued by the American Institute of Certified Public Accountants; and

(d) The costs assigned to a given fiscal year are funded for all plan participants within six months after the end of that year. However, increases to normal and past service pension costs caused by a delay in funding the actuarial liability beyond 30 days after each quarter of the year to which such costs are assignable are unallowable.

(2) Pension plan termination insurance premiums paid pursuant to the Employee Retirement Income Security Act of 1974 (Pub. L. 93-406) are allowable. Late payment charges on such premiums are unallowable.

(3) Excise taxes on accumulated funding deficiencies and other penalties imposed under the Employee Retirement Income Security Act are unallowable.

h. Incentive compensation. Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before the services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply, in effect, an agreement to make such payment.

i. Overtime, extra pay shift, and multishift premiums. See paragraph 27.

j. Severance pay. See paragraph 44.

k. Training and education costs. See paragraph 44.

l. Support of salaries and wages.

(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports as

prescribed in subparagraph (2) below, except when a substitute system has been approved in writing by the cognizant agency. (See paragraph E.2 of Attachment A)

(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by nonprofit organizations to satisfy these requirements must meet the following standards:

(a) The reports must reflect an *after-the-fact* determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

(c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.

(d) The reports must be prepared at least monthly and must coincide with one or more pay periods.

(3) Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in subparagraphs (1) and (2) above, must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act (29 CFR Part 516). For this purpose, the term "nonprofessional employee" shall have the same meaning as "nonexempt employee," under the Fair Labor Standards Act.

(4) Salaries and wages of employees used in meeting cost sharing or matching requirements on awards must be supported in the same manner as salaries and wages claimed for reimbursement from awarding agencies.

7. Contingency provisions. Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see paragraph 6.f.(3) and 18.a.(2)(d)); pension funds (see paragraph 6.(g)); and reserves for normal severance pay (see paragraph 44.(b)(1)).

8. Contributions. Contributions and donations by the organization to others are unallowable.

9. Depreciation and use allowances

a. Compensation for the use of buildings, other capital improvements, and equipment on hand may be made through use allowances or depreciation. However, except as provided in paragraph f. below a combination of the two methods may not be used in connection with a single class of fixed assets (e.g., buildings, office equipment, computer equipment, etc.).

b. The computation of use allowances or depreciation shall be based on the acquisition cost of the assets involved. The acquisition cost of an asset donated to the organization by a third party shall be its fair market value at the time of the donation.

c. The computation of use allowances or depreciation will exclude.

(1) The cost of land;

(2) Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides; and

(3) Any portion of the cost of buildings and equipment contributed by or for the organization in satisfaction of a statutory matching retirement.

d. Where the use allowance method is followed, the use allowance for buildings and improvement (including land improvements such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components (e.g. plumbing system, heating and air conditioning, etc.) cannot be segregated from the building's shell. The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the need for costly or extensive alterations or repairs to the building or the equipment. Equipment that meets these criteria will be subject to the six and two-thirds percent equipment use allowance limitation.

e. Where depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular program area, and the renewal and replacement policies followed for the individual items or classes of assets involved. The method of depreciation used to assign the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater or lesser in the early portions of its

useful life than in the later portions, the straight-line method shall be presumed to be the appropriate method. Depreciation methods once used shall not be changed unless approved in advance by the cognizant Federal agency. When the depreciation method is introduced for application to assets previously subject to a use allowance, the combination of use allowances and depreciation applicable to such assets must not exceed the total acquisition cost of the assets. When the depreciation method is used for buildings, a building's shell may be segregated from each building component (e.g., plumbing system, heating, and air conditioning system, etc.) and each item depreciated over its estimated useful life; or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life.

f. When the depreciation method is used for a particular class of assets, no depreciation may be allowed on any such assets that, under paragraph e. above, would be viewed as fully depreciated. However, a reasonable use allowance may be negotiated for such assets if warranted after taking into consideration the amount of depreciation previously charged to the Government, the estimated useful life remaining at time of negotiation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

g. Charges for use allowances or depreciation must be supported by adequate property records and physical inventories must be taken at least once every two years (a statistical sampling basis is acceptable) to ensure that assets exist and are usable and needed. When the depreciation method is followed, adequate depreciation records indicating the amount of depreciation taken each period must also be maintained.

10. Donations

a. Services received.

(1) Donated or volunteer services may be furnished to an organization by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost.

(2) The value of donated services utilized in the performance of a direct cost activity shall be considered in the determination of the organization's indirect cost rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs when the following circumstances exist:

(a) The aggregate value of the services is material;

(b) The services are supported by a significant amount of the indirect costs incurred by the organization;

(c) The direct cost activity is not pursued primarily for the benefit of the Federal Government.

(3) In those instances where there is no basis for determining the fair market value of the services rendered, the recipient and the cognizant agency shall negotiate an appropriate allocation of indirect cost to the services.

(4) Where donated services directly benefit a project supported by an award, the indirect

costs allocated to the services will be considered as a part of the total costs of the project. Such indirect costs may be reimbursed under the award or used to meet cost sharing or matching requirements.

(5) The value of the donated services may be used to meet cost sharing or matching requirements under conditions described in Attachment E, OMB Circular No. A-110. Where donated services are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

(6) Fair market value of donated services shall be computed as follows:

(a) *Rates for volunteer services.* Rates for volunteers shall be consistent with those regular rates paid for similar work in other activities of the organization. In cases where the kinds of skills involved are not found in the other activities of the organization, the rates used shall be consistent with those paid for similar work in the labor market in which the organization competes for such skills.

(b) *Services donated by other organizations.* When an employer donates the services of an employee, these services shall be valued at the employee's regular rate of pay (exclusive of fringe benefits and indirect costs) provided the services are in the same skill for which the employee is normally paid. If the services are not in the same skill for which the employee is normally paid, fair market value shall be computed in accordance with subparagraph (a) above.

b. Goods and space.

(1) Donated goods; i.e., expendable personal property/supplies, and donated use of space may be furnished to an organization. The value of the goods and space is not reimbursable either as a direct or indirect cost.

(2) The value of the donations may be used to meet cost sharing or matching share requirements under the conditions described in Attachment E, OMB Circular No. A-110. The value of the donations shall be determined in accordance with Attachment E. Where donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

11. *Employee morale, health, and welfare, costs and credits.* The costs of house publications, health or first-aid clinics, and/or infirmaries, recreational activities, employees' counseling services, and other expenses incurred in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable. Such costs will be equitably apportioned to all activities of the organization. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

12. *Entertainment costs.* Costs of amusement, diversion, social activities, ceremonials, and costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable (but see paragraphs 11 and 25).

13. *Equipment and other capital expenditures.*

a. As used in this paragraph, the following terms have the meanings set forth below:

(1) "Equipment" means an article of nonexpendable tangible personal property having a useful life of more than two years and an acquisition cost of \$500 or more per unit. An organization may use its own definition provided that it at least includes all nonexpendable tangible personal property as defined herein.

(2) "Acquisition cost" means the net invoice unit price of an item of equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in-transit insurance, freight, and installation shall be included in or excluded from acquisition cost in accordance with the organization's regular written accounting practices.

(3) "Special purpose equipment" means equipment which is usable only for research, medical, scientific, or technical activities. Examples of special purpose equipment include microscopes, x-ray machines, surgical instruments, and spectrometers.

(4) "General purpose equipment" means equipment which is usable for other than research, medical, scientific, or technical activities, whether or not special modifications are needed to make them suitable for a particular purpose. Examples of general purpose equipment include office equipment and furnishings, air conditioning equipment, reproduction and printing equipment, motor vehicles, and automatic data processing equipment.

b. (1) Capital expenditures for general purpose equipment are unallowable as a direct cost except with the prior approval of the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs provided that items with a unit cost of \$1000 or more have the prior approval of the awarding agency.

c. Capital expenditures for land or buildings are unallowable as a direct cost except with the prior approval of the awarding agency.

d. Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

e. Equipment and other capital expenditures are unallowable as indirect costs. However, see paragraph 9 for allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see paragraph 42 for allowability of rental costs for land, buildings, and equipment.

14. *Fines and penalties.* Costs of fines and penalties resulting from violations of, or failure of the organization to comply with Federal, State, and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of an award or instructions in writing from the awarding agency.

15. *Fringe benefits.* See paragraph 6. f.

16. *Idle facilities and idle capacity.*

a. As used in this paragraph the following terms have the meanings set forth below:

(1) "Facilities" means land and buildings or any portion thereof, equipment individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the organization.

(2) "Idle facilities" means completely unused facilities that are excess to the organization's current needs.

(3) "Idle capacity" means the unused capacity of partially used facilities. It is the difference between that which a facility could achieve under 100 per cent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays, and the extent to which the facility was actually used to meet demands during the accounting period. A multishift basis may be used if it can be shown that this amount of usage could normally be expected for the type of facility involved.

(4) "Costs of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs; e.g., property taxes, insurance, and depreciation or use allowances.

b. The costs of idle facilities are unallowable except to the extent that:

(1) They are necessary to meet fluctuations in workload; or

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subparagraph, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of such facilities (but see paragraphs 47.d. and d.).

c. The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be idle facilities.

17. *Independent research and development* [Reserved].

18. *Insurance and indemnification.*

a. Insurance includes insurance which the organization is required to carry, or which is approved, under the terms of the award and any other insurance which the organization maintains in connection with the general conduct of its operations. This paragraph does not apply to insurance which represents fringe benefits for employees (see paragraph 6.f. and 6.g.(2)).

(1) Costs of insurance required or approved, and maintained, pursuant to the award are allowable.

(2) Costs of other insurance maintained by the organization in connection with the

general conduct of its operations are allowable subject to the following limitations.

(a) Types and extent of coverage shall be in accordance with sound business practice and the rates and premiums shall be reasonable under the circumstances.

(b) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of management fees.

(c) Costs of insurance or of any provisions for a reserve covering the risk of loss or damage to Government property are allowable only to the extent that the organization is liable for such loss or damage.

(d) Provisions for a reserve under a self-insurance program are allowable to the extent that types of coverage, extent of coverage, rates, and premiums would have been allowed had insurance been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(e) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibilities are allowable only to the extent that the insurance represents additional compensation (see paragraph 6). The cost of such insurance when the organization is identified as the beneficiary is unallowable.

(3) Actual losses which could have been covered by permissible insurance (through the purchase of insurance or a self-insurance program) are unallowable unless expressly provided for in the award, except:

(a) Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound business practice are allowable.

(b) Minor losses not covered by insurance, such as spoilage, breakage, and disappearance of supplies, which occur in the ordinary course of operations, are allowable.

b. Indemnification includes securing the organization against liabilities to third persons and any other loss or damage, not compensated by insurance or otherwise. The Government is obligated to indemnify the organization only to the extent expressly provided in the award.

19. *Interest, fund raising, and investment management costs.*

a. Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

b. Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable.

c. Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are unallowable.

d. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in paragraph B of Attachment A.

20. *Labor relations costs.* Costs incurred in maintaining satisfactory relations between the organization and its employees, including costs of labor management committees,

employee publications, and other related activities are allowable.

21. *Losses on other awards.* Any excess of costs over income on any award is unallowable as a cost of any other award. This includes, but is not limited to, the organization's contributed portion by reason of cost sharing agreements or any underrecoveries through negotiation of lump sums for, or ceilings on, indirect costs.

22. *Maintenance and repair costs.* Costs incurred for necessary maintenance, repair, or upkeep of buildings and equipment (including Government property unless otherwise provided for) which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable. Costs incurred for improvements which add to the permanent value of the buildings and equipment or appreciably prolong their intended life shall be treated as capital expenditures (see paragraph 13).

23. *Materials and supplies.* The costs of materials and supplies necessary to carry out an award are allowable. Such costs should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the organization. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing consistently applied. Incoming transportation charges may be a proper part of material cost. Materials and supplies charged as a direct cost should include only the materials and supplies actually used for the performance of the contract or grant, and due credit should be given for any excess materials or supplies retained, or returned to vendors.

24. *Meetings, conferences.*

a. Costs associated with the conduct of meetings and conferences, include the cost of renting facilities, meals, speakers' fees, and the like. But see paragraph 12. *Entertainment costs*, and paragraph 29. *Participant support costs*.

b. To the extent that these costs are identifiable with a particular cost objective, they should be charged to that objective. (See paragraph B. of Attachment A.) These costs are allowable provided that they meet the general tests of allowability, shown in Attachment A to this Circular.

c. Costs of meetings and conferences held to conduct the general administration of the organization are allowable.

25. *Memberships, subscriptions, and professional activity costs.*

a. Costs of the organization's membership in civic, business, technical and professional organizations are allowable.

b. Costs of the organization's subscriptions to civic, business, professional, and technical periodicals are allowable.

c. Costs of attendance at meetings and conferences sponsored by others when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, and other items incidental to such attendance.

28. *Organization costs.* Expenditures, such as incorporation fees, brokers' fees, fees to promoters, organizers or management consultants, attorneys, accountants, or

investment counselors, whether or not employees of the organization, in connection with establishment or reorganization of an organization, are unallowable except with prior approval of the awarding agency.

27. *Overtime, extra-pay shift, and multishift premiums.* Premiums for overtime, extra-pay shifts, and multishift work are allowable only with the prior approval of the awarding agency except:

a. When necessary to cope with emergencies, such as those resulting from accidents, natural disasters, breakdowns of equipment, or occasional operational bottlenecks of a sporadic nature.

b. When employees are performing indirect functions such as administration, maintenance, or accounting.

c. In the performance of tests, laboratory procedures, or other similar operations which are continuous in nature and cannot reasonably be interrupted or otherwise completed.

d. When lower overall cost to the Government will result.

28. *Page charges in professional journals.* Page charges for professional journal publications are allowable as a necessary part of research costs, where:

a. The research papers report work supported by the Government; and

b. The charges are levied impartially on all research papers published by the journal, whether or not by Government-sponsored authors.

29. *Participant support costs.* Participant support costs are direct costs for items such as stipends or subsistence allowances, travel allowances, and registration fees paid to or on behalf of participants or trainees (but not employees) in connection with meetings, conferences, symposia, or training projects. These costs are allowable with the prior approval of the awarding agency.

30. *Patent costs.*

a. Costs of (i) preparing disclosures, reports, and other documents required by the award and of searching the art to the extent necessary to make such disclosures, (ii) preparing documents and any other patent costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is required by the Government to be conveyed to the Government, and (iii) general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements are allowable (but see paragraph 34).

b. Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures, if not required by the award, are unallowable. Costs in connection with (i) filing and prosecuting any foreign patent application, or (ii) any United States patent application, where the award does not require conveying title or a royalty-free license to the Government, are unallowable (also see paragraph 43).

31. *Pension plans.* See paragraph 6, g.

32. *Plant security costs.* Necessary expenses incurred to comply with Government security requirements or for facilities protection, including wages,

uniforms, and equipment of personnel are allowable.

33. *Preaward costs.* Preaward costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

34. *Professional service costs.*

a. Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the organization, are allowable, subject to b, c, and d, of this paragraph when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government.

b. In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:

(1) The nature and scope of the service rendered in relation to the service required.

(2) The necessity of contracting for the service, considering the organization's capability in the particular area.

(3) The past pattern of such costs, particularly in the years prior to Government awards.

(4) The impact of Government awards on the organization's business (i.e., what new problems have arisen).

(5) Whether the proportion of Government work to the organization's total business is such as to influence the organization in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Government grants and contracts.

(6) Whether the service can be performed more economically by direct employment rather than contracting.

(7) The qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-Government awards.

(8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).

c. In addition to the factors in paragraph b above, retainer fees to be allowable must be supported by evidence of bona fide services available or rendered.

d. Cost of legal, accounting, and consulting services, and related costs incurred in connection with defense of antitrust suits, and the prosecution of claims against the Government, are unallowable. Costs of legal, accounting and consulting services, and related costs, incurred in connection with patent infringement litigation, organization and reorganization, are unallowable unless otherwise provided for in the award (but see paragraph 47e).

35. *Profits and losses on disposition of depreciable property or other capital assets.*

a. (1) Gains and losses on sale, retirement, or other disposition of depreciable property

shall be included in the year in which they occur as credits or charges to cost grouping(s) in which the depreciation applicable to such property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate cost grouping(s) shall be the difference between the amount realized on the property and the undepreciated basis of the property.

(2) Gains and losses on the disposition of depreciable property shall not be recognized as a separate credit or charge under the following conditions.

(a) The gain or loss is processed through a depreciation reserve account and is reflected in the depreciation allowable under paragraph 9.

(b) The property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into account in determining the depreciation cost basis of the new item.

(c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in paragraph 18.a.(3).

(d) Compensation for the use of the property was provided through use allowances in lieu of depreciation in accordance with paragraph 9.

(e) Gains and losses arising from mass or extraordinary sales, retirements, or other dispositions shall be considered on a case-by-case basis.

b. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in paragraph a. above shall be excluded in computing award costs.

36. *Public information service costs.*

a. Public information service costs include the cost associated with pamphlets, news releases, and other forms of information services. Such costs are normally incurred to:

(1) Inform or instruct individuals, groups, or the general public.

(2) Interest individuals or groups in participating in a service program of the organization.

(3) Disseminate the results of sponsored and non-sponsored activities.

b. Public information service costs are allowable as direct costs with the prior approval of the awarding agency. Such costs are unallowable as indirect costs.

37. *Publication and printing costs.*

a. Publication costs include the costs of printing (including the processes of composition, plate-making, press work, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling.

b. If these costs are not identifiable with a particular cost objective, they should be allocated as indirect costs to all benefiting activities of the organization.

c. Publication and printing costs are unallowable as direct costs except with the prior approval of the awarding agency.

d. The cost of page charges in journals is addressed paragraph 28.

38. *Rearrangement and alteration costs.*

Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special arrangement and alteration costs incurred specifically for the project are allowable with the prior approval of the awarding agency.

39 *Reconversion costs.* Costs incurred in the restoration or rehabilitation of the organization's facilities to approximately the same condition existing immediately prior to commencement of Government awards, fair wear and tear excepted, are allowable.

40. *Recruiting costs.* The following recruiting costs are allowable: cost of "help wanted" advertising, operating costs of an employment office, costs of operating an educational testing program, travel expenses including food and lodging of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees (see paragraph 41c). Where the organization uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

41. *Relocation costs.*

a. Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee. Relocation costs are allowable, subject to the limitation described in paragraphs b, c, and d, below, provided that:

(1) The move is for the benefit of the employer.

(2) Reimbursement to the employee is in accordance with an established written policy consistently followed by the employer.

(3) The reimbursement does not exceed the employee's actual (or reasonably estimated) expenses.

b. Allowable relocation costs for current employees are limited to the following:

(1) The costs of transportation of the employee, members of his immediate family and his household, and personal effects to the new location.

(2) The costs of finding a new home, such as advance trips by employees and spouses to locate living quarters and temporary lodging during the transition period, up to a maximum period of 30 days, including advance trip time.

(3) Closing costs, such as brokerage, legal, and appraisal fees, incident to the disposition of the employee's former home. These costs, together with those described in (4) below, are limited to 8 per cent of the sales price of the employee's former home.

(4) The continuing costs of ownership of the vacant former home after the settlement or lease date of the employee's new permanent home, such as maintenance of buildings and grounds (exclusive of fixing up expenses), utilities, taxes, and property insurance.

(5) Other necessary and reasonable expenses normally incident to relocation, such as the costs of cancelling an unexpired lease, disconnecting and reinstalling household appliances, and purchasing insurance against loss of or damages to personal property. The cost of cancelling an unexpired lease is limited to three times the monthly rental.

c. Allowable relocation costs for new employees are limited to those described in (1) and (2) of paragraph b. above. When relocation costs incurred incident to the recruitment of new employees have been

allowed either as a direct or indirect cost and the employee resigns for reasons within his control within 12 months after hire, the organization shall refund or credit the Government for its share of the cost.

However, the costs of travel to an overseas location shall be considered travel costs in accordance with paragraph 50 and not relocation costs for the purpose of this paragraph if dependents are not permitted at the location for any reason and the costs do not include costs of transporting household goods.

d. The following costs related to relocation are unallowable:

(1) Fees and other costs associated with acquiring a new home.

(2) A loss on the sale of a former home.

(3) Continuing mortgage principal and interest payments on a home being sold.

(4) Income taxes paid by an employee related to reimbursed relocation costs.

42. *Rental costs.*

a. Subject to the limitations described in paragraphs b, through d, of this paragraph, rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property leased.

b. Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the organization continued to own the property.

c. Rental costs under less-than-length leases are allowable only up to the amount that would be allowed had title to the property vested in the organization. For this purpose, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between (i) divisions of an organization; (ii) organizations under common control through common officers, directors, or members; and (iii) an organization and a director, trustee, officer, or key employee of the organization or his immediate family either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

d. Rental costs under leases which create a material equity in the leased property are allowable only up to the amount that would be allowed had the organization purchased the property on the date the lease agreement was executed; e.g., depreciation or use allowances, maintenance, taxes, insurance but excluding interest expense and other unallowable costs. For this purpose, a material equity in the property exists if the lease is noncancelable or is cancelable only upon the occurrence of some remote contingency and has one or more of the following characteristics:

(1) The organization has the right to purchase the property for a price which at the beginning of the lease appears to be substantially less than the probable fair market value at the time it is permitted to purchase the property (commonly called a lease with a bargain purchase option);

(2) Title to the property passes to the organization at some time during or after the lease period;

(3) The term of the lease (initial term plus periods covered by bargain renewal options, if any) is equal to 75 per cent or more of the economic life of the leased property; i.e., the period the property is expected to be economically usable by one or more users.

43. *Royalties and other costs for use of patents and copyrights.*

a. Royalties on a patent or copyright or amortization of the cost of acquiring by purchase a copyright, patent, or rights thereto, necessary for the proper performance of the award are allowable unless:

(1) The Government has a license or the right to free use of the patent or copyright.

(2) The patent or copyright has been adjudicated to be invalid, or has been administratively determined to be invalid.

(3) The patent or copyright is considered to be unenforceable.

(4) The patent or copyright is expired.

b. Special care should be exercised in determining reasonableness where the royalties may have been arrived at as a result of less than arm's length bargaining; e.g.:

(1) Royalties paid to persons, including corporations, affiliated with the organization.

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government award would be made.

(3) Royalties paid under an agreement entered into after an award is made to an organization.

c. In any case involving a patent or copyright formerly owned by the organization, the amount of royalty allowed should not exceed the cost which would have been allowed had the organization retained title thereto.

44. *Severance pay.*

a. Severance pay, also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages, by organizations to workers whose employment is being terminated. Costs of severance pay are allowable only to the extent that in each case, it is required by (i) law, (ii) employer-employee agreement, (iii) established policy that constitutes, in effect, an implied agreement on the organization's part, or (iv) circumstances of the particular employment.

b. Costs of severance payments are divided into two categories as follows:

(1) Actual normal turnover severance payments shall be allocated to all activities; or, where the organization provides for a reserve for normal severances such method will be acceptable if the charge to current operations is reasonable in light of payments actually made for normal severances over a representative past period, and if amounts charged are allocated to all activities of the organization.

(2) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus, accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis in the event of occurrence.

45. *Specialized service facilities.*

a. The costs of services provided by highly complex or specialized facilities operated by

the organization, such as electronic computers and wind tunnels, are allowable provided the charges for the services meet the conditions of either b. or c. of this paragraph and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under paragraph A.5. of Attachment A.

b. The costs of such services, when material, must be charged directly to applicable awards based on actual usage of the services on the basis of a schedule of rates or established methodology that (i) does not discriminate against federally supported activities of the organization, including usage by the organization for internal purposes, and (ii) is designed to recover only the aggregate costs of the services. The costs of each service shall consist normally of both its direct costs and its allocable share of all indirect costs. Advance agreements pursuant to paragraph A.6. of Attachment A are particularly important in this situation.

c. Where the costs incurred for a service are not material, they may be allocated as indirect costs.

46. Taxes.

a. In general, taxes which the organization is required to pay and which are paid or accrued in accordance with generally accepted accounting principles, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable, except for (i) taxes from which exemptions are available to the organization directly or which are available to the organization based on an exemption afforded the Government and in the latter case when the awarding agency makes available the necessary exemption certificates, (ii) special assessments on land which represent capital improvements, and (iii) Federal income taxes.

b. Any refund of taxes, and any payment to the organization of interest thereon, which were allowed as award costs, will be credited either as a cost reduction or cash refund, as appropriate, to the Government.

47. *Termination costs.* Termination of awards generally give rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the award not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the other provisions of this Circular in termination situations.

a. *Common items.* The cost of items reasonably usable on the organization's other work shall not be allowable unless the organization submits evidence that it would not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the organization, the awarding agency should consider the organization's plans and orders for current and scheduled activity. Contemporaneous purchases of common items by the organization shall be regarded as evidence that such items are reasonably usable on the organization's other work. Any acceptance of common items as allocable to the terminated portion of the award shall be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

b. *Costs continuing after termination.* If in a particular case, despite all reasonable efforts by the organization, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this Circular, except that any such costs continuing after termination due to the negligent or willful failure of the organization to discontinue such costs shall be unallowable.

c. *Loss of useful value.* Loss of useful value of special tooling, machinery and equipment which was not charged to the award as a capital expenditure is generally allowable if:

(1) Such special tooling, machinery, or equipment is not reasonably capable of use in the other work of the organization.

(2) The interest of the Government is protected by transfer of title or by other means deemed appropriate by the awarding agency;

d. *Rental costs.* Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated award less the residual value of such leases, if (i) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the award and such further period as may be reasonable, and (ii) the organization makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the award, and of reasonable restoration required by the provisions of the lease.

e. *Settlement expenses.* Settlement expenses including the following are generally allowable:

(1) Accounting, legal, clerical, and similar costs reasonably necessary for:

(a) The preparation and presentation to awarding agency of settlement claims and supporting data with respect to the terminated portion of the award, unless the termination is for default. (See paragraph 4.a. of Attachment L, OMB Circular No. A-110; and

(b) The termination and settlement of subawards.

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Government or acquired or produced for the award; except when grantees are reimbursed for disposals at a predetermined amount in accordance with Attachment N of OMB Circular A-110.

(3) Indirect costs related to salaries and wages incurred as settlement expenses in subparagraphs (1) and (2) of this paragraph. Normally, such indirect costs shall be limited to fringe benefits, occupancy cost, and immediate supervision.

f. *Claims under subawards.* Claims under subawards, including the allocable portion of claims which are common to the award, and to other work of the organization are generally allowable. An appropriate share of the organization's indirect expense may be allocated to the amount of settlements with subcontractor/subgrantees; provided that the amount allocated is otherwise consistent

with the basic guidelines contained in Attachment A. The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

48. Training and education costs

a. Costs of preparation and maintenance of a program of instruction including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees, including training materials, textbooks, salaries or wages of trainees (excluding overtime compensation which might arise therefrom), and (i) salaries of the director of training and staff when the training program is conducted by the organization, or (ii) tuition and fees when the training is in an institution not operated by the organization, are allowable.

b. Costs of part-time education, at an undergraduate or postgraduate college level, including that provided at the organization's own facilities, are allowable only when the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work, and are limited to:

(1) Training materials.

(2) Textbooks.

(3) Fees charges by the educational institution.

(4) Tuition charged by the educational institution, or in lieu of tuition, instructors' salaries and the related share of indirect costs of the educational institution to the extent that the sum thereof is not in excess of the tuition which would have been paid to the participating educational institution.

(5) Salaries and related costs of instructors who are employees of the organization.

(6) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 150 hours per year and only to the extent that circumstances do not permit the operation of classes or attendance at classes after regular working hours; otherwise such compensation is unallowable.

c. Costs of tuition, fees, training materials, and textbooks (but not subsistence, salary, or any other emoluments) in connection with full-time education, including that provided at the organization's own facilities, at a postgraduate (but not undergraduate) college level, are allowable only when the course or degree pursued is related to the field in which the employee is now working or may reasonably be expected to work, and only where the costs receive the prior approval of the awarding agency. Such costs are limited to the costs attributable to a total period not to exceed one school year for each employee so trained. In unusual cases the period may be extended.

d. Costs of attendance of up to 16 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of executives or managers or to prepare employees for such positions are allowable. Such costs include enrollment fees, training materials, textbooks and related charges, employees' salaries, subsistence, and travel. Costs allowable under this paragraph do not include those for courses that are part of a degree-oriented

curriculum, which are allowable only to the extent set forth in b. and c. above.

e. Maintenance expense, and normal depreciation or fair rental, on facilities owned or leased by the organization for training purposes are allowable to the extent set forth in paragraphs 9, 22, and 42.

f. Contributions or donations to educational or training institutions, including the donation of facilities or other properties, and scholarships or fellowships, are unallowable.

g. Training and education costs in excess of those otherwise allowable under paragraphs b. and c. of this paragraph may be allowed with prior approval of the awarding agency. To be considered for approval, the organization must demonstrate that such costs are consistently incurred pursuant to an established training and education program, and that the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work.

49. *Transportation costs.* Transportation costs include freight, express, cartage, and postage charges relating either to goods purchased, in process, or delivered. These costs are allowable. When such costs can readily be identified with the items involved, they may be directly charged as transportation costs or added to the cost of such items (see paragraph 23). Where identification with the materials received cannot readily be made, transportation costs may be charged to the appropriate indirect cost accounts if the organization follows a consistent, equitable procedure in this respect.

50. *Travel costs.*

a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the organization. Travel costs are allowable subject to paragraphs b. through e. below, when they are directly attributable to specific work under an award or are incurred in the normal course of administration of the organization.

b. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used results in charges consistent with those normally allowed by the organization in its regular operations.

c. The difference in cost between first-class air accommodations and less than first-class air accommodations is unallowable except when less than first-class air accommodations are not reasonably available to meet necessary mission requirements, such as where less than first-class accommodations would (i) require circuitous routing, (ii) require travel during unreasonable hours, (iii) greatly increase the duration of the flight, (iv) result in additional costs which would offset the transportation savings, or (v) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

d. Necessary and reasonable costs of family movements and personnel movements of a special or mass nature are allowable, pursuant to paragraphs 40 and 41, subject to

allocation on the basis of work or time period benefited when appropriate. Advance agreements are particularly important.

e. Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must be approved. For purposes of this provision, foreign travel is defined as any travel outside of Canada and the United States and its territories and possessions. However, for an organization located in foreign countries, the term "foreign travel" means travel outside that country.

[Circular No. A-122]

Attachment C

Nonprofit Organizations not Subject to this Circular

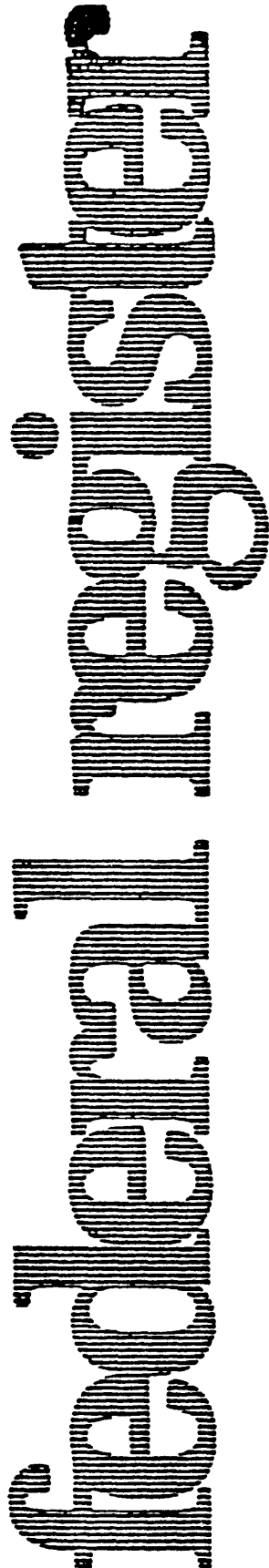
Aerospace Corporation, El Segundo, California
 Argonne Universities Association, Chicago, Illinois
 Associated Universities, Incorporated, Washington, D.C.
 Associated Universities for Research and Astronomy, Tucson, Arizona
 Atomic Casualty Commission, Washington, D.C.
 Battelle Memorial Institute, Headquartered in Columbus, Ohio
 Brookhaven National Laboratory, Upton, New York
 Center for Energy and Environmental Research (CEER), (University of Puerto Rico) Commonwealth of Puerto Rico
 Charles Stark Draper Laboratory, Incorporated, Cambridge, Massachusetts
 Comparative Animal Research Laboratory (CARL) (University of Tennessee), Oak Ridge, Tennessee
 Environmental Institute of Michigan, Ann Arbor, Michigan
 Hanford Environmental Health Foundation, Richland, Washington
 IIT Research Institute, Chicago, Illinois
 Institute for Defense Analysis, Arlington, Virginia
 Institute of Gas Technology, Chicago, Illinois
 Midwest Research Institute, Headquartered in Kansas City, Missouri
 Mitre Corporation, Bedford, Massachusetts
 Montana Energy Research and Development Institute, Inc. (MERDI), Butte, Montana
 National Radiological Astronomy Observatory, Green Bank, West Virginia
 Oak Ridge Associated Universities, Oak Ridge, Tennessee
 Project Management Corporation, Oak Ridge, Tennessee
 Rand Corporation, Santa Monica, California
 Research Triangle Institute, Research Triangle Park, North Carolina
 Riverside Research Institute, New York, New York
 Sandia Corporation, Albuquerque, New Mexico
 Southern Research Institute, Birmingham, Alabama
 Southwest Research Institute, San Antonio, Texas
 SRI International, Menlo Park, California
 Syracuse Research Corporation, Syracuse, New York

Universities Research Association, Incorporated (National Acceleration Lab), Argonne, Illinois
 Universities Corporation for Atmospheric Research, Boulder, Colorado
 Nonprofit Insurance Companies such as Blue Cross and Blue Shield Organizations
 Other nonprofit organizations as negotiated with awarding agencies.

[FR Doc. 80-20270 Filed 7-7-80; 8:48 am]

BILLING CODE 3110-01-M

[Note: This reprint incorporates corrections published at 46 FR 17185, Tuesday, March 17, 1981.]



Friday
April 27, 1984

Part VII

**Office of
Management and
Budget**

**Circular A-122: Cost Principles for
Nonprofit Organizations; "Lobbying"
Revision**

**Department of Defense
General Services Administration
National Aeronautics and Space
Administration**

**48 CFR Part 31
Federal Acquisition Regulation; Final Rule**

Issued in Washington, D.C., April 25, 1984.

Candice C. Bryant,

Deputy Associate Director for
Administration.

1. Insert a new paragraph in
Attachment B, as follows: "B21
Lobbying"

a. Notwithstanding other provisions of
this Circular, costs associated with the
following activities are unallowable:

a.(1) Attempts to influence the
outcomes of any Federal, State, or local
election, referendum, initiative, or
similar procedure, through in kind or
cash contributions, endorsements,
publicity, or similar activity;

a.(2) Establishing, administering,
contributing to, or paying the expenses
of a political party, campaign, political
action committee, or other organization
established for the purpose of
influencing the outcomes of elections;

a.(3) Any attempt to influence: (i) The
introduction of Federal or state
legislation; or (ii) the enactment or
modification of any pending Federal or
state legislation through communication
with any member or employee of the
Congress or state legislature (including
efforts to influence State or local
officials to engage in similar lobbying
activity), or with any government
official or employee in connection with
a decision to sign or veto enrolled
legislation;

a.(4) Any attempt to influence: (i) The
introduction of Federal or state
legislation; or (ii) the enactment or
modification of any pending Federal or
state legislation by preparing,
distributing or using publicity or
propaganda, or by urging members of
the general public or any segment
thereof to contribute to or participate in
any mass demonstration, march, rally,
fundraising drive, lobbying campaign or
letter writing or telephone campaign; or

a.(5) Legislative liaison activities,
including attendance at legislative
sessions or committee hearings,
gathering information regarding
legislation, and analyzing the effect of
legislation, when such activities are
carried on in support of or in knowing
preparation for an effort to engage in
unallowable lobbying.

b. The following activities are
excepted from the coverage of
subparagraph a:

b.(1) Providing a technical and factual
presentation of information on a topic
directly related to the performance of a
grant, contract or other agreement
through hearing testimony, statements

or letters to the Congress or a state
legislature, or subdivision, member, or
cognizant staff member thereof, in
response to a documented request
(including a Congressional Record
notice requesting testimony or
statements for the record at a regularly
scheduled hearing) made by the
recipient member, legislative body or
subdivision, or a cognizant staff member
thereof; provided such information is
readily obtainable and can be readily
put in deliverable form; and further
provided that costs under this section
for travel, lodging or meals are
unallowable unless incurred to offer
testimony at a regularly scheduled
Congressional hearing pursuant to a
written request for such presentation
made by the Chairman or Ranking
Minority Member of the Committee or
Subcommittee conducting such hearing.

b.(2) Any lobbying made unallowable
by section a.(3) to influence State
legislation in order to directly reduce the
cost, or to avoid material impairment of
the organization's authority to perform
the grant, contract, or other agreement.

b.(3) Any activity specifically
authorized by statute to be undertaken
with funds from the grant, contract, or
other agreement.

c.(1) When an organization seeks
reimbursement for indirect costs, total
lobbying costs shall be separately
identified in the indirect cost rate
proposal, and thereafter treated as other
unallowable activity costs in
accordance with the procedures of
paragraph B3 of Attachment A.

c.(2) Organizations shall submit as
part of their annual indirect cost rate
proposal a certification that the
requirements and standards of this
paragraph have been complied with.

c.(3) Organizations shall maintain
adequate records to demonstrate that
the determination of costs as being
allowable or unallowable pursuant to
paragraph B21 complies with the
requirements of this Circular.

c.(4) Time logs, calendars, or similar
records documenting the portion of an
employee's time that is treated as an
indirect cost shall not be required for the
purposes of complying with
subparagraph c, and the absence of such
records which are not kept pursuant to
the discretion of the grantee or
contractor, will not serve as a basis for
disallowing claims of allowable costs by
contesting estimates of unallowable
lobbying time spent by employees
during any calendar month unless: (1)
The employee engages in lobbying, as
defined in subparagraphs a and b, more
than 25% of his compensated hours of

employment during that calendar month; or (ii) the organization has materially misstated allowable or unallowable costs within the preceding five year period.

c.(5) Agencies shall establish procedures for resolving in advance, in consultation with OMB, any significant questions or disagreements concerning

the interpretation or application of paragraph B21. Any such advance resolution shall be binding in any subsequent settlements, audits or investigations with respect to that grant or contract for purposes of interpretation of this Circular; provided, however, that this shall not be construed to prevent a contractor or grantee from

contesting the lawfulness of such a determination.

2. Renumber subsequent paragraphs of Attachment B.

[FR Doc. 84-11284 Filed 4-26-84; 8:45 am]

[NOTE: This reprint incorporates corrections that are published in the Federal Register of Tuesday, May 8, 1984.]

SELLING CODE 3110-01-01



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

May 19, 1987

M-87-24

CIRCULAR NO. A-122, Revised
Transmittal Memorandum No. 2

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

SUBJECT: Cost Principles for Nonprofit Organizations

This memorandum revises OMB Circular A-122, "Cost Principles for Nonprofit Organizations, to clarify requirements for maintenance and access to records for costs associated with legislative lobbying and political activities.

In attachment B, section B21, "Lobbying," paragraph c.(4) is revised as follows:

c.(4) Time logs, calendars, or similar records shall not be required to be created for purposes of complying with this section during any particular calendar month when: (1) the employee engages in lobbying (as defined in paragraphs (a) and (b) above) 25 percent or less of the employee's compensated hours of employment during that calendar month, and (2) within the preceding five-year period, the organization has not materially misstated allowable or unallowable costs of any nature, including legislative lobbying costs. When conditions (1) and (2) above are met, organizations are not required to establish records to support the allowability of claimed costs in addition to records already required or maintained. Also, when conditions (1) and (2) above are met, the absence of time logs, calendars, or similar records will not serve as a basis for disallowing costs by contesting estimates of lobbying time spent by employees during a calendar month.


James C. Miller III
Director

OMB CIRCULAR A-110

***Uniform Administrative Requirements, Grants and
Agreements with Institutions of Higher Education,
Hospitals and Other Nonprofit Organizations***

federal register

FRIDAY, JULY 30, 1976



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- Publisher's Note—Attachment F, subparagraph 2h, of Circular A-110 is superseded by OMB Circular A-133, which appears in Appendix A-3 of this book. Circular A-133 was effective for audits for fiscal years beginning on or after January 1, 1990; i.e., for fiscal years ending on or after December 31, 1990. See Volume 1, chapter 4.

OFFICE OF MANAGEMENT AND BUDGET

GRANTS AND AGREEMENTS WITH INSTITUTIONS OF HIGHER EDUCATION, HOSPITALS, AND OTHER NONPROFIT ORGANIZATIONS

Uniform Administrative Requirements

ERRATA SHEET

OMB Circular No. A-110
Uniform Administrative Requirements for Grants and
Other Agreements with Institutions of Higher Education,
Hospitals, and Other Nonprofit Organizations

Page 32016

Paragraph 5 -- change "statue" to "statute"
Paragraph 11 -- change "contracting" to "contacting"
Attachment A, Paragraph 3 -- change "require" to "required"

Page 32017

Attachment D, Paragraph 1 -- change "coprights" to "copyrights"
Attachment E, Paragraph 2d -- change "non-expandable" to "non-expendable"

Page 32029

Attachment J, Paragraph 3c -- change "increases indirect" to "increase in direct"

Page 32030

Attachment J, Paragraph 9 -- delete "or contracts"
Attachment L, Paragraph 3 -- change "termination" to "terminate"
Attachment M, Paragraph 1 -- change "Cricular" to "Circular"
and "eixend" to "extend"

Page 32035

Attachment N, Paragraph 2c -- change "exempt" to "except"
Attachment N, Paragraph 6b(1)(a) should read as follows:
"(a) Activities sponsored by the same Federal agency."

Page 32036

Attachment N, Paragraph 6d(5) -- change "Adequately" to "Adequate"

Page 32037

Attachment O, Paragraph 4j -- change "Clear" to "Clean"

OFFICE OF MANAGEMENT AND
BUDGET

[Circular No. A-110]

GRANTS AND AGREEMENTS WITH INSTI-
TUTIONS OF HIGHER EDUCATION,
HOSPITALS, AND OTHER NONPROFIT
ORGANIZATIONS

Uniform Administrative Requirements

JULY 1, 1976.

To the heads of executive departments
and establishments.

Subject: Uniform administrative re-
quirements for grants and other agree-
ments with institutions of higher edu-
cation, hospitals, and other nonprofit
organizations

1. *Purpose.*—This Circular promul-
gates standards for obtaining consisten-
cy and uniformity among Federal agen-
cies in the administration of grants to,
and other agreements with, public and
private institutions of higher education,
public and private hospitals, and other
quasi-public and private nonprofit or-
ganizations. This Circular does not apply
to grants, contracts, or other agreements
between the Federal Government and
units of State or local governments
covered by Federal Management Cir-
cular 74-7.

2. *Effective date.*—The standards in
the attachments to this Circular will be
applied as soon as practicable but not
later than January 1, 1977.

3. *Supersession.*—This Circular res-
cinds and replaces parts III and IV of
the Appendix to Federal Management
Circular 73-7, Administration of college
and university research grants.

4. *Policy intent.*—The uniform stand-
ards and requirements included in the
attachments to this Circular replace the
varying and often conflicting require-
ments that have been imposed by Fed-
eral agencies as conditions of grants and
other agreements with recipients.

5. *Applicability and scope.*—Except as
provided below, the standards promul-
gated by this Circular are applicable to
all Federal agencies. If any statute ex-
pressly prescribes policies or specific re-
quirements that differ from the stand-
ards provided herein, the provisions of
the statute shall govern.

The provisions of the attachments of
this Circular shall be applied to subre-
cipients performing substantive work
under grants that are passed through or
awarded by the primary recipient if such
subrecipients are organizations de-
scribed in paragraph 1.

6. *Definitions.*

a. The term "grant" means money or
property provided in lieu of money paid
or furnished by the Federal Government
to recipients under programs that pro-
vide financial assistance or that provide
support or stimulation to accomplish a
public purpose. The term "other agree-
ments" does not include contracts which
are required to be entered into and ad-
ministered under procurement laws and
regulations. Grants and other agree-
ments exclude (a) technical assistance
programs, which provide services instead
of money, (b) assistance in the form of

general revenue sharing, loans, loan
guarantees, or insurance, and (c) direct
payments of any kind to individuals.

b. The term "recipient" includes the
following types of nonprofit organiza-
tions that are receiving Federal funds
from a Federal agency or through a
State or local government:

Public and private institutions of high-
er education; public and private hospi-
tals; and other quasi-public and pri-
vate nonprofit organizations such as (but
not limited to) community action agen-
cies, research institutes, educational as-
sociations, and health centers.

The term does not include foreign or
international organizations (such as
agencies of the United Nations) and
Government-owned contractor operated
facilities or research centers providing
continued support for mission-oriented,
large scale programs that are Govern-
ment-owned or controlled, or are de-
signed as federally-funded research and
development centers.

7. *Requests for exceptions.*—The Office
of Management and Budget may grant
exceptions from the requirements of this
Circular when exceptions are not pro-
hibited under existing laws.

However, in the interest of maximum
uniformity, exceptions from the re-
quirements of the Circular will be per-
mitted only in unusual cases. Agencies
may apply more restrictive requirements
to a class of recipients when approved by
the Office of Management and Budget.

8. *Attachments.*—The standards pro-
mulgated by this Circular are set forth
in the Attachments, which are:

Attachment A Cash depositories.
Attachment B Bonding and insurance.
Attachment C Retention and custodial re-
quirements for records.
Attachment D Program income.
Attachment E Cost sharing and matching.
Attachment F Standards for financial man-
agement systems.
Attachment G Financial reporting require-
ments.
Attachment H Monitoring and reporting
program performance.
Attachment I Payment requirements.
Attachment J Revision of financial plans.
Attachment K Closeout procedures.
Attachment L Suspension and termination
procedures.
Attachment M Standard form for applying
for federal assistance.
Attachment N Property management stand-
ards.
Attachment O Procurement standards.

9. *Exceptions for certain recipients.*—
Notwithstanding the provisions of para-
graph 7 if an applicant/recipient has a
history of poor performance, is not fi-
nancially stable, or its management sys-
tem does not meet the standards pre-
scribed in the Circular, Federal agencies
may impose additional requirements as
needed provided that such applicant/
recipient is notified in writing as to:
a. Why the additional standards are
being imposed;
b. what corrective action is needed.

Copies of such notifications shall be
sent to the Office of Management and
Budget and other agencies funding that
recipient at the same time the recipient
is notified.

10. *Responsibilities.*—Agencies respon-
sible for administering programs that in-
volve grants and other agreements with
recipients shall issue the appropriate
regulations necessary to implement the
provisions of this Circular. All portions
of such regulations that involve record-
keeping and/or reporting requirements
subject to the provisions of the Federal
Reports Act and OMB Circular A-40
must be submitted to OMB for clearance
before being introduced into use. Upon
request all regulations and instructions
implementing this Circular shall be
furnished to the Office of Management
and Budget. Agencies shall also desig-
nate an official to serve as the agency
representative on matters relating to the
implementation of this Circular. The
name and title of such representative
shall be furnished to the Office of Man-
agement and Budget not later than Au-
gust 30, 1976.

11. *Inquiries.*—Further information
concerning this Circular may be obtained
by contacting the Financial Manage-
ment Branch, Budget Review Division,
Office of Management and Budget,
Washington, D.C. 20503, telephone 395-
3993.

JAMES T. LYNN,
Director.

ATTACHMENT A.—CIRCULAR No. A-110

CASH DEPOSITORIES

1. This attachment sets forth standards
governing the use of banks and other in-
stitutions as depositories of funds advanced
under grants and other agreements.

2. Except for situations described in para-
graphs 3, 4, and 5, no Federal sponsoring
agency shall:

a. Require physical segregation of cash de-
positories for funds which are provided to a
recipient.

b. Establish any eligibility requirements
for cash depositories for funds which are pro-
vided to a recipient.

3. A separate bank account shall be require
when applicable letter-of-credit agreements
provide that drawdowns will be made when
the recipient's checks are presented to the
bank for payment.

4. Any moneys advanced to a recipient
which are subject to the control or regula-
tion of the United States or any of its officers,
agents or employees' (public moneys as de-
fined in Treasury Circular No. 176, as
amended) must be deposited in a bank with
Federal Deposit Insurance Corporation
(FDIC) insurance coverage and the balance
exceeding the FDIC coverage must be col-
laterally secured.

5. Consistent with the national goal of
expanding the opportunities for minority
business enterprises, recipients and sub-
recipients shall be encouraged to use minor-
ity banks (a bank which is owned at least 50
percent by minority group members).

ATTACHMENT B.—CIRCULAR No. A-110

BONDING AND INSURANCE

1. This attachment sets forth bonding and
insurance requirements for grants and other
agreements with recipients. No other bond-
ing and insurance requirements shall be im-
posed other than those normally required by
the recipient.

2. Except as otherwise required by law, a
grant or other agreement that requires the
contracting (or subcontracting) for con-
struction or facility improvements shall pro-
vide for the recipient to follow its own re-

requirements relating to bid guarantees, performance bonds, and payment bonds unless the construction contract or subcontract exceeds \$100,000. For those contracts or subcontracts exceeding \$100,000, the Federal agency may accept the bonding policy and requirements of the grante provided the Federal agency has made a determination that the Government's interest is adequately protected. If such a determination has not been made, the minimum requirements shall be as follows:

a. *A bid guarantee from each bidder equivalent to five percent of the bid price.*—The "bid guarantee" shall consist of a firm commitment such as a bid bond, certified check, or other negotiable instrument accompanying a bid as assurance that the bidder will, upon acceptance of his bid, execute such contractual documents as may be required within the time specified.

b. *A performance bond on the part of the contractor for 100 percent of the contract price.*—A "performance bond" is one executed in connection with a contract to secure fulfillment of all the contractor's obligations under such contract.

c. *A payment bond on the part of the contractor for 100 percent of the contract price.*—A "payment bond" is one executed in connection with a contract to assure payment as required by law of all persons supplying labor and material in the execution of the work provided for in the contract.

3. Where the Federal Government guarantees or insures the repayment of money borrowed by the recipient, the Federal agency, at its discretion, may require adequate bonding and insurance if the bonding and insurance requirements of the recipient are not deemed adequate to protect the interest of the Federal Government.

4. The Federal sponsoring agency may require adequate fidelity bond coverage where the recipient has no coverage and the bond is needed to protect the Government's interest.

5. Where bonds are required in the situations described above, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties (31 CFR 223).

ATTACHMENT C.—CIRCULAR No. A-110

RETENTION AND CUSTODIAL REQUIREMENTS FOR RECORDS

1. This attachment sets forth record retention requirements for grants and other agreements with recipients. Federal sponsoring agencies shall not impose any record retention requirements upon recipients other than those described below.

2. Except for paragraph 1, this attachment also applies to subrecipients as referred to in paragraph 3 of the basic circular.

3. Financial records, supporting documents, statistical records, and all other records pertinent to an agreement shall be retained for a period of three years, with the following qualifications:

a. If any litigation, claim or audit is started before the expiration of the 3-year period, the records shall be retained until all litigations, claims, or audit findings involving the records have been resolved.

b. Records for nonexpendable property acquired with Federal funds shall be retained for 3 years after its final disposition.

c. When records are transferred to or maintained by the Federal sponsoring agency, the 3-year retention requirement is not applicable to the recipient.

4. The retention period starts from the date of the submission of the final expenditure report or, for grants and other agreements that are renewed annually, from the date of the submission of the annual financial status report.

5. Recipient organizations should be authorized by the Federal sponsoring agency, if they so desire, to substitute microfilm copies in lieu of original records.

6. The Federal sponsoring agency shall request transfer of certain records to its custody from recipient organizations when it determines that the records possess long-term retention value. However, in order to avoid duplicate record-keeping, a Federal sponsoring agency may make arrangements with recipient organizations to retain any records that are continuously needed for joint use.

7. The head of the Federal sponsoring agency and the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any pertinent books, documents, papers, and records of the recipient organization and their subrecipients to make audits, examinations, excerpts and transcripts.

8. Unless otherwise required by law, no Federal sponsoring agency shall place restrictions on recipient organizations that will limit public access to the records of recipient organizations that are pertinent to a grant or agreement except when the agency can demonstrate that such records must be kept confidential and would have been exempted from disclosure pursuant to the Freedom of Information Act (5 U.S.C. 552) if the records had belonged to the Federal sponsoring agency.

ATTACHMENT D.—CIRCULAR No. A-110

PROGRAM INCOME

1. Federal sponsoring agencies shall apply the standards set forth in this attachment in requiring recipient organizations to account for program income related to projects financed in whole or in part with Federal funds. Program income represents gross income earned by the recipient from the federally supported activities. Such earnings exclude interest earned on advances and may include, but will not be limited to, income from service fees, sale of commodities, usage or rental fees, and royalties on patents and copyrights.

2. Interest earned on advances of Federal funds shall be remitted to the Federal agency except for interest earned on advances to States or instrumentalities of a State as provided by the Intergovernmental Cooperation Act of 1968 (Public Law 90-577).

3. Proceeds from the sale of real and personal property either provided by the Federal Government or purchased in whole or in part with Federal funds, shall be handled in accordance with Attachment N to this circular pertaining to property management.

4. Unless the agreement provides otherwise, recipients shall have no obligation to the Federal Government with respect to royalties received as a result of copyrights or patents produced under the grant or other agreement (see paragraph 8, Attachment N).

5. All other program income earned during the project period shall be retained by the recipient and, in accordance with the grant or other agreement, shall be:

a. Added to funds committed to the project by the Federal sponsoring agency and recipient organization and be used to further eligible program objectives;

b. Used to finance the non-Federal share of the project when approved by the Federal sponsoring agency; or

c. Deducted from the total project costs in determining the net costs on which the Federal share of costs will be based.

ATTACHMENT E.—CIRCULAR No. A-110

COST SHARING AND MATCHING

1. This attachment sets forth criteria and procedures for the allowability of cash and

in-kind contributions made by recipients or subrecipients (as referred to in paragraph 3 of the basic circular), or third parties in satisfying cost sharing and matching requirements of Federal sponsoring agencies. This attachment also establishes criteria for the evaluation of in-kind contributions made by third parties, and supplements the guidance set forth in Federal Management Circular 73-3 with respect to cost sharing on federally-sponsored research.

2. The following definitions apply for the purpose of this attachment:

a. *Project costs.*—Project costs are all allowable costs (as set forth in the applicable Federal cost principles) incurred by a recipient and the value of the in-kind contributions made by the recipient or third parties in accomplishing the objectives of the grant or other agreement during the project or program period.

b. *Cost sharing and matching.*—In general, cost sharing and matching represent that portion of project or program costs not borne by the Federal Government.

c. *Cash contributions.*—Cash contributions represent the recipient's cash outlay, including the outlay of money contributed to the recipient by non-Federal third parties.

d. *In-kind contributions.*—In-kind contributions represent the value of noncash contributions provided by the recipient and non-Federal third parties. Only when authorized by Federal legislation, may property purchased with Federal funds be considered as the recipient's in-kind contributions. In-kind contributions may be in the form of charges for real property and non-expandable personal property, and the value of goods and services directly benefiting and specifically identifiable to the project or program.

3. General guidelines for computing cost sharing or matching are as follows:

a. Cost sharing or matching may consist of:

(1) Charges incurred by the recipient as project costs. (Not all charges require cash outlays by the recipient during the project period; examples are depreciation and use charges for buildings and equipment.)

(2) Project costs financed with cash contributed or donated to the recipient by other non-Federal public agencies and institutions, and private organizations and individuals, and

(3) Project costs represented by services and real and personal property, or use thereof, donated by other non-Federal public agencies and institutions, and private organizations and individuals.

b. All contributions, both cash and in-kind, shall be accepted as part of the recipient's cost sharing and matching when such contributions meet all of the following criteria:

(1) Are verifiable from the recipient's records;

(2) Are not included as contributions for any other federally-assisted program;

(3) Are necessary and reasonable for proper and efficient accomplishment of project objectives;

(4) Are types of charges that would be allowable under the applicable cost principles;

(5) Are not paid by the Federal Government under another assistance agreement (unless the agreement is authorized by Federal law to be used for cost sharing or matching);

(6) Are provided for in the approved budget when required by the Federal agency; and

(7) Conform to other provisions of this attachment.

4. Values for recipient in-kind contributions will be established in accordance with the applicable cost principles.

5. Specific procedures for the recipients in establishing the value of in-kind contribu-

tions from non-Federal third parties are set forth below:

a. Valuation of volunteer services.—Volunteer services may be furnished by professional and technical personnel, consultants, and other skilled and unskilled labor. Volunteer services may be counted as cost sharing or matching if the service is an integral and necessary part of an approved program.

(1) **Rates for volunteer services.**—Rates for volunteers should be consistent with those paid for similar work in the recipient's organization. In those instances in which the required skills are not found in the recipient organization, rates should be consistent with those paid for similar work in the labor market in which the recipient competes for the kind of services involved.

(2) **Volunteers employed by other organizations.**—When an employer other than the recipient furnishes the services of an employee, these services shall be valued at the employee's regular rate of pay (exclusive of fringe benefits and overhead costs) provided these services are in the same skill for which the employee is normally paid.

b. Valuation of donated, expendable personal property.—Donated, expendable personal property includes such items as expendable equipment, office supplies, laboratory supplies or workshop and classroom supplies. Value assessed to expendable personal property included in the cost or matching share should be reasonable and should not exceed the market value of the property at the time of the donation.

c. Valuation of donated, nonexpendable personal property, buildings, and land or use thereof.

(1) The method used for charging cost sharing or matching for donated nonexpendable personal property, buildings and land may differ according to the purpose of the grant or other agreement as follows:

(a) If the purpose of the grant or other agreement is to assist the recipient in the acquisition of equipment, buildings or land, the total value of the donated property may be claimed as cost sharing or matching.

(b) If the purpose of the agreement is to support activities that require the use of equipment, buildings or land, depreciation or use charges for equipment and buildings may be made. The full value of equipment or other capital assets and fair rental charges for land may be allowed provided that the Federal agency has approved the charges.

(2) The value of donated property will be determined in accordance with the usual accounting policies of the recipient with the following qualifications:

(a) **Land and buildings.**—The value of donated land and buildings may not exceed its fair market value, at the time of donation to the recipient as established by an independent appraiser (e.g., certified real property appraiser or GSA representatives) and certified by a responsible official of the recipient.

(b) **Nonexpendable personal property.**—The value of donated nonexpendable personal property shall not exceed the fair market value of equipment and property of the same age and condition at the time of donation.

(c) **Use of space.**—The value of donated space shall not exceed the fair rental value of comparable space as established by an independent appraisal of comparable space and facilities in a privately-owned building in the same locality.

(d) **Loaned equipment.**—The value of loaned equipment shall not exceed its fair rental value.

6. The following requirements pertain to the recipient's supporting records for in-kind contributions from non-Federal third parties.

a. Volunteer services must be documented and, to the extent feasible, supported by the same methods used by the recipient for its employees.

b. The basis for determining the valuation for personal services, material, equipment, buildings and land must be documented.

ATTACHMENT F.—CIRCULAR NO. A-110
STANDARDS FOR FINANCIAL MANAGEMENT SYSTEMS

1. This attachment prescribes standards for financial management systems of recipients. Federal sponsoring agencies shall not impose additional standards on recipients unless specifically provided for in the applicable statutes (e.g., the Joint Funding Simplification Act, P.L. 93-310) or other attachments to this circular. However, Federal sponsoring agencies are encouraged to make suggestions and assist recipients in establishing or improving financial management systems when such assistance is needed or requested.

2. Recipients' financial management systems shall provide for:

a. Accurate, current and complete disclosure of the financial results of each federally sponsored project or program in accordance with the reporting requirements set forth in Attachment G to this circular. When a Federal sponsoring agency requires reporting on an accrual basis, the recipient shall not be required to establish an accrual accounting system but shall develop such accrual data for its reports on the basis of an analysis of the documentation on hand.

b. Records that identify adequately the source and application of funds for federally sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, and income.

c. Effective control over and accountability for all funds, property and other assets. Recipients shall adequately safeguard all such assets and shall assure that they are used solely for authorized purposes.

d. Comparison of actual outlays with budget amounts for each grant or other agreement. Whenever appropriate or required by the Federal sponsoring agency, financial information should be related to performance and unit cost data.

e. Procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the disbursement by the recipient, whenever funds are advanced by the Federal Government. When advances are made by a letter-of-credit method, the recipient shall make drawdowns as close as possible to the time of making disbursements.

f. Procedures for determining the reasonableness, allowability and allocability of costs in accordance with the provisions of the applicable Federal cost principles and the terms of the grant or other agreement.

g. Accounting records that are supported by source documentation.

h. Examinations in the form of audits or internal audits. Such audits shall be made by qualified individuals who are sufficiently independent of those who authorize the expenditure of Federal funds, to produce unbiased opinions, conclusions or judgments. They shall meet the independence criteria along the lines of Chapter J, Part 3 of the U.S. General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions. These examinations are intended to ascertain the effectiveness of the financial management systems and internal procedures that have been established to meet the terms and conditions of the agreements. It is not intended that each agreement awarded to the recipient be examined. Generally, examinations should be conducted on an organization-wide basis to test the fiscal integrity of

financial transactions, as well as compliance with the terms and conditions of the Federal grants and other agreements. Such tests would include an appropriate sampling of Federal agreements. Examinations will be conducted with reasonable frequency, on a continuing basis or at scheduled intervals, usually annually, but not less frequently than every two years. The frequency of these examinations shall depend upon the nature, size and the complexity of the activity. These examinations do not relieve Federal agencies of their audit responsibilities, but may affect the frequency and scope of such audits.

1. A systematic method to assure timely and appropriate resolution of audit findings and recommendations.

3. Primary recipients shall require subrecipients (as defined in paragraph 5 of the basic circular) to adopt the standards in paragraph 2, above except for the requirement in subparagraph 2e, regarding the use of the letter-of-credit method and that part of subparagraph 2a, regarding reporting forms and frequencies prescribed in Attachment G to this circular.

ATTACHMENT G.—CIRCULAR NO. A-110
FINANCIAL REPORTING REQUIREMENTS

1. This attachment prescribes uniform reporting procedures for recipients to: summarize expenditures made and Federal funds unexpended for each award, report the status of Federal cash advanced, request advances and reimbursement when the letter-of-credit method is not used; and promulgates standard forms incident thereto.

2. The following definitions apply for purposes of this attachment:

a. **Accrued expenditures.**—Accrued expenditures are the charges incurred by the recipient during a given period requiring the provision of funds for: (1) goods and other tangible property received; (2) services performed by employees, contractors, subrecipients, and other payees, and (3) other amounts becoming owed under programs for which no current services or performance is required.

b. **Accrued income.**—Accrued income is the sum of (1) earnings during a given period from (1) services performed by the recipient; and (11) goods and other tangible property delivered to purchasers; and (2) amounts becoming owed to the recipient for which no current services or performance is required by the recipient.

c. **Federal funds authorized.**—Federal funds authorized are the total amount of Federal funds obligated by the Federal Government for use by the recipient. This amount may include any authorized carry-over of unobligated funds from prior fiscal years when permitted by law or agency regulation.

d. **In-kind contributions.**—In-kind contributions are defined in Attachment E to this circular.

e. **Obligations.**—Obligations are the amounts of orders placed, contracts and grants awarded, services received, and similar transactions during a given period that will require payment by the recipient during the same or a future period.

f. **Outlays.**—Outlays or expenditures represent charges made to the project or program. They may be reported on a cash or accrual basis. For reports prepared on a cash basis, outlays are the sum of actual cash disbursements for direct charges for goods and services, the amount of indirect expense charged, the value of in-kind contributions applied, and the amount of cash advances and payments made to subrecipients. For reports prepared on an accrual basis, outlays are the sum of actual cash disbursements for direct charges for goods and services, the amount of indirect expense incurred, the value of in-

kind contributions applied, and the net increase (or decrease) in the amounts owed by the recipient for goods and other property received, for services performed by employees, contractors, subrecipients and other payees and other amounts becoming owed under programs for which no current services or performance are required.

g. *Program income.*—Program income is defined in Attachment D of this circular. It may be reported on a cash or accrual basis, whichever is used for reporting outlays.

h. *Unobligated balance.*—The unobligated balance is the portion of the funds authorized by the Federal sponsoring agency that has not been obligated by the recipient and is determined by deducting the cumulative obligations from the cumulative funds authorized.

i. *Unliquidated obligations.*—For reports prepared on a cash basis, unliquidated obligations represent the amount of obligations incurred by the recipient that has not been paid. For reports prepared on an accrued expenditure basis, they represent the amount of obligations incurred by the recipient for which an outlay has not been recorded.

3. Only the following forms will be authorized for obtaining financial information from recipients.

a. *Financial Status Report (Exhibit 1).*

(1) Each Federal sponsoring agency shall require recipients to use the standardized Financial Status Report to report the status of funds for all nonconstruction projects or programs. The Federal sponsoring agencies may, however, have the option of not requiring the Financial Status Report when the Request for Advance or Reimbursement (paragraph 4a) or Report of Federal Cash Transactions (paragraph 3b) is determined to provide adequate information to meet their needs, except that a final Financial Status Report shall be required at the completion of the project when the Request for Advance or Reimbursement form is used only for advances.

(2) The Federal sponsoring agency shall prescribe whether the report shall be on a cash or accrual basis. If the Federal sponsoring agency requires accrual information and the recipient's accounting records are not normally kept on the accrual basis, the recipient shall not be required to convert its accounting system, but shall develop such accrual information through best estimates based on an analysis of the documentation on hand.

(3) The Federal sponsoring agency shall determine the frequency of the Financial Status Report for each project or program considering the size and complexity of the particular project or program. However, the report shall not be required more frequently than quarterly or less frequently than annually except as provided in subparagraph 3a(1) above. A final report shall be required at the completion of the agreement.

(4) Federal sponsoring agencies shall require recipients to submit the Financial

Status Report (original and no more than two copies) no later than 30 days after the end of each specified reporting period for quarterly and semi-annual reports, and 90 days for annual and final reports. Extensions to reporting due dates may be granted upon request of the recipient.

b. *Report of Federal Cash Transactions (Exhibit 2).*

(1) When funds are advanced to recipients through letters of credit or with Treasury checks, the Federal sponsoring agencies shall require each recipient to submit a Report of Federal Cash Transactions. The Federal sponsoring agency shall use this report to monitor cash advanced to recipients and to obtain disbursement information for each agreement from the recipients.

(2) Federal sponsoring agencies may require forecasts of Federal cash requirements in the "Remarks" section of the report.

(3) When practical and deemed necessary, the Federal sponsoring agencies may require receipts to report in the "Remarks" section the amount of cash advances in excess of three days' requirements in the hands of subrecipients and to provide short narrative explanations of actions taken by the recipients to reduce the excess balances.

(4) Recipients shall be required to submit not more than the original and two copies of the Report of Federal Cash Transactions 15 working days following the end of each quarter. The Federal sponsoring agencies may require a monthly report from those recipients receiving advances totaling \$1 million or more per year.

(5) Federal sponsoring agencies may waive the requirement for submission of the Report of Federal Cash Transactions when monthly advances do not exceed \$10,000 per recipient, provided that such advances are monitored through other forms contained in this attachment, or if, in the Federal sponsoring agency's opinion, the recipient's accounting controls are adequate to minimize excessive Federal advances.

4. Except as noted below, only the following forms will be authorized for the recipients in requesting advances and reimbursements.

a. *Request for Advance or Reimbursement (Exhibit 3).*

(1) Each Federal sponsoring agency shall adopt the Request for Advance or Reimbursement as a standardized form for all nonconstruction programs when letters-of-credit or predetermined advance methods are not used. Federal sponsoring agencies, however, have the option of using this form for construction programs in lieu of the Outlay Report and Request for Reimbursement for Construction Programs (subparagraph 4b).

(2) Recipients shall be authorized to submit requests for advances and reimbursements at least monthly when letters-of-credit are not used. Federal sponsoring agencies shall not require the submission of more than the original and two copies of the Request for Advance or Reimbursement.

b. *Outlay report and request for reimbursement for construction programs (Exhibit 4).*

(1) Each Federal sponsoring agency shall adopt the Outlay Report and Request for Reimbursement for Construction Programs as the standardized format to be used for requesting reimbursement for construction programs. The Federal sponsoring agencies may, however, have the option of substituting the Request for Advance or Reimbursement Form (subparagraph 4a) when the Federal agencies determine that it provides adequate information to meet their needs.

(2) Recipients shall be authorized to submit requests for reimbursement at least monthly when letters-of-credit are not used. Federal sponsoring agencies shall not require more than the original and two copies of the Outlay Report and Request for Reimbursement for Construction Programs.

5. When the Federal sponsoring agencies need additional information in using these forms or more frequent reports, the following shall be observed:

a. When additional information is needed to comply with legislative requirements, Federal sponsoring agencies shall issue instructions to require recipients to submit such information under the "Remarks" section of the reports.

b. When necessary to meet specific program needs Federal sponsoring agencies shall submit the proposed reporting requirements to the Financial Management Branch, Budget Review Division, Office of Management and Budget for approval prior to submission of the reports for clearance under the provisions of OMB Circular No. A-40.

c. When a Federal sponsoring agency has determined that a recipient's accounting system does not meet the Standards for Financial Management contained in Attachment F to this circular, additional pertinent information to further monitor grants and other agreements may be obtained upon written notice to the recipient until such time as the system is brought up to standard.

d. The Federal sponsoring agency, in obtaining information as in paragraphs a, b and c above, must comply with report clearance requirements of the Office of Management and Budget Circular No. A-40, as revised.

6. Federal sponsoring agencies have the option of shading out any line item on any report that is unnecessary for decision-making purposes.

7. Federal sponsoring agencies should accept the identical information from the recipients in machine usable format or computer printouts in lieu of prescribed formats.

8. Federal sponsoring agencies may provide computer outputs to recipients when it will expedite or contribute to the accuracy of reporting.

9. Federal sponsoring agencies are authorized to reproduce these forms. The forms for reproduction purposes can be obtained from the Office of Management and Budget.

FINANCIAL STATUS REPORT

(Follow instructions on the back)

| | | | |
|---|---|---|---|
| 1. FEDERAL AGENCY AND ORGANIZATIONAL ELEMENT TO WHICH REPORT IS SUBMITTED 1. FEDERAL AGENCY OR OTHER IDENTIFYING NUMBER 2. FEDERAL GRANT OR OTHER IDENTIFYING NUMBER | 3. EMPLOYER IDENTIFICATION NUMBER 3. EMPLOYER IDENTIFICATION NUMBER | 4. FEDERAL GRANT OR OTHER IDENTIFYING NUMBER 4. FEDERAL GRANT OR OTHER IDENTIFYING NUMBER | 5. BASIS 5. BASIS <input type="checkbox"/> CASH <input type="checkbox"/> ACCRUAL |
| 6. PERIOD COVERED BY THIS REPORT 6. PERIOD COVERED BY THIS REPORT FROM (Month, day, year) TO (Month, day, year) | | 7. BASIS 7. BASIS <input type="checkbox"/> CASH <input type="checkbox"/> ACCRUAL | |

| | | | |
|--|---|--|--|
| 10. PROGRAMS/FUNCTIONS/ACTIVITIES ▶ a. Net outlays previously reported b. Total outlays this report period c. Less: Program income credits d. Net outlays this report period (Line b minus line c) e. Net outlays to date (Line a plus line d) f. Less: Non-Federal share of outlays g. Total Federal share of outlays (Line e minus line f) h. Total unliquidated obligations i. Less: Non-Federal share of unliquidated obligations shown on line h j. Federal share of unliquidated obligations k. Total Federal share of outlays and unliquidated obligations l. Total cumulative amount of Federal funds authorized m. Unobligated balance of Federal funds | STATUS OF FUNDS (a) (b) (c) (d) (e) (f) (g) \$ \$ \$ \$ \$ \$ \$ | 11. CERTIFICATION I certify to the best of my knowledge and belief that this report is correct and complete and that all outlays and unliquidated obligations are for the purposes set forth in the award documents. | SIGNATURE OF AUTHORIZED CERTIFYING OFFICIAL TYPED OR PRINTED NAME AND TITLE TELEPHONE (Area code, number and extension) |
|--|---|--|--|

| | | | |
|---|--|------------------------------|---------------------------|
| 11. REPORT TYPE (Place "F" in appropriate box) a. BASE <input type="checkbox"/> b. FEDERAL SHARE <input type="checkbox"/> c. FEDERAL SHARE <input type="checkbox"/> d. TOTAL AMOUNT <input type="checkbox"/> e. FEDERAL SHARE <input type="checkbox"/> f. FEDERAL SHARE <input type="checkbox"/> | 12. REMARKS Attach any explanations deemed necessary or information required by Federal sponsoring agency in compliance with previously regulations. | DATE REPORT SUBMITTED | PAGE OF PAGE OF |
|---|--|------------------------------|---------------------------|

STANDARD FORM 300 (7-78)
 Issued by Office of Management and Budget
 CIRCULAR NO. 2-118

INSTRUCTIONS

Please type or print legibly. Items 1, 2, 3, 6, 7, 9, 10d, 10e, 10g, 10i, 10l, 11a, and 12 are self-explanatory, specific instructions for other items are as follows:

| <i>Item</i> | <i>Entry</i> | <i>Item</i> | <i>Entry</i> |
|-------------|---|-------------|--|
| 4 | Enter the employer identification number assigned by the U.S. Internal Revenue Service or FICE (institution) code, if required by the Federal sponsoring agency. | 10c | Enter the amount of all program income realized in this period that is required by the terms and conditions of the Federal award to be deducted from total project costs. For reports prepared on a cash basis, enter the amount of cash income received during the reporting period. For reports prepared on an accrual basis, enter the amount of income earned since the beginning of the reporting period. When the terms or conditions allow program income to be added to the total award, explain in remarks, the source, amount and disposition of the income. |
| 5 | This space is reserved for an account number or other identifying numbers that may be assigned by the recipient. | 10d | Enter amount pertaining to the non-Federal share of program outlays included in the amount on line e. |
| 8 | Enter the month, day, and year of the beginning and ending of this project period. For formula grants that are not awarded on a project basis, show the grant period. | 10h | Enter total amount of unliquidated obligations for this project or program, including unliquidated obligations to subgrantees and contractors. Unliquidated obligations are: Cash basis—obligations incurred but not paid; Accrued expenditure basis—obligations incurred but for which an outlay has not been recorded. Do not include any amounts that have been included on lines a through g. On the final report, line h should have a zero balance. |
| 10 | The purpose of vertical columns (a) through (f) is to provide financial data for each program, function, and activity in the budget as approved by the Federal sponsoring agency. If additional columns are needed, use as many additional forms as needed and indicate page number in space provided in upper right; however, the totals of all programs, functions or activities should be shown in column (g) of the first page. For agreements pertaining to several Catalog of Federal Domestic Assistance programs that do not require a further functional or activity classification breakdown, enter under columns (a) through (f) the title of the program. For grants or other assistance agreements containing multiple programs where one or more programs require a further breakdown by function or activity, use a separate form for each program showing the applicable functions or activities in the separate columns. For grants or other assistance agreements containing several functions or activities which are funded from several programs, prepare a separate form for each activity or function when requested by the Federal sponsoring agency. | 10i | Enter the Federal share of unliquidated obligations shown on line h. The amount shown on this line should be the difference between the amounts on lines h and L. |
| 10a | Enter the net outlay. This amount should be the same as the amount reported in Line 10e of the last report. If there has been an adjustment to the amount shown previously, please attach explanation. Show zero if this is the initial report. | 10k | Enter the sum of the amounts shown on lines g and j. If the report is final the report should not contain any unliquidated obligations. |
| 10b | Enter the total gross program outlays (less rebates, refunds, and other discounts) for this report period, including disbursements of cash realized as program income. For reports that are prepared on a cash basis, outlays are the sum of actual cash disbursements for goods and services, the amount of indirect expense charged, the value of in-kind contributions applied, and the amount of cash advances and payments made to contractors and subgrantees. For reports prepared on an accrued expenditure basis, outlays are the sum of actual cash disbursements, the amount of indirect expense incurred, the value of in-kind contributions applied, and the net increase (or decrease) in the amounts owed by the recipient for goods and other property received and for services performed by employees, contractors, subgrantees, and other payees. | 10m | Enter the unobligated balance of Federal funds. This amount should be the difference between lines k and L. |
| | | 11b | Enter rate in effect during the reporting period. |
| | | 11c | Enter amount of the base to which the rate was applied. |
| | | 11d | Enter total amount of indirect cost charged during the report period. |
| | | 11e | Enter amount of the Federal share charged during the report period. If more than one rate was applied during the project period, include a separate schedule showing bases against which the indirect cost rates were applied, the respective indirect rates the month, day, and year the indirect rates were in effect, amounts of indirect expense charged to the project, and the Federal share of indirect expense charged to the project to date. |

| FEDERAL CASH TRANSACTIONS REPORT | | Approved by Office of Management and Budget, No. 80-RO182 | | | |
|--|--|---|--|-----------------------|-------------|
| (See instructions on the back. If report is for more than one grant or assistance agreement, attach completed Standard Form 273-A.) | | 1. Federal sponsoring agency and organizational element to which this report is submitted | | | |
| 2. RECIPIENT ORGANIZATION Name _____ Number and Street _____ City, State and ZIP Code: _____ | | 4. Federal grant or other identification number | 3. Recipient's account number or identifying number | | |
| | | 6. Letter of credit number | 7. Last payment voucher number | | |
| | | Give total number for this period | | | |
| | | 8. Payment Vouchers credited to your account | 9. Treasury checks received (whether or not deposited) | | |
| | | 10. PERIOD COVERED BY THIS REPORT | | | |
| 3. FEDERAL EMPLOYER IDENTIFICATION NO. | | FROM (month, day, year) | TO (month, day year) | | |
| 11. STATUS OF FEDERAL CASH (See specific instructions on the back) | a. Cash on hand beginning of reporting period | | \$ | | |
| | b. Letter of credit withdrawals | | | | |
| | c. Treasury check payments | | | | |
| | d. Total receipts (Sum of lines b and c) | | | | |
| | e. Total cash available (Sum of lines a and d) | | | | |
| | f. Gross disbursements | | | | |
| | g. Federal share of program income | | | | |
| | h. Net disbursements (Line f minus line g) | | | | |
| | i. Adjustments of prior periods | | | | |
| | j. Cash on hand end of period | | \$ | | |
| 12. THE AMOUNT SHOWN ON LINE 11J, ABOVE, REPRESENTS CASH REQUIREMENTS FOR THE ENSUING | | 13. OTHER INFORMATION | | | |
| a. Interest income | | \$ | | | |
| b. Advances to subgrantees or subcontractors | | \$ | | | |
| 14. REMARKS (Attach additional sheets of plain paper, if more space is required) | | | | | |
| 15. CERTIFICATION | | | | | |
| I certify to the best of my knowledge and belief that this report is true in all respects and that all disbursements have been made for the purpose and conditions of the grant or agreement | AUTHORIZED CERTIFYING OFFICIAL | SIGNATURE | | DATE REPORT SUBMITTED | |
| | | TYPED OR PRINTED NAME AND TITLE | | | |
| | | TELEPHONE | (Area Code) | (Number) | (Extension) |
| | | THIS SPACE FOR AGENCY USE | | | |

INSTRUCTIONS

Please type or print legibly. Items 1, 2, 8, 9, 10, 11d, 11e, 11h, and 15 are self explanatory, specific instructions for other items are as follows:

| <i>Item</i> | <i>Entry</i> | <i>Entry</i> | <i>Item</i> |
|-------------|---|--|--|
| 3 | Enter employer identification number assigned by the U.S. Internal Revenue Service or the FICE (institution) code. If this report covers more than one grant or other agreement, leave items 4 and 5 blank and provide the information on Standard Form 272-A, Report of Federal Cash Transactions—Continued; otherwise; | employee's share of benefits if treated as a direct cost, interdepartmental charges for supplies and services, and the amount to which the recipient is entitled for indirect costs. | |
| 4 | Enter Federal grant number, agreement number, or other identifying numbers if requested by sponsoring agency. | 11g | Enter the Federal share of program income that was required to be used on the project or program by the terms of the grant or agreement. |
| 5 | This space reserved for an account number or other identifying number that may be assigned by the recipient. | 11i | Enter the amount of all adjustments pertaining to prior periods affecting the ending balance that have not been included in any lines above. Identify each grant or agreement for which adjustment was made, and enter an explanation for each adjustment under "Remarks." Use plain sheets of paper if additional space is required. |
| 6 | Enter the letter of credit number that applies to this report. If all advances were made by Treasury check, enter "NA" for not applicable and leave items 7 and 8 blank. | 11j | Enter the total amount of Federal cash on hand at the end of the reporting period. This amount should include all funds on deposit, imprest funds, and undeposited funds (line e, less line h, plus or minus line i). |
| 7 | Enter the voucher number of the last letter-of-credit payment voucher (Form TUS 5401) that was credited to your account. | 12 | Enter the estimated number of days until the cash on hand, shown on line 11j, will be expended. If more than three days cash requirements are on hand, provide an explanation under "Remarks" as to why the drawdown was made prematurely, or other reasons for the excess cash. The requirement for the explanation does not apply to prescheduled or automatic advances. |
| 11a | Enter the total amount of Federal cash on hand at the beginning of the reporting period including all of the Federal funds on deposit, imprest funds, and undeposited Treasury checks. | 13a | Enter the amount of interest earned on advances of Federal funds but not remitted to the Federal agency. If this includes any amount earned and not remitted to the Federal sponsoring agency for over 60 days, explain under "Remarks." Do not report interest earned on advances to States. |
| 11b | Enter total amount of Federal funds received through payment vouchers (Form TUS 5401) that were credited to your account during the reporting period. | 13b | Enter amount of advance to secondary recipients included in item 11h. |
| 11c | Enter the total amount of all Federal funds received during the reporting period through Treasury checks, whether or not deposited. | 14 | In addition to providing explanations as required above, give additional explanation deemed necessary by the recipient and for information required by the Federal sponsoring agency in compliance with governing legislation. Use plain sheets of paper if additional space is required. |
| 11f | Enter the total Federal cash disbursements, made during the reporting period, including cash received as program income. Disbursements as used here also include the amount of advances and payments less refunds to subgrantees or contractors, the gross amount of direct salaries and wages, including the | | |

| FEDERAL CASH TRANSACTIONS REPORT | | Approved by Office of Management and Budget, No. 80-RO182 | |
|--|--|--|------------------------------|
| CONTINUATION | | 1. FEDERAL SPONSORING AGENCY AND ORGANIZATIONAL ELEMENT TO WHICH THIS REPORT IS SUBMITTED | |
| (This form is completed and attached to Standard Form 272 only when reporting more than one grant or assistance agreement.) | | 2. RECIPIENT ORGANIZATION (Give name only as shown in item 2, SF 272) | |
| | | 3. PERIOD COVERED BY THIS REPORT (As shown on SF 272) | |
| | | FROM (Month, day, year) | TO (Month, day, year) |
| 4. List information below for each grant or other agreement covered by this report. Use additional forms if more space is required. | | | |
| FEDERAL GRANT OR OTHER IDENTIFICATION <i>(Show a subdivision by other identifying numbers if required by the Federal Sponsoring Agency)</i> | RECIPIENT ACCOUNT NUMBER OR OTHER IDENTIFYING NUMBER | FEDERAL SHARE OF NET DISBURSEMENTS | |
| (a) | (b) | NET DISBURSEMENTS (Gross disbursements less program income received) FOR REPORTING PERIOD | CUMULATIVE NET DISBURSEMENTS |
| | | \$ (c) | \$ (d) |
| | | \$ | \$ |
| 5. TOTALS (Should correspond with amounts shown on SF 272 as follows: column (c) the same as line 11k; column (d) the sum of lines 11k and 11l, of this SF 272 and cumulative disbursements shown on last report. Attach explanation of any differences.) | | \$ | \$ |

| | | | | |
|---|---|--|--|-----------|
| <h2 style="margin: 0;">REQUEST FOR ADVANCE OR REIMBURSEMENT</h2> <p style="font-size: small; margin: 5px 0;">(See instructions on back)</p> | | Approved by Office of Management and Budget, No. 80-RO183 | PAGE OF PAGES | |
| 1. FEDERAL SPONSORING AGENCY AND ORGANIZATIONAL ELEMENT TO WHICH THIS REPORT IS SUBMITTED | | 1. TYPE OF PAYMENT REQUESTED a. "X" one, or both boxes <input type="checkbox"/> ADVANCE <input type="checkbox"/> REIMBURSEMENT b. "X" the applicable box <input type="checkbox"/> FINAL <input type="checkbox"/> PARTIAL | 2. BASIS OF REQUEST <input type="checkbox"/> CASH <input type="checkbox"/> ACCRUAL | |
| 6. EMPLOYER IDENTIFICATION NUMBER | 7. RECIPIENT'S ACCOUNT NUMBER OR IDENTIFYING NUMBER | 4. FEDERAL GRANT OR OTHER IDENTIFYING NUMBER ASSIGNED BY FEDERAL AGENCY | | |
| 8. RECIPIENT ORGANIZATION | | 5. PERIOD COVERED BY THIS REQUEST FROM (month, day, year) TO (month, day, year) | | |
| Name Number and Street City, State and ZIP Code | | 10. PAYEE (Where check is to be sent is different than item 9) Name Number and Street City, State and ZIP Code | | |
| 11. COMPUTATION OF AMOUNT OF REIMBURSEMENTS/ADVANCES REQUESTED | | | | |
| PROGRAMS/FUNCTIONS/ACTIVITIES ▶ | (a) | (b) | (c) | TOTAL |
| a. Total program outlays to date (As of date) | \$ | \$ | \$ | \$ |
| b. Less: Cumulative program income | | | | |
| c. Net program outlays (Line a minus line b) | | | | |
| d. Estimated net cash outlays for advance period | | | | |
| e. Total (Sum of lines c & d) | | | | |
| f. Non-Federal share of amount on line e | | | | |
| g. Federal share of amount on line e | | | | |
| h. Federal payments previously requested | | | | |
| i. Federal share now requested (Line g minus line h) | | | | |
| j. Advances required by month, when requested by Federal grantor agency for use in making pre-scheduled advances | 1st month | | | |
| | 2nd month | | | |
| | 3rd month | | | |
| 12. ALTERNATE COMPUTATION FOR ADVANCES ONLY | | | | |
| a. Estimated Federal cash outlays that will be made during period covered by the advance | | | \$ | |
| b. Less: Estimated balance of Federal cash on hand as of beginning of advance period | | | | |
| c. Amount requested (Line a minus line b) | | | \$ | |
| 13. CERTIFICATION | | | | |
| I certify that to the best of my knowledge and belief the data above are correct and that all outlays were made in accordance with the grant conditions or other agreement and that payment is due and has not been previously requested. | SIGNATURE OF AUTHORIZED CERTIFYING OFFICIAL | | DATE REQUEST SUBMITTED | |
| | TYPED OR PRINTED NAME AND TITLE | | | |
| | TELEPHONE | Area Code | Number | Extension |

This space for agency use

NOTICES

INSTRUCTIONS

Please type or print legibly. Items 1, 3, 5, 9, 10, 11c, 11e, 11f, 11g, 11i, 12 and 13 are self-explanatory; specific instructions for other items are as follows:

| <i>Item</i> | <i>Entry</i> | <i>Item</i> | <i>Entry</i> |
|-------------|--|-------------|---|
| 2 | Indicate whether request is prepared on cash or accrued expenditure basis. All requests for advances shall be prepared on a cash basis. | | use as many additional forms as needed and indicate page number in space provided in upper right; however, the summary totals of all programs, functions, or activities should be shown in the "total" column on the first page. |
| 4 | Enter the Federal grant number, or other identifying number assigned by the Federal sponsoring agency. If the advance or reimbursement is for more than one grant or other agreement, insert N/A; then, show the aggregate amounts. On a separate sheet, list each grant or agreement number and the Federal share of outlays made against the grant or agreement. | 11a | Enter in "as of date", the month, day, and year of the ending of the accounting period to which this amount applies. Enter program outlays to date (net of refunds, rebates, and discounts), in the appropriate columns. For requests prepared on a cash basis, outlays are the sum of actual cash disbursements for goods and services, the amount of indirect expenses charged, the value of in-kind contributions applied, and the amount of cash advances and payments made to subcontractors and subrecipients. For requests prepared on an accrued expenditure basis, outlays are the sum of the actual cash disbursements, the amount of indirect expenses incurred, and the net increase (or decrease) in the amounts owed by the recipient for goods and other property received and for services performed by employees, contracts, subgrantees and other payees. |
| 6 | Enter the employer identification number assigned by the U.S. Internal Revenue Service, or the FICE (Institution) code if requested by the Federal agency. | 11b | Enter the cumulative cash income received to date, if requests are prepared on a cash basis. For requests prepared on an accrued expenditure basis, enter the cumulative income earned to date. Under either basis, enter only the amount applicable to program income that was required to be used for the project or program by the terms of the grant or other agreement. |
| 7 | This space is reserved for an account number or other identifying number that may be assigned by the recipient. | 11d | Only when making requests for advance payments, enter the total estimated amount of cash outlays that will be made during the period covered by the advance. |
| 8 | Enter the month, day, and year for the beginning and ending of the period covered in this request. If the request is for an advance or for both an advance and reimbursement, show the period that the advance will cover. If the request is for reimbursement, show the period for which the reimbursement is requested. | 13 | Complete the certification before submitting this request. |
| Note: | The Federal sponsoring agencies have the option of requiring recipients to complete items 11 or 12, but not both. Item 12 should be used when only a minimum amount of information is needed to make an advance and outlay information contained in item 11 can be obtained in a timely manner from other reports. | | |
| 11 | The purpose of the vertical columns (a), (b), and (c), is to provide space for separate cost breakdowns when a project has been planned and budgeted by program, function, or activity. If additional columns are needed, | | |

| | | | | | | |
|---|-------------------------------|--|-----|---|---|--|
| OUTLAY REPORT AND REQUEST FOR REIMBURSEMENT FOR CONSTRUCTION PROGRAMS (See instructions on back) | | Approved by Office of Management and Budget, No. 80-RO181 | | PAGE OF PAGES | | |
| | | 1. TYPE OF REQUEST <input type="checkbox"/> FINAL <input type="checkbox"/> PARTIAL | | 2. BASIS OF REQUEST <input type="checkbox"/> CASH <input type="checkbox"/> ACCRUAL | | |
| 3. FEDERAL SPONSORING AGENCY AND ORGANIZATIONAL ELEMENT TO WHICH THIS REPORT IS SUBMITTED | | 4. FEDERAL GRANT OR OTHER IDENTIFYING NUMBER ASSIGNED BY FEDERAL AGENCY | | 5. PARTIAL PAYMENT REQUEST NO. | | |
| 6. EMPLOYER IDENTIFICATION NUMBER | | 7. RECIPIENT ACCOUNT OR OTHER IDENTIFYING NUMBER | | PERIOD COVERED BY THIS REPORT | | |
| | | | | FROM (Month, day, year) TO (Month, day, year) | | |
| 8. RECIPIENT ORGANIZATION Name : No. and Street : City, State and ZIP Code : | | 10. PAYEE (Where check should be sent if different than those 8) Name : No. and Street : City, State and ZIP Code : | | | | |
| 11. STATUS OF FUNDS | | | | | | |
| CLASSIFICATION | PROGRAMS—FUNCTIONS—ACTIVITIES | | | TOTAL | | |
| | (a) | (b) | (c) | | | |
| a. Administrative expense | \$ | \$ | \$ | \$ | | |
| b. Preliminary expense | | | | | | |
| c. Land, structures, right-of-way | | | | | | |
| d. Architectural engineering basic fees | | | | | | |
| e. Other architectural engineering fees | | | | | | |
| f. Project inspection fees | | | | | | |
| g. Land development | | | | | | |
| h. Relocation expense | | | | | | |
| i. Relocation payments to individuals and businesses | | | | | | |
| j. Demolition and removal | | | | | | |
| k. Construction and project improvement cost | | | | | | |
| l. Equipment | | | | | | |
| m. Miscellaneous cost | | | | | | |
| n. Total cumulative to date (sum of lines a thru m) | | | | | | |
| o. Deductions for program income | | | | | | |
| p. Net cumulative to date (Line n minus line o) | | | | | | |
| q. Federal share to date | | | | | | |
| r. Rehabilitation grants (100% reimbursement) | | | | | | |
| s. Total Federal share (sum of lines q and r) | | | | | | |
| t. Federal payments previously requested | | | | | | |
| u. Amount requested for reimbursement | \$ | \$ | \$ | \$ | | |
| v. Percentage of physical completion of project | % | % | % | % | | |
| 12. CERTIFICATION I certify that to the best of my knowledge and belief the billed costs or disbursements are in accordance with the terms of the project and that the reimbursement represents the Federal share due which has not been previously requested and that an inspection has been performed and all work is in accordance with the terms of the award. | | a. RECIPIENT | | SIGNATURE OF AUTHORIZED CERTIFYING OFFICIAL | DATE REPORT SUBMITTED | |
| | | | | TYPED OR PRINTED NAME AND TITLE | TELEPHONE (Area code, number and extension) | |
| | | b. Representative certifying to line 11v. | | SIGNATURE OF AUTHORIZED CERTIFYING OFFICIAL | | DATE SIGNED |
| | | | | TYPED OR PRINTED NAME AND TITLE | | TELEPHONE (Area code number and extension) |

INSTRUCTIONS

Please type or print legibly. Items 3, 4, 5, 8, 9, 10, 11s, and 11v are self-explanatory; specific instructions for other items are as follows:

| <i>Item</i> | <i>Entry</i> | <i>Item</i> | <i>Entry</i> |
|-------------|--|-------------|---|
| 1 | Mark the appropriate box. If the request is final, the amounts billed should represent the final cost of the project. | 11j | Enter gross salaries and wages of employees of the recipient and payments to third party contractors directly engaged in performing demolition or removal of structures from developed land. All proceeds from the sale of salvage or the removal of structures should be credited to this account; thereby reflecting net amounts if required by the Federal agency. |
| 2 | Show whether amounts are computed on an accrued expenditure or cash disbursement basis. | 11k | Enter those amounts associated with the actual construction of, addition to, or restoration of a facility. Also, include in this category, the amounts for project improvements such as sewers, streets, landscaping, and lighting. |
| 6 | Enter the employer identification number assigned by the U.S. Internal Revenue Service (or FICE (Institution) code if requested by the Federal agency). | 11l | Enter amounts for all equipment, both fixed and movable, exclusive of equipment used for construction. For example, permanently attached laboratory tables, built-in audio visual systems, movable desks, chairs, and laboratory equipment. |
| 7 | This space is reserved for an account number or other identifying number that may be assigned by the recipient. | 11m | Enter the amounts for all items not specifically mentioned above. |
| 11 | The purpose of vertical columns (a) through (c) is to provide space for separate cost breakdowns when a large project has been planned and budgeted by program, function or activity. If additional columns are needed, use as many additional forms as needed and indicate page number in space provided in upper right; however, the summary totals of all programs, functions, or activities should be shown in the "total" column on the first page. All amounts are reported on a cumulative basis. | 11n | Enter the total cumulative amount to date which should be the sum of lines a through m. |
| 11a | Enter amounts expended for such items as travel, legal fees, rental of vehicles and any other administrative expenses. Include the amount of interest expense when authorized by program legislation. Also show the amount of interest expense on a separate sheet. | 11o | Enter the total amount of program income applied to the grant or contract agreement except income included on line j. Identify on a separate sheet of paper the sources and types of the income. |
| 11b | Enter amounts pertaining to the work of locating and designing, making surveys and maps, sinking test holes, and all other work required prior to actual construction. | 11p | Enter the net cumulative amount to date which should be the amount shown on line n minus the amount on line o. |
| 11c | Enter all amounts directly associated with the acquisition of land, existing structures and related right-of-way. | 11q | Enter the Federal share of the amount shown on line p. |
| 11d | Enter basic fees for services of architectural engineers. | 11r | Enter the amount of rehabilitation grant payments made to individuals when program legislation provides 100 percent payment by the Federal agency. |
| 11e | Enter other architectural engineering services. Do not include any amounts shown on line d. | 11t | Enter the total amount of Federal payments previously requested, if this form is used for requesting reimbursement. |
| 11f | Enter inspection and audit fees of construction and related programs. | 11u | Enter the amount now being requested for reimbursement. This amount should be the difference between the amounts shown on lines s and t. If different, explain on a separate sheet. |
| 11g | Enter all amounts associated with the development of land where the primary purpose of the grant is land improvement. The amount pertaining to land development normally associated with major construction should be excluded from this category and entered on line k. | 12a | To be completed by the recipient official who is responsible for the operation of the program. The date should be the actual date the form is submitted to the Federal agency. |
| 11h | Enter the dollar amounts used to provide relocation advisory assistance and net costs of replacement housing (last resort). Do not include amounts needed for relocation administrative expenses; these amounts should be included in amounts shown on line a. | 12b | To be completed by the official representative who is certifying to the percent of project completion as provided for in the terms of the grant or agreement. |
| 11i | Enter the amount of relocation payments made by the recipient to displaced persons, farms, business concerns, and nonprofit organizations. | | |

ATTACHMENT H.—CIRCULAR No. A-110
MONITORING AND REPORTING PROGRAM
PERFORMANCE

1. This attachment sets forth the procedures for monitoring and reporting program performance of recipients.

2. Recipients shall monitor the performance under grants and other agreements and, where appropriate, ensure that time schedules are being met, projected work units by time periods are being accomplished, and other performance goals are being achieved. This review shall be made for each program, function, or activity of each agreement as set forth in the approved application or award document.

3. Recipients shall submit a performance report (technical report) for each agreement that briefly presents the following information for each program, function, or activity involved as prescribed by the Federal sponsoring agency:

a. A comparison of actual accomplishments with the goals established for the period, the findings of the investigator, or both. If the output of programs or projects can be readily quantified, such quantitative data should be related to cost data for computation of unit costs.

b. Reasons why established goals were not met.

c. Other pertinent information including, when appropriate, analysis and explanation of cost overruns or high unit costs.

4. Except as provided in a and b below, and in subparagraph 3a(1), Attachment G, recipients shall submit the performance or technical reports to Federal sponsoring agencies and the Financial Status Reports covering the same period in the frequency established by Attachment G of this Circular and, where appropriate, a final technical or performance report after completion of the project on a date specified by the Federal sponsoring agency. The Federal sponsoring agency shall prescribe the frequency with which the performance reports will be submitted with the request for advance or reimbursement when that form is used in lieu of the Financial Status Report. Except as provided for in paragraph 5 below, performance reports shall not be required more frequently than quarterly or less frequently than annually. Federal sponsoring agencies may waive the requirement for recipients to submit performance reports with the financial reports under the following circumstances:

a. When the recipient is required to submit a performance report with a continuation or renewal application.

b. When the Federal sponsoring agency determines that on-site technical inspections and certified completion data will be sufficient to evaluate construction projects.

c. When the Federal sponsoring agency requests annual financial reports on a fiscal year basis but it is necessary to get annual progress reports on a calendar year basis.

5. Between the required performance reporting dates, events may occur that have significant impact upon the project or program. In such instances, the recipient shall inform the Federal sponsoring agency as soon as the following types of conditions become known:

a. Problems, delays, or adverse conditions that will materially affect the ability to attain program objectives, prevent the meeting of time schedules and goals, or preclude the attainment of project work units by established time periods. This disclosure shall be accompanied by a statement of the action taken, or contemplated, and any Federal assistance needed to resolve the situation.

b. Favorable developments or events that enable time schedules to be met sooner than

anticipated or more work units to be produced than originally projected.

6. If any performance review conducted by the recipient discloses the need for change in the budget estimates in accordance with the criteria established in Attachment J of this Circular, the recipient shall submit a request for budget revision.

7. The Federal sponsoring agency shall make site visits as frequently as practicable to:

a. Review program accomplishments and management control systems, and

b. Provide such technical assistance as may be required.

8. Federal sponsoring agencies shall submit proposed technical and performance reports to the Office of Management and Budget for approval in accordance with the report clearance requirements of OMB Circular No. A-40 as revised.

ATTACHMENT I.—CIRCULAR No. A-110

PAYMENT REQUIREMENTS

1. This attachment establishes the required methods of making payments to recipients. These methods will minimize the time elapsing between the disbursement by these recipients and the transfer of funds from the United States Treasury to these recipients whether such disbursement occurs prior to or subsequent to the transfer of funds.

2. Payments can be made to recipients through a letter-of-credit, an advance by Treasury check, or a reimbursement by Treasury check. The following definitions apply for the purpose of this attachment:

a. *Letter-of-Credit*.—A letter-of-credit is an instrument certified by an authorized official of a Federal sponsoring agency that authorizes a recipient to draw funds when needed from the Treasury, through a Federal Reserve bank and the recipient's commercial bank, in accordance with the provisions of Treasury Circular No. 1075, as revised.

b. *Advance by Treasury check*.—An advance by Treasury check is a payment made by a Treasury check to a recipient upon its request before outlays are made by the recipient, or through the use of predetermined payment schedules.

c. *Reimbursement by Treasury check*.—A reimbursement by Treasury check is a Treasury check paid to a recipient upon request for reimbursement from the recipient.

3. Except for construction grants and other construction agreements for which optional payment methods are authorized, as described in paragraph 5, the letter-of-credit method shall be used by Federal sponsoring agencies if all of the following conditions exist:

a. If there is or will be a continuing relationship between a recipient and a Federal sponsoring agency for at least a 12-month period and the total amount of advance payments expected to be received within that period from the Federal sponsoring agency is \$250,000 or more, as prescribed by Treasury Circular No. 1075. For joint funded projects the Treasury has authorized a dollar criteria of \$120,000.

b. If the recipient has established or demonstrated to the Federal sponsoring agency the willingness and ability to maintain procedures that will minimize the time elapsing between the transfer of funds and their disbursement by the recipient.

c. If the recipient's financial management system meets the standards for fund control and accountability prescribed in Attachment F to this Circular, "Standards for Financial Management Systems."

4. The method of advancing funds by Treasury check shall be used, in accordance with the provisions of Treasury Circular No.

1075, when the recipient meets all of the requirements specified in paragraph 3, above, except those in subparagraph 3a.

5. The reimbursement by Treasury check method shall be the preferred method if the recipient does not meet the requirements specified in subparagraphs 3b and 3c, above. At the option of the Federal sponsoring agency, this method may also be used on any construction agreement, or if the major portion of the program is accomplished through private market financing or Federal loans, and the Federal assistance constitutes a minor portion of the program. When the reimbursement method is used, the Federal sponsoring agency shall make payment within thirty days after receipt of the billing, unless the billing is improper.

6. When the letter-of-credit procedure is used, the recipient shall be issued one consolidated letter-of-credit whenever possible to cover anticipated cash needs for all grants and other agreements awarded by the sponsoring agency. Likewise, to the extent possible, when the advance by Treasury check method is used, advances should be consolidated (pooled) for all grants and other agreements made by the sponsoring agency to that recipient.

7. Unless otherwise required by law, Federal sponsoring agencies shall not withhold payments for proper charges made by recipients at any time during the project or program period unless (a) a recipient has failed to comply with the program objectives, award conditions, or Federal reporting requirements; or (b) the recipient is indebted to the United States, and collection of the indebtedness will not impair accomplishment of the objectives of a project or program sponsored by the United States.

Under such conditions, the sponsoring agency may, upon reasonable notice, inform the recipient that payments will not be made for obligations incurred after a specified date until the conditions are corrected or the indebtedness to the Federal Government is liquidated.

ATTACHMENT J.—CIRCULAR No. A-110

REVISION OF FINANCIAL PLANS

1. This attachment sets forth criteria and procedures to be followed by Federal sponsoring agencies in requiring recipients to report deviations from financial plans and to request approvals for financial plan revisions.

2. The financial plan is the financial expression of the project or program as approved during the application and/or award process. It may include either the Federal and non-Federal share, or only the Federal share, depending upon sponsoring agency requirements. It should be related to performance for program evaluation purposes whenever appropriate and required by the Federal sponsoring agency.

3. For nonconstruction awards, recipients shall immediately request approvals from Federal sponsoring agencies when there is reason to believe that within the next seven days a revision will be necessary for the following reasons:

a. Changes in the scope or the objective of the project or program.

b. The need for additional Federal funding.

c. The transfer of amounts budgeted for indirect costs to absorb increases indirect costs or vice versa. If approval is required by the Federal sponsoring agency.

d. The expenditures as require approval in accordance with FMC 73-8, "Cost Principles for Educational Institutions." For all other awards, approval requirements for other items of expenditures may be imposed if they are consistent with those in FMC 73-8. No other requirements for specific items may be

imposed unless a deviation has been approved by the Office of Management and Budget.

e. Recipients plan to transfer funds allotted for training allowances (direct payments to trainees) to other categories of expense.

4. None of the substantive programmatic work under a grant or other agreement may be subcontracted or transferred without prior approval of the Federal sponsoring agency. This provision does not apply to the purchase of supplies, material, equipment, or general support services.

5. The Federal sponsoring agency may also, at its option, restrict transfers of funds among direct cost categories for awards in which the Federal share exceeds \$100,000 when the cumulative amount of such transfers exceeds or is expected to exceed five percent of the total budget as last approved by the sponsoring agency. The same criteria shall apply to the cumulative amount of transfers among programs, functions, and activities when budgeted separately for an award, except that the Federal sponsoring agency shall permit no transfer that would cause any Federal appropriation, or part thereof, to be used for purposes other than those intended.

6. All other changes to nonconstruction budgets, except for the changes described in paragraph 8, below, do not require approval. This includes the use of recipient funds in furtherance of program objectives over and above the recipient minimum share included in the approved budget.

7. For construction awards, recipients shall request prior approvals promptly from Federal sponsoring agencies for budget revisions wherever:

a. The revision results from changes in the scope or the objective of the project or program, and

b. The revision increases the budget amounts of Federal funds needed to complete the project.

8. When a Federal sponsoring agency makes an award that provides support for both construction and nonconstruction work, the Federal sponsoring agency may require the recipient to request prior approval from the Federal sponsoring agency before making any fund or budget transfers between the two types of work supported.

9. For both construction and nonconstruction awards, Federal sponsoring agencies shall require recipients to notify the Federal sponsoring agency promptly whenever the amount of Federal authorized funds is expected to exceed the needs of the recipient by more than \$5,000 or five percent of the Federal award, whichever is greater. This notification will not be required if applications for additional funding are submitted for continuing grants or contracts.

10. When requesting approval for budget revisions, recipients shall use the budget forms that were used in the application unless a letter request will suffice.

11. Within 30 calendar days from the date of receipt of the request for budget revisions, Federal sponsoring agencies shall review the request and notify the recipient whether the budget revisions have been approved. If the revision is still under consideration at the end of 30 calendar days, the Federal sponsoring agency shall inform the recipient in writing of the date when the recipient may expect the decision.

ATTACHMENT K.—CIRCULAR No. A-110

CLOSEOUT PROCEDURES

1. This attachment prescribes uniform closeout procedures for Federal grants and other agreements with recipients.

2. The following definitions shall apply for the purpose of this attachment:

a. *Closeout.*—The closeout of a grant agreement is the process by which a Federal sponsoring agency determines that all applicable administrative actions and all required work of the agreement have been completed by the recipient and the Federal sponsoring agency.

b. *Date of completion.*—The date of completion is the date on which all work under grants and other agreements is completed or the date on the award document, or any supplement or amendment thereto, on which Federal sponsorship ends.

c. *Disallowed costs.*—Disallowed costs are those charges to a grant or other agreement that the Federal sponsoring agency or its representative determines to be unallowable, in accordance with the applicable Federal cost principles or other conditions contained in the agreements.

3. All Federal sponsoring agencies shall establish closeout procedures that include the following requirements:

a. Upon request, the Federal sponsoring agency shall make prompt payments to a recipient for allowable reimbursable costs under the grant or other agreement being closed out.

b. The recipient shall immediately refund any balance of unobligated (unencumbered) cash that the Federal sponsoring agency has advanced or paid and that is not authorized to be retained by the recipient for use in other grants or other agreements.

c. The Federal sponsoring agency shall obtain from the recipient within 90 calendar days after the date of completion of the agreement all financial, performance, and other reports required as the condition of the agreement. The agency may grant extensions when requested by the recipient.

d. When authorized by the grant or other agreement, the Federal sponsoring agency shall make a settlement for any upward or downward adjustments to the Federal share of costs after these reports are received.

e. The recipient shall account for any property acquired with Federal funds, or received from the Government in accordance with the provisions of Attachment N to this Circular, Property Management Standards.

f. In the event a final audit has not been performed prior to the closeout of the grant or other agreement, the Federal sponsoring agency shall retain the right to recover an appropriate amount after fully considering the recommendations on disallowed costs resulting from the final audit.

4. Suspension and termination procedures are contained in Attachment L to this Circular.

ATTACHMENT L.—CIRCULAR No. A-110

SUSPENSION AND TERMINATION PROCEDURES

1. This attachment prescribes uniform suspension and termination procedures for Federal grants and other agreements with recipients.

2. The following definitions shall apply for the purpose of this attachment:

a. *Termination.*—The termination of a grant or other agreement means the cancellation of Federal sponsorship, in whole or in part, under an agreement at any time prior to the date of completion.

b. *Suspension.*—The suspension of a grant or other agreement is an action by a Federal sponsoring agency that temporarily suspends Federal sponsorship under the grant or other agreement, pending corrective action by the recipient or pending a decision to terminate the grant or other agreement by the Federal sponsoring agency.

3. All Federal sponsoring agencies shall provide procedures to be followed when a recipient has failed to comply with the terms

of the grant or other agreement and conditions or standards. When that occurs, the Federal sponsoring agency may, on reasonable notice to the recipient, suspend the grant or other agreement, and withhold further payments, prohibit the recipient from incurring additional obligations of funds, pending corrective action by the recipient, or a decision to termination in accordance with paragraph 4. The Federal sponsoring agency shall allow all necessary and proper costs that the recipient could not reasonably avoid during the period of suspension provided that they meet the provisions of the applicable Federal cost principles.

4. Federal sponsoring agencies shall provide for the systematic settlement of terminated grants or other agreements including the following:

a. *Termination for cause.*—The Federal sponsoring agency may reserve the right to terminate any grant or other agreement in whole or in part at any time before the date of completion, whenever it is determined that the recipient has failed to comply with the conditions of the agreement. The Federal sponsoring agency shall promptly notify the recipient in writing of the determination and the reasons for the termination, together with the effective date. Payments made to recipients or recoveries by the Federal sponsoring agencies under grants or other agreements terminated for cause shall be in accordance with the legal rights and liabilities of the parties.

b. *Termination for convenience.*—The Federal sponsoring agency or recipient may terminate grants and other agreements in whole or in part when both parties agree that the continuation of the project would not produce beneficial results commensurate with the further expenditure of funds. The two parties shall agree upon the termination conditions, including the effective date and, in the case of partial terminations, the portion to be terminated. The recipient shall not incur new obligations for the terminated portion after the effective date, and shall cancel as many outstanding obligations as possible. The Federal sponsoring agency shall allow full credit to the recipient for the Federal share of the noncancellable obligations, properly incurred by the recipient prior to termination.

ATTACHMENT M.—CIRCULAR No. A-110

STANDARD FORM FOR APPLYING FOR FEDERAL ASSISTANCE

1. This attachment promulgates a standard form (SF 424) to be used by public and private institutions of higher education, public and private hospitals and other quasi-public and private nonprofit organizations as a face sheet for applications when applying for Federal grants under programs covered by Part I, Attachment A, OMB Circular No. A-95. In addition, agencies are particularly encouraged to extend the use of SF 424 to common programs with State and local governments where this form is now required by FMC 74-7.

2. The SF 424 may also be used, on an optional basis, to fulfill the requirements of OMB Circular A-95 for a notification of intent, from applicant to clearinghouses, that Federal assistance will be applied for. Local or State clearinghouse procedures will govern the use of the form for this purpose.

3. The standard form will also be used by Federal agencies to report to the clearinghouses on major actions taken on applications reviewed by clearinghouses in accordance with OMB Circular A-95, and to notify States of grants-in-aid awarded in accordance with Treasury Circular 1082.

| | | | | | | | | | | | | | | | | | | | | | | | |
|---|----------------|--|--|---|---|-----------------------------|---|--|----------------|-----|---|--|--|----------|--|-----|----------|----|-----|--|--|---|--|
| FEDERAL ASSISTANCE | | 2. APPLICANT'S APPLICATION | a. NUMBER | 3. STATE APPLICATION IDENTIFIER | a. NUMBER | | | | | | | | | | | | | | | | | | |
| 1. TYPE OF ACTION <input type="checkbox"/> PREAPPLICATION <input type="checkbox"/> APPLICATION <small>(Mark appropriate box)</small> <input type="checkbox"/> NOTIFICATION OF INTENT (Opt.) <input type="checkbox"/> REPORT OF FEDERAL ACTION | | b. DATE Year month day 19 | b. DATE Year month day 19 | | | | | | | | | | | | | | | | | | | | |
| | | | Leave Blank | | | | | | | | | | | | | | | | | | | | |
| 4. LEGAL APPLICANT/RECIPIENT a. Applicant Name : b. Organization Unit : c. Street/P.O. Box : d. City : f. State : h. Contact Person (Name & telephone No.) : | | | a. County : | | g. ZIP Code: | | | | | | | | | | | | | | | | | | |
| | | | | | | | 5. FEDERAL EMPLOYER IDENTIFICATION NO. | | | | | | | | | | | | | | | | |
| 7. TITLE AND DESCRIPTION OF APPLICANT'S PROJECT | | | 6. PROGRAM (From Federal Catalog) a. NUMBER : b. TITLE : | | 8. TYPE OF APPLICANT/RECIPIENT A-State H-Community Action Agency B-Interstate I-Higher Educational Institution C-Substate J-Indian Tribe District K-Other (Specify): D-County E-City F-School District G-Special Purpose District Enter appropriate letter <input type="checkbox"/> | | | | | | | | | | | | | | | | | | |
| | | | | | | | 9. TYPE OF ASSISTANCE A-Basic Grant D-Insurance B-Supplemental Grant E-Other C-Loan Enter appropriate letter(s) <input type="checkbox"/> | | | | | | | | | | | | | | | | |
| 10. AREA OF PROJECT IMPACT (Names of cities, counties, States, etc.) | | 11. ESTIMATED NUMBER OF PERSONS BENEFITING | | 12. TYPE OF APPLICATION A-New C-Revision E-Augmentation B-Renewal D-Continuation Enter appropriate letter <input type="checkbox"/> | | | | | | | | | | | | | | | | | | | |
| | | | | | | 13. PROPOSED FUNDING | | | | | | | | | | | | | | | | | |
| <table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;">a. FEDERAL</td> <td style="width:15%;">\$</td> <td style="width:15%;">.00</td> </tr> <tr> <td>b. APPLICANT</td> <td></td> <td>.00</td> </tr> <tr> <td>c. STATE</td> <td></td> <td>.00</td> </tr> <tr> <td>d. LOCAL</td> <td></td> <td>.00</td> </tr> <tr> <td>e. OTHER</td> <td></td> <td>.00</td> </tr> <tr> <td>f. TOTAL</td> <td>\$</td> <td>.00</td> </tr> </table> | | a. FEDERAL | \$ | .00 | b. APPLICANT | | .00 | c. STATE | | .00 | d. LOCAL | | .00 | e. OTHER | | .00 | f. TOTAL | \$ | .00 | 14. CONGRESSIONAL DISTRICTS OF: a. APPLICANT b. PROJECT | | 15. TYPE OF CHANGE (For 13a or 13b) A-Increase Dollars F-Other (Specify): B-Decrease Dollars C-Increase Duration D-Decrease Duration E-Cancellation Enter appropriate letter(s) <input type="checkbox"/> | |
| a. FEDERAL | \$ | .00 | | | | | | | | | | | | | | | | | | | | | |
| b. APPLICANT | | .00 | | | | | | | | | | | | | | | | | | | | | |
| c. STATE | | .00 | | | | | | | | | | | | | | | | | | | | | |
| d. LOCAL | | .00 | | | | | | | | | | | | | | | | | | | | | |
| e. OTHER | | .00 | | | | | | | | | | | | | | | | | | | | | |
| f. TOTAL | \$ | .00 | | | | | | | | | | | | | | | | | | | | | |
| <table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;">16. PROJECT START DATE</td> <td style="width:15%;">Year month day</td> <td style="width:15%;">19</td> </tr> <tr> <td>17. PROJECT DURATION</td> <td>Months</td> <td></td> </tr> <tr> <td>18. ESTIMATED DATE TO BE SUBMITTED TO FEDERAL AGENCY</td> <td>Year month day</td> <td>19</td> </tr> </table> | | 16. PROJECT START DATE | Year month day | 19 | 17. PROJECT DURATION | Months | | 18. ESTIMATED DATE TO BE SUBMITTED TO FEDERAL AGENCY | Year month day | 19 | 19. EXISTING FEDERAL IDENTIFICATION NUMBER | | 20. FEDERAL AGENCY TO RECEIVE REQUEST (Name, City, State, ZIP code) | | | | | | | | | | |
| 16. PROJECT START DATE | Year month day | 19 | | | | | | | | | | | | | | | | | | | | | |
| 17. PROJECT DURATION | Months | | | | | | | | | | | | | | | | | | | | | | |
| 18. ESTIMATED DATE TO BE SUBMITTED TO FEDERAL AGENCY | Year month day | 19 | | | | | | | | | | | | | | | | | | | | | |
| 21. REMARKS ADDED <input type="checkbox"/> Yes <input type="checkbox"/> No | | 22. THE APPLICANT CERTIFIES THAT | | | | | | | | | | | | | | | | | | | | | |
| a. To the best of my knowledge and belief, data in this preapplication/application are true and correct. The document has been duly authorized by the governing body of the applicant and the applicant will comply with the attached assurances if the assistance is approved. | | b. If required by OMB Circular A-95 this application was submitted, pursuant to instructions therein, to appropriate clearinghouses and all responses are attached: | | No response <input type="checkbox"/> Response attached <input type="checkbox"/> | | | | | | | | | | | | | | | | | | | |
| 23. CERTIFYING REPRESENTATIVE a. TYPED NAME AND TITLE | | b. SIGNATURE | | c. DATE SIGNED Year month day 19 | | | | | | | | | | | | | | | | | | | |
| 24. AGENCY NAME | | 25. APPLICATION RECEIVED Year month day 19 | | 26. FEDERAL APPLICATION IDENTIFICATION | | | | | | | | | | | | | | | | | | | |
| 28. ORGANIZATIONAL UNIT | | 27. ADMINISTRATIVE OFFICE | | 29. FEDERAL GRANT IDENTIFICATION | | | | | | | | | | | | | | | | | | | |
| 29. ADDRESS | | 30. FEDERAL GRANT IDENTIFICATION | | 31. ACTION TAKEN <input type="checkbox"/> a. AWARDED <input type="checkbox"/> b. REJECTED <input type="checkbox"/> c. RETURNED FOR AMENDMENT <input type="checkbox"/> d. DEFERRED <input type="checkbox"/> e. WITHDRAWN | | | | | | | | | | | | | | | | | | | |
| 32. FUNDING a. FEDERAL \$.00 b. APPLICANT .00 c. STATE .00 d. LOCAL .00 e. OTHER .00 f. TOTAL \$.00 | | 33. ACTION DATE Year month day 19 | | 34. STARTING DATE Year month day 19 | | | | | | | | | | | | | | | | | | | |
| 35. CONTACT FOR ADDITIONAL INFORMATION (Name and telephone number) | | 36. ENDING DATE Year month day 19 | | 37. REMARKS ADDED <input type="checkbox"/> Yes <input type="checkbox"/> No | | | | | | | | | | | | | | | | | | | |
| 38. FEDERAL AGENCY A-95 ACTION | | a. In taking above action, any comments received from clearinghouses were considered. If agency response is due under provisions of Part 1, OMB Circular A-95, it has been or is being made. | | b. FEDERAL AGENCY A-95 OFFICIAL (Name and telephone no.) | | | | | | | | | | | | | | | | | | | |

SECTION I - APPLICANT/RECIPIENT DATA

SECTION II - CERTIFICATION

SECTION III - FEDERAL AGENCY ACTION

SECTION IV—REMARKS *(Please reference the proper item number from Sections I, II or III, if applicable)*

GENERAL INSTRUCTIONS

This is a multi-purpose standard form. First, it will be used by applicants as a required facesheet for pre-applications and applications submitted in accordance with Federal Management Circular 74-7. Second, it will be used by Federal agencies to report to Clearinghouses on major actions taken on applications reviewed by clearinghouses in accordance with OMB Circular A-95. Third, it will be used by Federal agencies to notify States of grants-in-aid awarded in accordance with Treasury Circular 1082. Fourth, it may be used, on an optional basis, as a notification of intent from applicants to clearinghouses, as an early initial notice that Federal assistance is to be applied for (clearinghouse procedures will govern).

APPLICANT PROCEDURES FOR SECTION I

Applicant will complete all items in Section I. If an item is not applicable, write "NA". If additional space is needed, insert an asterisk "*", and use the remarks section on the back of the form. An explanation follows for each item:

- | Item | Item |
|--|---|
| 1. Mark appropriate box. Pre-application and application guidance is in FMC 74-7 and Federal agency program instructions. Notification of intent guidance is in Circular A-95 procedures from clearinghouse. Applicant will not use "Report of Federal Action" box. | D. Insurance. Self explanatory. E. Other. Explain on remarks page. |
| 2a. Applicant's own control number, if desired. | 10. Governmental unit where significant and meaningful impact could be observed. List only largest unit or units affected, such as State, county, or city. If entire unit affected, list it rather than subunits. |
| 2b. Date Section I is prepared. | 11. Estimated number of persons directly benefiting from project. |
| 3a. Number assigned by State clearinghouse, or if delegated by State, by areawide clearinghouse. All requests to Federal agencies must contain this identifier if the program is covered by Circular A-95 and required by applicable State/areawide clearinghouse procedures. If in doubt, consult your clearinghouse. | 12. Use appropriate code letter. Definitions are: A. New. A submittal for the first time for a new project. B. Renewal. An extension for an additional funding/budget period for a project having no projected completion date, but for which Federal support must be renewed each year. C. Revision. A modification to project nature or scope which may result in funding change (increase or decrease). D. Continuation. An extension for an additional funding/budget period for a project the agency initially agreed to fund for a definite number of years. E. Augmentation. A requirement for additional funds for a project previously awarded funds in the same funding/budget period. Project nature and scope unchanged. |
| 3b. Date applicant notified of clearinghouse identifier. | 13. Amount requested or to be contributed during the first funding/budget period by each contributor. Value of in-kind contributions will be included. If the action is a change in dollar amount of an existing grant (a revision or augmentation), indicate only the amount of the change. For decreases enclose the amount in parentheses. If both basic and supplemental amounts are included, breakout in remarks. For multiple program funding, use totals and show program breakouts in remarks. Item definitions: 13a, amount requested from Federal Government; 13b, amount applicant will contribute; 13c, amount from State, if applicant is not a State; 13d, amount from local government, if applicant is not a local government; 13e, amount from any other sources, explain in remarks. |
| 4a-4h. Legal name of applicant/recipient, name of primary organizational unit which will undertake the assistance activity, complete address of applicant, and name and telephone number of person who can provide further information about this request. | 14a. Self explanatory. |
| 5. Employer identification number of applicant as assigned by Internal Revenue Service. | 14b. The district(s) where most of actual work will be accomplished. If city-wide or State-wide, covering several districts, write "city-wide" or "State-wide." |
| 6a. Use Catalog of Federal Domestic Assistance number assigned to program under which assistance is requested. If more than one program (e.g., joint-funding) write "multiple" and explain in remarks. If unknown, cite Public Law or U.S. Code. | 15. Complete only for revisions (Item 12c), or augmentations (Item 12e). |
| 6b. Program title from Federal Catalog. Abbreviate if necessary. | |
| 7. Brief title and appropriate description of project. For notification of intent, continue in remarks section if necessary to convey proper description. | |
| 8. Mostly self-explanatory. "City" includes town, township or other municipality. | |
| 9. Check the type(s) of assistance requested. The definitions of the terms are: A. Basic Grant. An original request for Federal funds. This would not include any contribution provided under a supplemental grant. B. Supplemental Grant. A request to increase a basic grant in certain cases where the eligible applicant cannot supply the required matching share of the basic Federal program (e.g., grants awarded by the Appalachian Regional Commission to provide the applicant a matching share). C. Loan. Self explanatory. | |

| <i>Item</i> | | <i>Item</i> | |
|-------------|--|-------------|--|
| 16. | Approximate date project expected to begin (usually associated with estimated date of availability of funding). | 19. | Existing Federal identification number if this is not a new request and directly relates to a previous Federal action. Otherwise write "NA". |
| 17. | Estimated number of months to complete project after Federal funds are available. | 20. | Indicate Federal agency to which this request is addressed. Street address not required, but do use ZIP. |
| 18. | Estimated date preapplication/application will be submitted to Federal agency if this project requires clearinghouse review. If review not required, this date would usually be same as date in item 2b. | 21. | Check appropriate box as to whether Section IV of form contains remarks and/or additional remarks are attached. |

APPLICANT PROCEDURES FOR SECTION II

Applicants will always complete items 23a, 23b, and 23c. If clearinghouse review is required, item 22b must be fully completed. An explanation follows for each item:

| <i>Item</i> | | <i>Item</i> | |
|-------------|---|--------------|---|
| 22b. | List clearinghouses to which submitted and show in appropriate blocks the status of their responses. For more than three clearinghouses, continue in remarks section. All written comments submitted by or through clearinghouses must be attached. | 23b. | Self explanatory. |
| 23a. | Name and title of authorized representative of legal applicant. | 23c. | Self explanatory. |
| | | <i>Note:</i> | Applicant completes only Sections I and II. Section III is completed by Federal agencies. |

FEDERAL AGENCY PROCEDURES FOR SECTION III

If applicant-supplied information in Sections I and II needs no updating or adjustment to fit the final Federal action, the Federal agency will complete Section III only. An explanation for each item follows:

| <i>Item</i> | | <i>Item</i> | |
|-------------|--|-------------|---|
| 24. | Executive department or independent agency having program administration responsibility. | 35. | Name and telephone no. of agency person who can provide more information regarding this assistance. |
| 25. | Self explanatory. | 36. | Date after which funds will no longer be available. |
| 26. | Primary organizational unit below department level having direct program management responsibility. | 37. | Check appropriate box as to whether Section IV of form contains Federal remarks and/or attachment of additional remarks. |
| 27. | Office directly monitoring the program. | 38. | For use with A-95 action notices only. Name and telephone of person who can assure that appropriate A-95 action has been taken—if same as person shown in item 35, write "same". If not applicable, write "NA". |
| 28. | Use to identify non-award actions where Federal grant identifier in item 30 is not applicable or will not suffice. | | |
| 29. | Complete address of administering office shown in item 26. | | |
| 30. | Use to identify award actions where different from Federal application identifier in item 28. | | |
| 31. | Self explanatory. Use remarks section to amplify where appropriate. | | |
| 32. | Amount to be contributed during the first funding/budget period by each contributor. Value of in-kind contributions will be included. If the action is a change in dollar amount of an existing grant (a revision or augmentation), indicate only the amount of change. For decreases, enclose the amount in parentheses. If both basic and supplemental amounts are included, breakout in remarks. For multiple program funding, use totals and show program breakouts in remarks. Item definitions: 32a, amount awarded by Federal Government; 32b, amount applicant will contribute; 32c, amount from State, if applicant is not a State; 32d, amount from local government if applicant is not a local government; 32e, amount from any other sources, explain in remarks. | | |
| 33. | Date action was taken on this request. | | |
| 34. | Date funds will become available. | | |

Federal Agency Procedures—special considerations

A. *Treasury Circular 1082 compliance.* Federal agency will assure proper completion of Sections I and III. If Section I is being completed by Federal agency, all applicable items must be filled in. Addresses of State Information Reception Agencies (SCIRA's) are provided by Treasury Department to each agency. This form replaces SF 240, which will no longer be used.

B. *OMB Circular A-95 compliance.* Federal agency will assure proper completion of Sections I, II, and III. This form is required for notifying all reviewing clearinghouses of major actions on all programs reviewed under A-95. Addresses of State and areawide clearinghouses are provided by OMB to each agency. Substantive differences between applicant's request and/or clearinghouse recommendations, and the project as finally awarded will be explained in A-95 notifications to clearinghouses.

C. *Special note.* In most, but not all States, the A-95 State clearinghouse and the (TC 1082) SCIRA are the same office. In such cases, the A-95 award notice to the State clearinghouse will fulfill the TC 1082 award notice requirement to the State SCIRA. Duplicate notification should be avoided.

ATTACHMENT N.—CIRCULAR NO. A-110

PROPERTY MANAGEMENT STANDARDS

1. This attachment prescribes uniform standards governing management of property furnished by the Federal Government or whose cost was charged to a project supported by a Federal grant or other agreement. Federal sponsoring agencies shall require recipients to observe these standards under grants and other agreements and shall not impose additional requirements unless specifically required by Federal law. The recipient may use its own property management standards and procedures provided it observes the provisions of this attachment. This attachment also applies to subrecipients as referred to in paragraph 5 of the basic circular.

2. The following definitions apply for the purpose of this attachment:

a. *Real property.*—Real property means land, including land improvements, structures and appurtenances thereto, but excluding movable machinery and equipment.

b. *Personal property.*—Personal property of any kind except real property. It may be tangible—having physical existence, or intangible—having no physical existence, such as patents, inventions and copyrights.

c. *Nonexpendable personal property.*—Nonexpendable personal property means tangible personal property having a useful life of more than one year and an acquisition cost of \$300 or more per unit exempt that recipients subject to Cost Accounting Standards Board regulations may use the CASB standard of \$500 per unit and useful life of two years. A recipient may use its own definition of nonexpendable personal property provided that the definition would at least include all tangible personal property as defined above.

d. *Expendable personal property.*—Expendable personal property refers to all tangible personal property other than nonexpendable property.

e. *Excess property.*—Excess property means property under the control of any Federal agency that, as determined by the head thereof, is no longer required for its needs or the discharge of its responsibilities.

f. *Acquisition cost of purchased nonexpendable personal property.*—Acquisition cost of an item of purchased nonexpendable personal property means the net invoice unit price of the property including the cost of modifications, attachments, accessories, or auxiliary apparatus necessary to make the property usable for the purpose for which it was acquired. Other charges such as the cost of installation, transportation, taxes, duty or protective in-transit insurance, shall be included or excluded from the unit acquisition cost in accordance with the recipient's regular accounting practices.

g. *Exempt property.*—Exempt property means tangible personal property acquired in whole or in part with Federal funds, and title to which is vested in the recipient without further obligation to the Federal Government except as provided in subparagraph 6a below. Such unconditional vesting of title will be pursuant to any Federal legislation that provides the Federal sponsoring agency with adequate authority.

3. *Real property.*—Each Federal sponsoring agency shall prescribe requirements for recipients concerning the use and disposition of real property acquired partly or wholly under grants or other agreements. Unless otherwise provided by statute, such requirements, as a minimum, shall contain the following:

a. Title to real property shall vest in the recipient subject to the condition that the recipient shall use the real property for the authorized purpose of the project, as long as it is needed.

b. The recipient shall obtain approval by the Federal sponsoring agency for the use of real property in other projects when the recipient determines that the property is no longer needed for the purpose of the original project. Use in other projects shall be limited to those under other federally sponsored projects (i.e., grants or other agreements) or programs that have purposes consistent with those authorized for support by the Federal sponsoring agency.

c. When the real property is no longer needed as provided in a and b above, the recipient shall request disposition instructions from the Federal sponsoring agency or its successor Federal sponsoring agency. The Federal sponsoring agency shall observe the following rules in the disposition instructions:

(1) The recipient may be permitted to retain title after it compensates the Federal Government in an amount computed by applying the Federal percentage of participation in the cost of the original project to the fair market value of the property.

(2) The recipient may be directed to sell the property under guidelines provided by the Federal sponsoring agency and pay the Federal Government an amount computed by applying the Federal percentage of participation in the cost of the original project to the proceeds from sale (after deducting actual and reasonable selling and fix-up expenses, if any, from the sales proceeds). When the recipient is authorized or required to sell the property, proper sales procedures shall be established that provide for competition to the extent practicable and result in the highest possible return.

(3) The recipient may be directed to transfer title to the property to the Federal Government provided that in such cases the recipient shall be entitled to compensation computed by applying the recipient's percentage of participation in the cost of the program or project to the current fair market value of the property.

4. *Federally-owned nonexpendable personal property.*—Title to federally-owned property remains vested in the Federal Government. Recipients shall submit annually an inventory listing of federally-owned property in their custody to the Federal sponsoring agency. Upon completion of the agreement or when the property is no longer needed, the recipient shall report the property to the Federal sponsoring agency for further agency utilization.

If the Federal sponsoring agency has no further need for the property, it shall be declared excess and reported to the General Services Administration. Appropriate disposition instructions will be issued to the recipient after completion of the Federal agency review.

5. *Exempt property.*—When statutory authority exists, (e.g., P.L. 85-934, 42 U.S.C. 1892) title to nonexpendable personal property acquired with project funds, shall be vested in the recipient upon acquisition unless it is determined that to do so is not in furtherance of the objectives of the Federal sponsoring agency. When title is vested in the recipient, the recipient shall have no other obligation or accountability to the Federal Government for its use or disposition except as provided in 6a below.

6. *Other nonexpendable property.*—When other nonexpendable tangible personal property is acquired by a recipient with project funds, title shall not be taken by the Federal Government but shall vest in the recipient subject to the following conditions:

a. *Right to transfer title.*—For items of nonexpendable personal property having a unit acquisition cost of \$1,000 or more, the Federal sponsoring agency may reserve the right to transfer the title to the Federal

Government or to a third party named by the Federal Government when such third party is otherwise eligible under existing statutes. Such reservation shall be subject to the following standards:

(1) The property shall be appropriately identified in the grant or other agreement or otherwise made known to the recipient in writing.

(2) The Federal sponsoring agency shall issue disposition instructions within 120 calendar days after the end of the Federal support of the project for which it was acquired. If the Federal sponsoring agency fails to issue disposition instructions within the 120 calendar day period, the recipient shall apply the standards of subparagraphs 6b and 6c as appropriate.

(3) When the Federal sponsoring agency exercises its right to take title, the personal property shall be subject to the provisions for federally-owned nonexpendable property discussed in paragraph 4, above.

(4) When title is transferred either to the Federal Government or to a third party the provisions of subparagraph 6c(2)(b) should be followed.

b. *Use of other tangible nonexpendable property for which the recipient has title.*

(1) The recipient shall use the property in the project or program for which it was acquired as long as needed, whether or not the project or program continues to be supported by Federal funds. When no longer needed for the original project or program, the recipient shall use the property in connection with its other federally sponsored activities, in the following order of priority:

(a) Activities, in the following order of priority:

(b) Activities sponsored by other Federal agencies.

(2) *Shared use.*—During the time that nonexempt nonexpendable personal property is held for use on the project or program for which it was acquired, the recipient shall make it available for use on other projects or programs if such other use will not interfere with the work on the project or program for which the property was originally acquired. First preference for such other use shall be given to other projects or programs sponsored by the Federal agency that financed the property; second preference shall be given to projects or programs sponsored by other Federal agencies. If the property is owned by the Federal Government, use on other activities not sponsored by the Federal Government shall be permissible if authorized by the Federal agency. User charges should be considered if appropriate.

c. *Disposition of other nonexpendable property.*—When the recipient no longer needs the property as provided in 6b above, the property may be used for other activities in accordance with the following standards:

(1) *Nonexpendable property with a unit acquisition cost of less than \$1,000.*—The recipient may use the property for other activities without reimbursement to the Federal Government or sell the property and retain the proceeds.

(2) *Nonexpendable personal property with a unit acquisition cost of \$1,000 or more.*—The recipient may retain the property for other uses provided that compensation is made to the original Federal sponsoring agency or its successor. The amount of compensation shall be computed by applying the percentage of Federal participation in the cost of the original project or program to the current fair market value of the property. If the recipient has no need for the property and the property has further use value, the recipient shall request disposition instructions from the original sponsoring agency.

The Federal sponsoring agency shall determine whether the property can be used to meet the agency's requirements. If no requirement exists within that agency, the availability of the property shall be reported to the General Services Administration by the Federal agency to determine whether a requirement for the property exists in other Federal agencies. The Federal sponsoring agency shall issue instructions to the recipient no later than 120 days after the recipient's request and the following procedures shall govern:

(a) If so instructed or if disposition instructions are not issued within 120 calendar days after the recipient's request, the recipient shall sell the property and reimburse the Federal sponsoring agency an amount computed by applying to the sales proceeds the percentage of Federal participation in the cost of the original project or program. However, the recipient shall be permitted to deduct and retain from the Federal share 3100 or ten percent of the proceeds, whichever is greater, for the recipient's selling and handling expenses.

(b) If the recipient is instructed to ship the property elsewhere, the recipient shall be reimbursed by the benefiting Federal agency with an amount which is computed by applying the percentage of the recipient's participation in the cost of the original grant project or program to the current fair market value of the property, plus any reasonable shipping or interim storage costs incurred.

(c) If the recipient is instructed to otherwise dispose of the property, the recipient shall be reimbursed by the Federal sponsoring agency for such costs incurred in its disposition.

d. Property management standards for nonexpendable property.—The recipient's property management standards for nonexpendable personal property shall include the following procedural requirements:

(1) Property records shall be maintained accurately and shall include:

(a) A description of the property.

(b) Manufacturer's serial number, model number, Federal stock number, national stock number, or other identification number.

(c) Source of the property, including grant or other agreement number.

(d) Whether title vests in the recipient or the Federal Government.

(e) Acquisition date (or date received, if the property was furnished by the Federal Government) and cost.

(f) Percentage (at the end of the budget year) of Federal participation in the cost of the project or program for which the property was acquired. (Not applicable to property furnished by the Federal Government.)

(g) Location, use and condition of the property and the date the information was reported.

(h) Unit acquisition cost.

(1) Ultimate disposition data, including date of disposal and sales price or the method used to determine current fair market value where a recipient compensates the Federal sponsoring agency for its share.

(2) Property owned by the Federal Government must be marked to indicate Federal ownership.

(3) A physical inventory of property shall be taken and the results reconciled with the property records at least once every two years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the property.

(4) A control system shall be in effect to insure adequate safeguards to prevent loss,

damage, or theft of the property. Any loss, damage, or theft of nonexpendable property shall be investigated and fully documented; if the property was owned by the Federal Government, the recipient shall promptly notify the Federal sponsoring agency.

(5) Adequately maintenance procedures shall be implemented to keep the property in good condition.

(6) Where the recipient is authorized or required to sell the property, proper sales procedures shall be established which would provide for competition to the extent practicable and result in the highest possible return.

7. Expendable personal property.—Title to expendable personal property shall vest in the recipient upon acquisition. If there is a residual inventory of such property exceeding \$1,000 in total aggregate fair market value, upon termination or completion of the grant or other agreement, and the property is not needed for any other federally sponsored project or program, the recipient shall retain the property for use on nonfederally sponsored activities, or sell it, but must in either case, compensate the Federal Government for its share. The amount of compensation shall be computed in the same manner as nonexpendable personal property.

8. Intangible property.

a. Inventions and patents.—If any program produces patentable items, patent rights, processes, or inventions, in the course of work sponsored by the Federal Government, such fact shall be promptly and fully reported to the Federal sponsoring agency. Unless there is a prior agreement between the recipient and the Federal sponsoring agency on disposition of such items, the Federal sponsoring agency shall determine whether protection on the invention or discovery shall be sought. The Federal sponsoring agency will also determine how the rights in the invention or discovery—including rights under any patent issued thereon—shall be allocated and administered in order to protect the public interest consistent with "Government Patent Policy" (President's Memorandum for Heads of Executive Departments and Agencies, August 23, 1971, and statement of Government Patent Policy as printed in 36 P.R. 16889).

b. Copyrights.—Except as otherwise provided in the terms and conditions of the agreement, the author or the recipient organization is free to copyright any books, publications, or other copyrightable materials developed in the course of or under a Federal agreement, but the Federal sponsoring agency shall reserve a royalty-free, nonexclusive and irrevocable right to reproduce, publish, or otherwise use, and to authorize others to use, the work for Government purposes.

ATTACHMENT O.—CIRCULAR No. A-110

PROCUREMENT STANDARDS

1. This attachment provides standards for use by recipients in establishing procedures for the procurement of supplies, equipment, construction and other services with Federal funds. These standards are furnished to ensure that such materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal law and executive orders. No additional procurement standards or requirements shall be imposed by the Federal sponsoring agencies upon recipients unless specifically required by Federal statute or executive orders.

2. The standards contained in this attachment do not relieve the recipient of the contractual responsibilities arising under its contracts. The recipient is the responsible authority, without recourse to the Federal sponsoring agency regarding the settlement and satisfaction of all contractual and administra-

trative issues arising out of procurements entered into, in support of a grant or other agreement. This includes disputes, claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of law are to be referred to such local, State or Federal authority as may have proper jurisdiction.

3. Recipients may use their own procurement policies and procedures. However, all recipients shall adhere to the standards set forth in paragraphs 3 and 4.

a. The recipient shall maintain a code or standards of conduct that shall govern the performance of its officers, employees or agents engaged in the awarding and administration of contracts using Federal funds. No employee, officer or agent shall participate in the selection, award or administration of a contract in which Federal funds are used, where, to his knowledge, he or his immediate family, partners, or organization in which he or his immediate family or partner has a financial interest or with whom he is negotiating or has any arrangement concerning prospective employment. The recipients' officers, employees or agents shall neither solicit nor accept gratuities, favors or anything of monetary value from contractors or potential contractors. Such standards shall provide for disciplinary actions to be applied for violations of such standards by the recipients' officers, employees or agents.

b. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient should be alert to organizational conflicts of interest or non-competitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals should be excluded from competing for such procurements. Awards shall be made to the bidder/officer whose bid/offer is responsive to the solicitation and is most advantageous to the recipient, price and other factors considered. Solicitations shall clearly set forth all requirements that the bidder/officer must fulfill in order for his bid/offer to be evaluated by the recipient. Any and all bids/offers may be rejected when it is in the recipient's interest to do so.

c. All recipients shall establish procurement procedures that provide for, at a minimum, the following procedural requirements.

(1) Proposed procurement actions shall follow a procedure to assure the avoidance of purchasing unnecessary or duplicative items. Where appropriate, an analysis shall be made of lease and purchase, alternatives to determine which would be the most economical, practical procurement.

(2) Solicitations for goods and services shall be based upon a clear and accurate description of the technical requirements for the material, product or service to be procured. Such a description shall not, in competitive procurements, contain features which unduly restrict competition. "Brand name or equal" descriptions may be used as a means to define the performance or other salient requirements of a procurement, and when so used the specific features of the named brand which must be met by bidders/officers shall be clearly specified.

(3) Positive efforts shall be made by the recipients to utilize small business and minority-owned business sources of supplies and services. Such efforts should allow these sources the maximum feasible opportunity to compete for contracts utilizing Federal funds.

(4) The type of procuring instruments used, e.g., fixed price contracts, cost reim-

burable contracts, purchase orders, incentive contracts, shall be determined by the recipient but must be appropriate for the particular procurement and for promoting the best interest of the program involved. The "cost-plus-a-percentage-of-cost" method of contracting shall not be used.

(5) Contracts shall be made only with responsible contractors who possess the potential ability to perform successfully under the terms and conditions of a proposed procurement. Consideration shall be given to such matters as contractor integrity, record of past performance, financial and technical resources or accessibility to other necessary resources.

(6) All proposed sole source contracts or where only one bid or proposal is received in which the aggregate expenditure is expected to exceed \$5,000 shall be subject to prior approval at the discretion of the Federal sponsoring agency.

(7) Some form of price or cost analysis should be made in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.

(8) Procurement records and files for purchases in excess of \$10,000 shall include the following:

(a) Basis for contractor selection;

(b) Justification for lack of competition when competitive bids or offers are not obtained;

(c) Basis for award cost or price.

(9) A system for contract administration shall be maintained to ensure contractor conformance with terms, conditions and specifications of the contract, and to ensure adequate and timely followup of all purchases.

4. The recipient shall include, in addition to provisions to define a sound and complete agreement, the following provisions in all contracts. These provisions shall also be applied to subcontracts.

a. Contracts in excess of \$10,000 shall contain contractual provisions or conditions that will allow for administrative, contractual or legal remedies in instances in which contractors violate or breach contract terms, and provide for such remedial actions as may be appropriate.

b. All contracts in excess of \$10,000 shall contain suitable provisions for termination by the recipient including the manner by which termination will be effected and the basis for settlement. In addition, such contracts shall describe conditions under which

the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

c. In all contracts for construction or facility improvement awarded for more than \$100,000, recipients shall observe the bonding requirements provided in Attachment B to this circular.

d. All contracts awarded by recipients and their contractors or subgrantees having a value of more than \$10,000, shall contain a provision requiring compliance with Executive Order 11246, entitled "Equal Employment Opportunity," as amended by Executive Order 11375, and as supplemented in Department of Labor regulations (41 CFR, Part 60).

e. All contracts and subgrants in excess of \$2,000 for construction or repair awarded by recipients and subrecipients shall include a provision for compliance with the Copeland "Anti-Kick Back" Act (18 U.S.C. 874) as supplemented in Department of Labor regulations (29 CFR, Part 3). This Act provides that each contractor or subgrantee shall be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he is otherwise entitled. The recipient shall report all suspected or reported violations to the Federal sponsoring agency.

f. When required by the Federal program legislation, all construction contracts awarded by the recipients and subrecipients of more than \$2,000 shall include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 276a to a-7) and as supplemented by Department of Labor regulations (29 CFR, Part 5). Under this Act contractors shall be required to pay wages to laborers and mechanics at a rate not less than the minimum wages specified in a wage determination made by the Secretary of Labor. In addition, contractors shall be required to pay wages not less than once a week. The recipient shall place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation and the award of a contract shall be conditioned upon the acceptance of the wage determination. The recipient shall report all suspected or reported violations to the Federal sponsoring agency.

g. Where applicable, all contracts awarded by recipients in excess of \$2,000 for construction contracts and in excess of \$2,500 for other contracts that involve the employment of mechanics or laborers, shall include a provision for compliance with sections 103 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327-330) as supplemented by Department of Labor regula-

tions (29 CFR, Part 5). Under section 103 of the Act, each contractor shall be required to compute the wages of every mechanic and laborer on the basis of a standard work day of 8 hours and a standard work week of 40 hours. Work in excess of the standard workday or workweek is permissible provided that the worker is compensated at a rate of not less than 1½ times the basic rate of pay for all hours worked in excess of 8 hours in any calendar day or 40 hours in the workweek. Section 107 of the Act is applicable to construction work and provides that no laborer or mechanic shall be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous to his health and safety as determined under construction safety and health standards promulgated by the Secretary of Labor. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

h. Contracts or agreements, the principal purpose of which is to create, develop or improve products, processes or methods; or for exploration into fields that directly concern public health, safety or welfare; or contracts in the field of science or technology in which there has been little significant experience outside of work funded by Federal assistance, shall contain a notice to the effect that matters regarding rights to inventions and materials generated under the contract or agreement are subject to the regulations issued by the Federal sponsoring agency and the recipient. The contractor shall be advised as to the source of additional information regarding these matters.

i. All negotiated contracts (except those of \$10,000 or less) awarded by recipients shall include a provision to the effect that the recipient, the Federal sponsoring agency, the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.

j. Contracts and subgrants of amounts in excess of \$100,000 shall contain a provision that requires the recipient to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act of 1970 (42 U.S.C. 1857 et seq.) and the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.) as amended. Violations shall be reported to the Federal sponsoring agency and the Regional Office of the Environmental Protection Agency.

[FR Doc.76-21904 Filed 7-29-76; 8:45 am]

January 16, 1987

Circular No. A-110
Revised
Transmittal Memorandum

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

FROM: James ~~Miller III~~
Director

SUBJECT: ~~Interest Earned~~ on Federal Funds

This Transmittal Memorandum revises Circular A-110 by adding a new paragraph 8 to Attachment I, "Payment Requirements." The new paragraph provides for recipients to maintain advances of Federal funds in interest bearing accounts. Interest earned on Federal advances must be remitted promptly to the Federal agencies that provided the funds.

Revision to OMB Circular A-110

The following paragraph is added to Attachment I, "Payment Requirements."

"8.a Recipients shall maintain advances of Federal funds in interest bearing accounts. Interest earned on Federal advances deposited in such accounts shall be remitted promptly, but at least quarterly, to the Federal agencies that provided the funds. Interest amounts up to \$100 per year may be retained by the recipient for administrative expense."

OFFICE OF MANAGEMENT AND BUDGET

Revision to Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations"

AGENCY: Office of Management and Budget.

ACTION: Final revision to circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations."

SUMMARY: This notice revises OMB Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations," originally published July 30, 1976. The revision provides that recipients shall maintain advances of Federal funds in interest bearing accounts. Interest earned on Federal advances deposited in such accounts shall be remitted promptly to the Federal agencies that provided the funds.

The revision is based on a recommendation by the Inspector General (IG), Department of Health and Human Services. The IG made an audit to determine what percentage of grantees were using interest bearing accounts for deposits of Federal funds. The IG reviewed about 4,000 nonprofit grantees of the Office of Human Development Services and the Public Health Service. The review disclosed that 80 percent of the grantees did not earn interest on Federal funds kept in banks, 18 percent earned interest but did not report or return any of it to the Federal Government and only 4 percent earned and returned interest. From the limited test made, the IG estimated that the Federal Government lost about \$15 million in potential interest income.

OMB Circular A-110 provides that Federal cash made available to recipients of grants shall be timed to coincide with their cash needs. This proposed revision is not intended to change that policy by encouraging grantees to maintain unnecessary balances of Federal funds. The revision recognizes that all Federal cash will not always be disbursed immediately upon receipt. Therefore, it is proposed that when cash is available it should be deposited in interest bearing accounts.

EFFECTIVE DATE: These revisions to Circular A-110 are effective immediately.

FOR FURTHER INFORMATION CONTACT: Office of Management and Budget, Financial Management Division, New Executive Office Building, 726 Jackson Place NW., Room 10235, Washington, DC 20503, (202) 395-3993.

SUPPLEMENTARY INFORMATION: Notice of the proposed revision was published for comment in the Federal Register on October 30, 1985, (50 FR 45183). In response, OMB received over 100 comments from Federal agencies, States, universities and other nonprofit organizations.

Following is a summary of the major comments grouped by subject and a response to each.

Comment: The requirement to remit interest earned to individual Federal agencies would impose an unreasonable administrative burden on recipients.

Response: The requirement to return interest to individual Federal agencies has been in effect for a number of years. Therefore, we do not anticipate any new burdens being placed on grantees as a result of this revision. However, we have asked the Treasury Department to explore the feasibility of having grantees remit interest earned on Federal advances directly to the Treasury.

Comment: Any interest accrued from excess cash on grants or cooperative agreements should be deducted from interest that would have been earned on institutional funds that were used for cost reimbursement contracts.

Response: Institutions accepting cost reimbursement contracts do so with the understanding that they will be required to use their own working capital. There is no provision in the *Federal Acquisition Regulations* for institutions to take credit for interest which would have been earned on working capital. If Federal agencies are late in paying bills the Prompt Payment Act, Pub. L. 97-177, and OMB Circular A-125, "Prompt Payment," require Federal agencies to pay interest penalties when payments are made late.

Comments: Revision of Circular A-110 as proposed would require the creation of separate bank accounts for Federal cash, thus increasing administrative activities and costs.

Response: There appears to be a misunderstanding here. Attachment A, "Cash Depositories," to Circular A-110

specifically prohibits Federal agencies from requiring separate bank accounts. This prohibition remains in effect.

Comment: Interest earned on Federal funds should be applied to related program activities rather than returned to the Federal Government.

Response: In a 1982 decision (42 Comp. Gen. 289 (1982)), the Comptroller General held that grantees may not retain interest earned on grant funds unless specifically authorized by law. Interest earned on grant funds, according to the decision should accrue to the United States and should be accounted for and deposited in the Treasury as miscellaneous receipts.

Comment: If the recipient has an overall negative balance, the Federal Government should be willing to pay interest to the recipient.

Response: Attachment I, "Payment Requirements," to Circular A-110, provides for recipients to get advances or grants and cooperative agreements when the recipient has procedures for minimizing cash balances. Therefore, generally recipients should not be running negative balances. Instances where Federal agencies are unwilling or unable to provide advance funding in accordance with the provision of the circular should be referred to the Financial Management Division, Office of Management and Budget.

Comment: The proposed revision did not provide procedures for computing interest.

Response: The revision now calls for interest to be remitted at least quarterly. The requirement to return interest to the Federal Government is not a new one and recipients should have well established procedures to account for interest on Federal funds. Since 1976 Attachment D, "Program Income" to Circular A-110 has required interest earned on advances of Federal funds to be remitted to the Federal Government. Procedures should be consistent with sound cash management procedures and Treasury Department guidance in this area.

Comment: The proposed revision is not clear as to whether State universities, covered by Circular A-110, will be required to remit interest income to the Federal Government.

Response: Section 203 of the Intergovernmental Cooperation Act of 1968; 42 U.S.C. 34213 (1976) provides that States and their instrumentalities generally are not accountable for

interest earned on grant-in-aid funds. Therefore, State universities that are instrumentalities of a State would not be subject to the proposed revision.

Comment: Increased administrative cost as a result of the revision will in some cases exceed interest income, particularly when accounting for small amount of interest.

Response: The revision now authorizes recipients to keep interest income up to \$100 to pay administrative expenses.

The following paragraph is added to Attachment L "Payment Requirements."

"&a Recipients shall maintain advances of Federal funds in interest bearing accounts. Interest earned on Federal advances deposited in such accounts shall be remitted promptly, but at least quarterly, to the Federal agencies that provided the funds. Interest amounts up to \$100 per year may be retained by the recipient for administrative expense.

James C. Miller III,

Director.

[FR Doc. 87-2701 Filed 2-9-87; 8:45 am]

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***OMB Compliance Supplement for Audits of Institutions
of Higher Learning and Other Nonprofit Institutions***



Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions

October 1991

**Executive Office of the President
Office of Management and Budget**

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Part I. INTRODUCTION

This document sets forth the major compliance requirements that should be considered in an organization-wide audit of universities and other nonprofit institutions that receive Federal assistance. It supplements OMB Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Institutions."

Following this Introduction, this compliance supplement is divided into Parts 2, 3, and 4. Part 2 contains the General Requirements that shall be considered in all financial and compliance audits. Generally, requirements are national policies prescribed by statute, executive order, or other authoritative source that apply to the assistance programs of two or more agencies. The General Requirements included here are the ones that, if not observed, could have a material effect on the organization's financial statements including those prepared for Federal programs.

Of particular note is the inclusion of the requirement for periodic Federal financial reports, as specified in OMB Circular A-110, "Uniform Administrative Requirements for Grants and Cooperative Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations," and agency regulations. The auditor's tests of compliance with this requirement provide the Federal Government with assurance that these reports are complete and reliable.

Part 3 sets forth Common Major Program Requirements for research and development programs and student financial aid programs. These common requirements are used in lieu of program specific requirements because Circular A-133, "Audits of Institutions of Higher Education and other Nonprofit Institutions," designates these two categories as major programs if either category's expenditures is greater than three percent of total expenditures or \$100,000, whichever is larger. The Guaranteed Student Loan Program, which applies to guarantee agencies, has separate requirements included in the supplement.

Part 4 of the document provides requirements that are specific to larger Agency Programs. For each program, the following information is provided: Objectives of the program, a brief description of how the program operates, and major compliance requirements, including Code of Federal Regula-

tions (CFR) or statutory citations, where applicable. The requirements are organized into five categories: (1) types of service allowed or unallowed; (2) eligibility; (3) matching, level of effort, and/or earmarking requirements; (4) special reporting requirements; and, (5) special tests and provisions. Federal agencies have determined that, in general, noncompliance with these requirements might materially affect the program.

Each requirement is accompanied by suggested audit procedures that can be used to test for compliance. These audit procedures are not mandatory. Nor are they the only procedures the auditor can apply. Auditors should use professional judgment when deciding which procedures to apply, and the extent to which reviews and tests should be performed. Some of the audit procedures require a review and evaluation of internal controls. If the reviews and evaluations have been performed as a part of a review of the internal controls structure, the audit procedures used for individual programs should be altered to avoid duplication of procedures.

The Federal departments and agencies have identified the compliance requirements and included suggested audit procedures, as of the date of publication for each program that will meet the compliance testing requirements of Circular A-133. However, the auditor is responsible for ensuring that specific requirements which are modified because of changes in laws or regulations are reflected in the audit procedures.

The compliance requirements and suggested audit procedures replace the individual program audit guides issued by the departments and agencies.

Questions regarding a requirement, including requests for information about changes in requirements, should be addressed to the granting department or agency. Requirements and suggested audit procedures for smaller grant programs not contained herein can also be obtained from the granting department or agency. Auditors may refer to the statute or the CFR to obtain complete requirements. Also, the auditor should refer to the Compliance Supplement for Single Audits of State and Local Governments. This supplement contains programs for which nonprofit institutions are eligible.

Part 2. GENERAL REQUIREMENTS

PART 2. GENERAL REQUIREMENTS

Several statutory and regulatory requirements are applicable to all or most Federal assistance programs. The following are those requirements that involve a significant national policy. Failure to comply with these requirements could have a

material impact on an organization's financial statements including those prepared for Federal programs. Accordingly, these compliance requirements shall be included as part of every audit that involves Federal financial assistance.

POLITICAL ACTIVITY

Compliance Requirement

Federal Funds cannot be used for partisan political purposes of any kind by any person or organization involved in the administration of federally-assisted programs.

[Hatch Act of 1940 (5 U.S.C. 1501-1508) and Intergovernmental Personnel Act of 1970 (45 U.S.C. 4701), as amended by Title VI of Civil Service Reform Act of 1978 (Public Law 95-454 Section 602)].

Suggested Audit Procedures

- Test the expenditure and related records for indications of activities, publications, or other materials intended for influencing legislation or similar type costs.
- Test the personnel and payroll records, and identify persons whose responsibilities or activities include partisan political activity.
- Test whether the above costs, if any exist, are charged directly or indirectly, to federally-assisted programs.

DAVIS-BACON ACT

Compliance Requirement

When required by Federal grant program legislation, all laborers and mechanics employed by contractors or subcontractors to work on construction projects financed by Federal assistance must be paid wages not less than those established for the locality of the project by the Secretary of Labor [40 Stat 1494, Mar. 3, 1921, Chap. 411, 40 U.S.C. 276a-276a-5].

Suggested Audit Procedures

- Identify the programs involving construction activities.
- Review selected construction contracts and subcontracts and determine whether they contain provisions requiring the payment of "prevailing" wages.
- Review the recipient's system for monitoring applicable contractors and subcontractors with

respect to payment of prevailing wages and evaluate for adequacy.

- Review the monitoring system for contracts for selected programs and determine whether there is adherence to the prescribed procedures.
- For recipients which have not developed a system, or whose system is not operating effectively:
 - Obtain the "local" Department of Labor (DOL) wage determination from the auditee, the architect/engineer (A/E) managing the project, or DOL.
 - Obtain from the auditee payroll registers of the construction company and test to determine whether wages paid conform to prevailing wages.

CIVIL RIGHTS

Compliance Requirement

No person shall, on the grounds of race, color, national origin, age, or handicap, be excluded from participation in or be subjected to discrimination in any program or activity funded, in whole or in part, by Federal funds. Discrimination on the basis of sex or religion is also prohibited in some Federal programs (Age—42 U.S.C. 6101 et seq.; Race—42 U.S.C. 2000d; Handicap—29 U.S.C. 794).

Suggested Audit Procedures

- Determine whether the recipient has announced a formal policy of nondiscrimination.
- For recipients employing 15 or more persons, ascertain whether a person has been designated to oversee civil rights compliance. If a person has been designated, interview that person and get an understanding of how the civil rights compliance program operates.
- Ascertain from the grant agreements whether any of the programs contain prohibitions against discrimination on the basis of sex or religion.
- Ascertain the number of complaints filed with Federal, State and/or local agencies responsible for ensuring nondiscrimination in government programs during the fiscal year, the status of unresolved complaints or investigations, and the actions taken on resolved complaints or completed investigations.
- Ascertain whether programs contain prohibitions against discrimination in employment. For those programs: (1) review the annual report filed with the Equal Employment Opportunity Commission (EEOC), if any; (2) ascertain the number of complaints or completed investigations; and, (3) review the status of unresolved complaints or investigations and the actions taken on unresolved complaints or completed investigations.
- Determine whether facilities financed by Federal funds that are required to be located in a nondiscriminatory manner are so located.
- Obtain representation and/or attorney letters to determine if any civil rights suits have been adjudicated or are pending.

CASH MANAGEMENT

Compliance Requirements

Recipient financial management systems shall include procedures to minimize the time elapsed between the transfer of funds from the U.S. Department of the Treasury and the disbursement of funds by the grantee.

Advances made by primary recipients to sub-recipients shall conform substantially to the same standards of timing and amount as apply to advances by Federal agencies to primary recipient organizations.

- Recipients shall maintain advances of Federal funds in interest bearing accounts. Interest earned on Federal advances deposited in such accounts shall be remitted promptly, but at least quarterly, to the Federal agencies that provided the funds. Interest amounts up to \$100 per year may be retained by the recipient for administrative expense (OMB Circular A-110, Attachment I, 8(a)). However, some nonprofit institutions may be instrumentalities of a State and covered by the provisions of the Cash Management Improvement Act of 1990 (Public Law 101-453).

Suggested Audit Procedures

Review the recipient's cash forecasting process and evaluate for adequacy. (Note: For purposes of this supplement, adequacy can be interpreted as providing a reasonable assurance that the system or procedures, if followed, will result in the intended event or action occurring.)

Review the recipient's system for requesting Federal funds and evaluate whether it is adequate to keep Federal cash disbursements limited to the organization's immediate needs.

For selected grant programs, determine dates and amounts for selected advances, drawdowns and other receipts of Federal funds and compare to the dates the funds were disbursed and/or checks were presented to the banks for payment.

For the same programs, evaluate the size of the balances in relation to the program's needs.

Review the recipient's system for monitoring advances and payment requests by secondary recipients. Evaluate whether the system is sufficient to limit payments to amounts needed to meet immediate cash requirements.

- Review selected cash reports submitted by subrecipients and determine if the reports show large amounts of excess cash. If they do, ascertain why.
- Review the recipient's system for maintaining Federal funds in interest bearing accounts, calculating the interest earned on these funds, and remitting the interest promptly.

FEDERAL FINANCIAL REPORTS

Compliance Requirements

Most Federal programs require the periodic submission of financial reports. The special requirements for each grant program are presented in the Reporting Requirements (III-D) section for the program. The suggested audit procedures are provided below to facilitate the requirement for the auditor to comment on completeness and accuracy [OMB Circular A-110, and Treasury Circular 1075, "Withdrawal of Cash from the Treasury for Advances under Federal Grant and Other Programs"].

1. OMB Circular A-110 lists four required financial reports that apply to most of the programs described in this supplement.

- **Financial Status Reports (SF-269 and SF-269A)**—Report status of funds for all non-construction programs.
- **Request for Advance or Reimbursement (SF-270)**—Requests funds for nonconstruction programs when advance letter of credit or predetermined advance payments are not used.
- **Outlay Report and Request for Reimbursement for Construction Programs (SF-271)**—Requests reimbursements and reports status of funds for construction programs.

- **Federal Cash Transactions (SF-272 and SF-272A)**—Reports cash transactions and balances for grantees receiving advances or reimbursement by Treasury checks.

2. Certain Federal agencies have received OMB approval to adapt the above reports or require other financial reports to meet their particular program needs.

Suggested Audit Procedures

- Verify on a test basis that reports on file were actually submitted to the Federal agency.
- Review the procedures for preparing the Federal financial reports and evaluate for adequacy.
- Sample Federal financial reports for each major and/or material program and review for completeness of submission.
- Trace data to the supporting documentation, i.e., worksheets, ledgers, etc.
- Review adjustments made to the general ledger amounts in the report affecting Federal programs and evaluate for propriety.

ALLOWABLE COSTS/COST PRINCIPLES

Compliance Requirement (Direct and Indirect Costs)

The costs of a federally-supported program are comprised of the allowable direct costs of the program plus its allowable indirect costs, less applicable credits. Federal cost principles are designed to provide that Federal programs bear their fair share of recognized costs as determined by applicable cost principles. No provisions for profit or other increment above cost is intended.

OMB Circulars No. A-21, "Cost Principles for Educational Institutions," and Circular A-122, "Cost Principles for Nonprofit Organizations," and other principles issued by Federal granting agencies, such as the Department of Health and Human Services (HHS) 45 CFR 74 Appendix E, "Principles for

Determining Cost Applicable to Research and Development Under Grants and Contracts with Hospitals," establish principles and standards for determining costs applicable to grants, contracts, and other agreements with colleges and universities, nonprofit organizations, and hospitals, respectively. A cost is allowable for Federal reimbursement only to the extent of benefits received by Federal programs, and costs must meet the basic guidelines of allowability, reasonableness, and allocability and be the net of all applicable credits.

OMB's grants management circulars are issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; Reorganization Plan No. 2 of 1970; and, Executive

Order 11541. The HHS hospital cost principles are issued under the authority of 5 U.S.C. 301.

The auditor is responsible for auditing direct and indirect costs. The suggested procedures for auditing direct costs applicable to all programs are presented in the following paragraphs. This avoids having to list these audit procedures for each individual program. The suggested audit procedures for auditing direct costs applicable to each specific program are included in parts 3 and 4 of this compliance supplement. The suggested audit procedures for auditing indirect costs are included as a general requirement in this part of compliance supplement.

Suggested Audit Procedures (Direct and Indirect Costs)

The following suggested audit procedures should be developed in conjunction with the audit tests of indirect costs and direct costs for major and individual programs.

- For transactions selected by the auditor which involve Federal funds, determine whether the costs meet the criteria generally contained in the "Basic Considerations" section of the various applicable cost principles, i.e., that the cost is:
 - (1) Necessary and reasonable for the performance and administration of the Federal program and allocable thereto under the provisions of the cost principles.
 - (2) Authorized or not prohibited under State or local laws or regulations and approved by the awarding agency, if appropriate. Certain costs require specific approval by the grantor agency while some costs are not allowed as set forth in the section of the applicable cost principles dealing with "Selected Items of Costs."
 - (3) In conformance with any limitations or exclusions set forth in the applicable cost principles, or limitations in the program agreement or specific requirements in the program regulations.
 - (4) Given consistent treatment with policies, regulations, and procedures applied uniformly to Federal and non-Federal activities of the recipient organization.
 - (5) Given consistent accounting treatment within and between accounting periods and not allocable to, or included as a direct cost of, a Federal program if the same or similar costs are allocated to the Federal program as an indirect cost.

- (6) Determined in accordance with generally accepted accounting principles or other comprehensive basis of accounting.
- (7) Not included as a cost or used to meet cost sharing requirements of other federally-supported activity of the current or a prior period.
- (8) Net of all applicable credits, e.g., volume or cash discounts, refunds, rental income, trade-ins, scrap sales, direct billings (in the case of indirect cost), etc.
- (9) Supported by underlying documentation, e.g., time and attendance payroll records, personnel activity reports or other time and effort records for employees charged to Federal awards or to more than one activity, approved purchase orders, receiving reports, vendor invoices, canceled checks, etc., as appropriate, and correctly charged as to account, amount, and period.

Compliance Requirement (Indirect Costs Only)

In order to receive reimbursement for indirect costs, recipients must prepare indirect cost rate proposals that provide the basis for allocating indirect costs to Federal programs. Each recipient must submit its proposal to the Federal Government for negotiation of an indirect cost rate. Circulars A-88 and A-122 provide for cognizance systems whereby one Federal agency is designated as the cognizant agency to deal with a college, university or nonprofit organization on behalf of the entire Federal Government and negotiate indirect cost and other rates which are used by all other Federal agencies in dealing with that recipient organization. In most cases, therefore, proposals are submitted to an appropriate cognizant agency.

Proposals are usually prepared on a prospective basis using actual financial data from a prior period or budgeted data for the current year. When the actual costs for the year are determined, the difference between the originally proposed costs and the actual costs are either carried forward to a subsequent period's rate or adjusted with the granting Federal agency on a retroactive basis. In cases where predetermined rates are determined and approved by the cognizant Federal agency, subsequent adjustments are not made with the exception of eliminating any unallowable costs. Audit procedures must be tailored according to the type of rate and size and type of organization being reviewed. If unallowable costs are found, cost

recoveries and adjustments should be made in accordance with the provisions of the applicable cost principles.

Suggested Audit Procedures (General)

- Determine whether indirect costs are charged to Federal awards. If not, the rest of this section does not apply. If such costs are charged, the following guidelines should be followed.
- Obtain and read the current negotiation agreement as well as any agreements, conditions or understandings related thereto and determine the types of rates and procedures required.
- Select a sample of claims for reimbursement submitted to the Federal agency and determine if the amounts charged and rates used are in accordance with the agreements and if rates are being properly applied to the appropriate base.
- Determine whether the rates used or amounts charged are final or predetermined or are still open to adjustment or revision, either immediately or as a carry forward adjustment in a future period. If final, the results of the audit work should be reflected, if appropriate, in recommendations for future procedural improvements. However, if the final or predetermined rates include unallowable costs, they should be identified and reported along with the estimated Federal share of the costs.
- Determine whether costs or types of costs, chargeable directly to Federal awards or any other direct activity (including any costs required for matching or cost charging) have been eliminated from the pool of indirect costs and included in the allocation or rate base.
- Determine whether the established procedures to identify and eliminate unallowable costs are comprehensive and applied in a consistent manner. Verify that the results of these procedures are incorporated into the indirect cost proposal submitted to the cognizant agency.
- Review on a test basis supporting documentation to determine whether:
 - The indirect cost pools contain only items that are consistent with the applicable cost principles and negotiated agreements. This part of the review should be aimed at determining whether the indirect cost pools contain any unallowable costs as defined by

the cost principles (e.g., entertainment, lobbying, etc.).

- The methods of allocating the costs are in accordance with the provisions of the appropriate cost principles, other applicable regulations, and negotiated agreements and produce an equitable distribution of costs.
- Statistical data (e.g., square footage, population or full-time equivalents, salaries and wages) in the proposed allocation bases are current, reasonable, updated as necessary, and do not contain any material omissions.
- Personnel activity reports, time and effort reports, or other methods used to allocate salary and wage costs 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.
- Special costs analysis studies (such as library studies or energy studies) are mathematically and statistically accurate, are factually based to the extent possible, use reasonable and supportable assumptions, produce reasonable results, and, if appropriate, agree with any prior agreements with, or conditions placed by, the cognizant agency concerning such studies.
- The data can be reconciled to the most recently issued financial statements. Investigate significant reconciling items.

Additional Suggested Audit Procedures—Other Types of Rates

Organizations frequently act as self-insurers or provide some types of services for direct activities from centralized service departments on a charge for use basis. In addition, they frequently charge fringe benefits to all activities by means of a fringe benefit rate applied to the salary and wage costs incurred in those activities. The cognizant negotiators, while responsible for such rate activities, may or may not actually negotiate and publish the rates themselves, but merely negotiate the rate setting methodologies and/or resolve any problems which arise.

- When such practices exist determine, whether:
 - The rate bases include all users and all are treated in a consistent manner.
 - Billing rates (or charges) have been adjusted to eliminate profits and unallowable costs.

- The methods used to adjust for accumulated over/under recoveries distributed them in reasonable proportion to the same users as were originally billed for the services which created the accumulation.
- Any retained or unexpended earning (including reserves) are present and, if so, determine: (a) if they have been computed in accordance with the applicable cost principles, (b) if they are excessive in amount, and (c) whether a refund has been made to the Federal Government for its fair share of any amounts thereof which have been removed (transferred out) or borrowed from the fund.
- Fringe benefit allocations, charges, or rates deal fairly with differing levels, if any, of benefits provided to different classes of employees and whether the pool of fringe benefit costs has been reduced for any refunds or rebates received.
- Independent actuarial studies appropriate for self-insurance programs and certain types of fringe benefit programs are performed, and, if so, are kept current, reflect actual conditions, and use reasonable actuarial assumptions.

DRUG-FREE WORKPLACE ACT

Compliance Requirements

- All recipients receiving grants, including cooperative agreements, from any Federal agency must certify that they will provide a drug-free workplace, or, in the case of a grantee who is an individual, certify to the agency that his or her conduct of grant activity will be drug-free. Making the required certification has been a precondition of receiving a grant from a Federal agency since March 18, 1989. Every recipient is required to make this certification for each grant.
- The recipient certifies that it will provide a drug-free workplace by:
 - (a) Publishing a policy statement notifying employees that the unlawful manufacture, distribution, dispensing, possession or use of a controlled substance is prohibited in the grantee's workplace and specifying the actions that will be taken against employees for violation of such prohibition.
 - (b) Establishing an on-going drug-free awareness program to inform employees about:
 - (1) The dangers of drug abuse in the workplace.
 - (2) The grantee's policy of maintaining a drug-free workplace.
 - (3) Any available drug counseling, rehabilitation, and employee assistance programs.
 - (4) The penalties that may be imposed upon employees for drug abuse violations occurring in the workplace.
 - (c) Making it a requirement that each employee to be engaged in the performance of the grant be given a copy of the statement required by paragraph (a).
 - (d) Notifying the employee in the statement required by paragraph (a) that as a condition of employment under the grant the employee will:
 - (1) Abide by the terms of the statement.
 - (2) Notify the employer in writing of any criminal drug statute conviction for a violation occurring in a workplace no later than five calendar days after such conviction.
 - (e) Notifying the agency in writing within ten calendar days after receiving notice under subparagraph (d)(2) from an employee or otherwise receiving actual notice of such conviction.
 - (f) Taking one of the following actions, within 30 calendar days of receiving notice under subparagraph (d)(2), with respect to any employee who is so convicted—
 - (1) Taking appropriate personnel action against such an employee, up to and including termination; or
 - (2) Requiring such employee to participate satisfactorily in a drug abuse assistance or rehabilitation program approved for such purposes by a Federal, State, or local health, law enforcement, or other appropriate agency.

[Public Law 100-690 Title V, Subtitle D, 41 U.S.C. 701 et seq.]

Suggested Audit Procedures

- Determine through discussions with employees and written communications to employees whether the grantee has taken action to provide a copy of the policy statement to each employee engaged in the performance of a grant.
- Ascertain whether the statement contains all the necessary notifications.

- Determine whether the report made to Federal grantor agencies on convictions of employees is filed and complete.
- Test a sample of files of convicted employees and determine whether the report made to Federal grantor agencies on convictions was reported within 10 calendar days after the employer received any notice of an employee's conviction.
- Ascertain whether the grantee took the required personnel or treatment referral action within 30 calendar days after receiving notice of an employee conviction.

ADMINISTRATIVE REQUIREMENTS

Federal assistance programs, are subject to the provisions of Circular A-110, "Uniform Administrative Requirements for Grants and Cooperative Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations."

Three administrative requirements, financial reporting, cost principles, and cash management principles, are covered elsewhere in this part of the Compliance Supplement. The auditor should also consider those common agency administrative requirements listed below from Circular A-110. The scope of the audit work performed for these requirements will depend on the amount of testing performed in connection with individual programs and whether the requirement is material to Federal programs.

- Interest earned on advances
- Period of availability of funds (1)
- Program income
- Real property
- Equipment
- Supplies
- Subawards to debarred and suspended parties (1)
- Procurement
- Subawards¹
- Revolving fund repayments

(See procedures under the following compliance requirements.)

¹ Will be included in the revised Circular.

Compliance Requirement

Program income consists of earnings from federally-supported activities, i.e., income from service fees, sale of commodities, usage or rental fees, and royalties on patents and copyrights. Program income may be used in one of three ways: as a general rule, program income must be used as a deduction from total project costs. If permitted by the terms of awards, such income may be used instead, to further eligible program objectives, or finance the non-federal share of the project. The auditor should refer to the agreement to determine which option applies. Program income excludes interest earned on advances.

The institution must have procedures to ensure proper accountability for program income (Circular A-110, Attachment D).

Suggested Audit Procedures

- Determine whether systems and procedures are in place for the identification and assignment of program income to assume appropriate use in accordance with the terms of awards.
- Test selected items to determine whether program income was properly accounted for and utilized.

Compliance Requirement

The institution must maintain a property management system for its Federal award programs and related activities that is adequate to meet the standards of OMB Circular A-110, Attachment N.

and the requirements of OMB Circular A-21 or A-122.

Suggested Audit Procedures

- Review and evaluate the institution's property management system.
- Test the system to determine whether the institution is:
 - maintaining adequate records of equipment purchased under Federal awards.
 - properly disposing of equipment no longer necessary to project and properly accounting for the Federal share of such equipment.

Compliance Requirement

The institution must have a procurement system which meets the requirements of OMB Circular A-110, Attachment O.

Suggested Audit Procedures

- Review and evaluate the institution's policies and procedures for ensuring that:

- procurement practices provide for competition
- unnecessary equipment purchases are avoided
- subcontractor and subgrantee proposal and performance are adequately reviewed
- Test a sample of procurement transactions to determine whether the minimum requirements of Attachment O are met.

Compliance Requirement

Determine if any of the other administrative requirements listed above are material to Federal awards.

Suggested Audit Procedures

- Review and evaluate internal controls in the administrative areas selected for review.
- Test transactions for compliance.

**Part 3. COMMON MAJOR PROGRAM
REQUIREMENTS**

Part 3. COMMON MAJOR PROGRAM REQUIREMENTS

RESEARCH AND DEVELOPMENT PROGRAMS

I. PROGRAM OBJECTIVES

Specific and general research are sponsored by the Federal Government to achieve objectives agreed upon between the sponsoring agency and the institution. The types of research conducted under

these agreements are widely varied. The objective of individual research projects is explained in the grant agreement or contract.

II. PROGRAM PROCEDURES

Research grants and contracts are awarded to colleges and universities on the basis of research proposals submitted to Federal Government agencies. These proposals are sometimes unsolicited. A

grant or contract agreement is then negotiated in which the purpose of the project is specified, the amount of the award is indicated, and terms of administration are delineated.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

The objectives of individual research projects are explained in the grant agreement or contract; therefore, there are no specific compliance requirements listed here. However, the auditor should ensure funds were used to meet the objectives of the grant.

Suggested Audit Procedures

- See the suggested audit procedures for direct and indirect costs in the General Requirements section of this guide.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

Institutions may be required to share in the cost of research either on an overall institutional or individual grant basis (Circular A-110, Attachment E).

Suggested Audit Procedures

- Obtain an understanding of the cost sharing arrangements with the Federal awarding agencies. Determine whether cost sharing is on an institutional or project-by-project basis.
- Examine the cost-sharing or matching commitment specified by the sponsoring agency in the award document.
- Test whether the organization met these requirements.
- Determine whether in-kind contributions for cost sharing were valued in accordance with applicable Federal cost principles (OMB Circular A-21) and with OMB Circular A-110, Attachment E.

D. Special Reporting Requirements

Compliance Requirement

The grant and contract agreement will specify the required reports.

Suggested Audit Procedure

- See procedures for Federal Financial Reports in the "General Requirements" section of this supplement.

E. Special tests and provisions

Compliance Requirement

The institution should have an accounting system that provides accurate and timely financial reports on Federal awards and related activities. Costs claimed should be allowable and allocable in accordance with Federal cost principles (OMB Circular A-110, Attachment F).

Suggested Audit Procedures

- Review the institution's accounting system to determine whether it is adequate to:
 - Identify the federally-supported activities including the award, authorizations, obligations, unobligated balances, assets, liabilities, outlays and revenues.
 - Accumulate and record expenditures by cost categories provided in the approved Federal award.
 - Account for the institution's financial participation, if required.
 - Assess the reasonableness and allowability of costs claimed in accordance with the provisions of applicable Federal cost principles and the terms of the agreement.
 - Assure that individual items of costs are not claimed against more than one project.
- Test the accounting system to determine if it is operating effectively.

Compliance Requirement

The distribution of individual employee compensation to federally-sponsored research projects must follow the guidance as stated in OMB Circulars A-21 and A-122, HHS Hospital Cost Principles (45 CFR Part 74 Appendix E), and applicable award documents.

Suggested Audit Procedures

- Review and evaluate the institution's system of internal controls and test time distribution and other records to determine whether:
 - Personal service costs have been properly recorded and distributed based on a distribution of activity.
 - Personal service costs incurred were properly approved.
 - Personal service costs were not materially misstated due to processing errors.
 - A liability was accrued for all costs applicable to the period.

— For personal service costs charged to Federal awards:

- Recorded activity is appropriate for the Federal award.
- The salary charge is commensurate with the amount of actual activity.
- The record of activity is signed by authorized personnel.
 - Full distribution of personnel costs is reconciled to the books of accounts at least annually.
 - For a sample of personal service compensation charges, determine whether the system is working as intended by conducting interviews of employees, comparing records or other tests.

Compliance Requirements

Employee benefits must be charged to Federal awards in accordance with OMB Circulars A-21 and A-122.

Suggested Audit Procedures

- Review and evaluate the institution's system of internal controls and the accounting records to determine whether:
 - The fringe benefits were authorized by the personnel policies.
 - The fringe benefits charged to Federal awards were supported by the accounting records.

Compliance Requirements

Direct costs charged to Federal awards must be charged in accordance with OMB Circulars A-21 and A-122 and applicable awards documents.

Suggested Audit Procedures

- Review and evaluate the institution's system of internal controls and test the accounting records to determine whether:
 - The institution has a policy on the use of consultants that is in accordance with Federal requirements.
 - The institution has an acceptable travel policy.
- Select separate samples for travel costs, consultant costs, cost transfers between projects and other direct charges and determine if they are properly documented and are allowable.

Compliance Requirement

The grant award may have special terms and conditions which should be considered during the audit.

Suggested Audit Procedures

- Determine the significant compliance requirements from the research grant or award.
- Develop audit procedures to test compliance with these requirements.

STUDENT FINANCIAL AID PROGRAMS ¹

I. PROGRAM OBJECTIVES

The objective of student financial assistance programs is to provide financial assistance to eligible students attending institutions of higher education.

II. PROGRAM PROCEDURES

Individual program procedures are contained in Appendix A.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirements

Health Professions Student Loan (HPSL), Nursing Student Loans (NSL), Health Education Assistance Loans (HEAL), Scholarship Program for First-Year Students of Exceptional Financial Need (EFNS), Pell Grants (PELL), Perkins Loan (PL), Income Contingent Loan (ICL), College Work Study Funds (CWS), Supplemental Education Opportunity Grant (SEOG), Guaranteed Student Loan (GSL)

General: The school will select qualified applicants and determine the amount to award after considering the financial resources available to the student and the cost reasonably necessary for the student's attendance. The school must make its selection based on the order of the greater financial need, after taking into consideration the other resources available to the student (PL 34 CFR 674.10; HPSL, 42 CFR 57.206; NSL, 42 CFR 57.306(b); HEAL, 42 CFR 60.51(f); EFN, 42 CFR 57.2806).

In determining the financial resources available, the school must use one of the national need analysis systems or any other procedure approved by the Secretary of Education. The school must also take into account other information that it has regarding the student's financial status (ICL, 34 CFR 673.26; PL, 34 CFR 674.14; HPSL, 42 CFR 57.206(b); NSL, 42 CFR 57.306(b)(2); HEAL, 42 CFR 60.51(f); EFNS, 42, CFR 57.2804(b); 471 of Higher Education Act (HEA)).

The costs reasonably necessary for the student's attendance include any special needs and obligations which directly affect the student's ability to attend the school. The school must document the criteria used for determining these costs (PL, 34 CFR 674.19, 673.32; HPSL, 42 CFR 57.206(b)(2); NSL, 42 CFR 57.306(b)(2)(ii); HEAL, 42 CFR 60.51(f)(2); EFNS, 42 CFR 57.2804(b)(3); Sec. 472 OF HEA).

Health Professions Student Loan (HPSL)

The total amount of loans made to a student for a school year may not exceed \$2,500 plus the cost of tuition (42 CFR 57.207).

For medical and osteopathic students who are applying for a HPSL loan, the school must make its selection based on the order of greatest financial need, taking into consideration the other resources available to the student. The resources may include summer earnings, educational loans, veteran (G.I.) benefits, and earning during the school year (HPSL, 42 CFR 57.206(c)). Funds may also be used for capital distribution in Section 743, or, as agreed to by the Secretary for costs of litigation; costs associated with membership in credit bureaus and, to the extent specifically approved by the Secretary, for other collection costs that exceed the usual expenses incurred in the collection of HPSL, NSL loans Funds may also be used for repayments of principal and interest on Federal capital loans. (HPSL, 42 CFR 57.205; NSL, 42 CFR 57.30(a), 57.305(a).

¹ Programs covered are identified in Appendix A.

Nursing Student Loan (NSL)

The total amount of loans made to a student for a school year may not exceed \$2,500 (NSL, 42 CFR 57.307). Funds may also be used for capital distribution in Section 743, or as agreed to by the Secretary. Costs of litigation, costs associated with membership in credit bureaus and, to the extent specifically approved by the Secretary, for other collection costs that exceed the usual expenses incurred in the collection of HPSL, NSL loans (HPSL, 42 CFR 57.205; NSL 42 CFR 57.30(a), 57.305(a)). Funds may also be used for repayments of principal and interest on Federal capital loans.

Health Education Assistance Loans (HEAL)

The maximum amount allowable under this program is determined by health professions as follows: (1) a medical, osteopathy, dentistry, veterinary medicine, optometry or podiatry student may receive no more than \$20,000 per academic year and \$80,000 in total and (2) a public health, pharmacy or chiropractic student and a graduate in health administration, clinical psychiatry and allied health may received no more than \$12,500 per academic year and \$50,000 in total. The lender may disburse funds only for making loans in accordance with the HEAL Insurance Contract (42 CFR 60.10(a)).

Scholarship Program for First-Year Students of Exceptional Financial Need (EFNS)

This program applies to the health profession only.

Scholarships must be awarded successively to the eligible individual with the greatest financial need at that school. A scholarship will include the student's tuition for the first year of study, the cost of all other reasonable educational expenses, and a stipend of \$400 per month (adjusted in accordance with Section 751(g)(3) of the Act) for 12 consecutive months beginning with the first month of the school year (42 CFR 57.2805).

If a recipient ceases to be a full-time student at the school, the school must discontinue all scholarship payments to a student and remit the unused balance of the scholarship to the Federal Government (42 CFR 57.2807).

Pell Grants (PELL)

The institution may expend Pell Grant funds only for grants to students and administration of the Pell program. The institution must (1) calculate grants based on the institution's cost of attendance, the Student Aid Index (SAI), and the enrollment status,

and (2) disburse funds at prescribed times. The maximum and minimum Pell awards vary depending on the payment schedule in effect for the award year. (34 CFR 690.10, 690.82, 690.61-690.66, 690.65-7, Pell Grant Payment Schedules and Federal Student Aid Handbook).

Perkins Loan Program and Income Contingent Loan Program (PL and ICL)

The institution may expend Perkins Loan Program and Income Contingent Loan Program funds only for making loans or administering the loan program or other student financial aid programs in accordance with the Program Participation Agreement. Undergraduate students can receive up to \$9,000, during their undergraduate years with a limit of \$4,500 during the first two years. Graduate students can receive up to \$18,000, including any amounts received as a undergraduate (34 CFR 674.8, 674.18, 674.47; and the Federal SFA Handbook). Certain billing, collection, and litigation costs must first be charged to the borrower and cannot be charged to the loan fund unless specified otherwise under 34 CFR 67.47.

If amounts recovered from the borrower are not sufficient to pay these collection costs, program funds can be used to pay these costs with certain limits (34 CFR 647.7). Funds may also be used for repayment of principal and interest on Federal capital loans.

College Work Study Funds (CWS)

The institution may use college work study funds only for awards to students, transfers to SEOG, Job Location and Development (JLD), Community Services Learning (CSL) and administrative costs (34 CFR 675.18, 675.21, 675.26, 675.33).

Supplemental Education Opportunity Grant (SEOG)

The institution may expend SEOG funds only for grants to students, transfers to the CWS program, and administrative costs. A maximum of \$4,000 and a minimum of \$100 can be granted during an academic year (34 CFR 676.18, and 676.21).

Guaranteed Student Loan Program (GSL)

The auditor is not expected to test expenditures of the Higher Education Act Insured Loan Programs.

General**Compliance Requirement**

In addition to the above described limits, the awarding of Title IV funds must be coordinated with other Federal and nonfederal aid to assure that awards are not made in excess of students' financial needs (34 CFR 668.14, 674.14, 675.14, 676.14, 674.15, 675.15, 676.15, 682.603).

Suggested Audit Procedures

- Review and evaluate the controls used in calculating the student's available financial resources and the cost of attendance, and verify on a test basis the significant financial information on the student's application.
- Verify that the system used to calculate the student's available financial resources was one of the national need analysis systems or a procedure approved by the Secretary of Education.
- Test expenditures and related records to determine if expenditures are made only for allowable services and loan, grant and scholarship amounts were within prescribed limits and made at the prescribed time.

B. Eligibility**Institutional Eligibility and Participation****Compliance Requirement**

In order to participate in the Pell or campus-based programs, the institution must be an eligible institution of higher education, a public or private nonprofit institution of higher education, or a postsecondary vocational institution. These institutions must enter into a written agreement with the Secretary of Education. Public or private nonprofit institutions of higher education, vocational schools, and certain foreign schools, which meet statutory and regulatory requirements, may be eligible to participate in the Stafford Loan, Supplemental Loans for Students and Parent Loans for Undergraduate Students programs (34. CFR 668 Subpart B, 668.11, 682.200, 682.600, 674.8, 675.8, 676.8, 690.7).

To participate in the HEAL program, a school must enter into a written agreement with the Secretary of Health and Human Services, which includes a promise to comply with provisions of the HEAL law and regulations. The school must be accredited and must be legally authorized within the

State to conduct a course of study leading to one of the degrees listed in 42 CFR 60.50.

In regards to the HPSL and NSL programs, each school seeking a Federal capital contribution must submit an application which meets the requirements of the Secretary of HHS. The application must be signed by an authorized individual who assumes, on behalf of the applicant, the obligations imposed by statute, regulations and the terms and conditions of the award (HPSL, 42 CFR 57.203(a); NSL, 42 CFR 57.303(a)).

For the EFNS scholarship program, any health professions school located in the United States or a State (as defined by 42 CFR 57.2802) may apply for a grant. The application must include a list in order of greatest financial need of eligible scholarship recipients and the name of the analysis service used in evaluating the financial status of applicants (42 CFR 57.2803).

Suggested Audit Procedures

- Review the current, signed participation agreement with the applicable Secretary for each of its SFA programs.
- Determine whether the school is accredited by an accrediting agency recognized by the Department of Education and legally licensed by a State to conduct business within the jurisdiction in which it is located.
- Verify that the eligible programs offered by the institution meet the required minimum length or duration and are being offered at their approved length.

Student Eligibility

The requirements for student eligibility are contained in Appendix B to this program supplement.

Suggested Audit Procedures

- Review and evaluate the institution's procedures for determining student eligibility.
- Test student files to determine adherence to prescribed procedures and determine if students were eligible.

C. Matching, Level of Effort, and/or Earmarking Requirements**Compliance Requirement**

For the SEOG program, beginning in award year 1989-90, the institution must pay 5 percent of the award. For 1990-91, the institution share is in-

creased to 10 percent (34 CFR 676.21). For 1991-1992 and subsequent years the institutional share is 15 percent. For all other years, the Secretary may authorize 100 percent Federal funding if certain conditions are met.

The Federal share of CWS compensation is limited according to the following schedule for work performed, unless the institution has received a partial waiver of institutional matching.

Institutional

| Award Year | Nonprofit | For Profit |
|-----------------------------------|-----------|------------|
| 1987-88..... | 80% | 60% |
| 1988-89..... | 80% | 60% |
| 1989-90..... | 75% | 55% |
| 1990-91 and subsequent years..... | 70% | 50% |

A Federal share of 100 percent may be authorized for work performed by a student for the institution, a public agency, or a nonprofit organization. The student must be enrolled in an institution that is designated an eligible institution under the HEA Title III Strengthening Institutions Program or the Strengthening Historically Black Colleges and Universities Program. In addition, the increased Federal share must have been requested by the institution as part of its CWS application for that year (34 CFR 675.23, 675.25, 675.26).

If the institution uses CWS funds to establish or expand a JLD program, the program must be administered in accordance with a written agreement and appropriate records must be maintained by the institution. The institution can only use up to 10 percent of its CWS allocation or \$30,000, whichever is less, to pay up to 80 percent of the JLD program costs. The matching 20 percent of JLD costs cannot be waived by the institution but may be in the form of services. In addition, there are restrictions on allowable costs of the program (34 CFR 675 Subpart B).

Suggested Audit Procedures

- For the SEOG program, ascertain whether the institution has met the matching requirements, or determine whether the institution obtained authorization for 100 percent Federal funding.
- For the CWS program, ascertain whether the Secretary waived a portion of the matching requirement.
- Test expenditures of the institution and determine if the matching requirements have been met.

D. Special Reporting Requirements

Compliance Requirements

The Pell Institutional Payment Summary (ED Form 255-3b) must be submitted to the Department of Education and the Student Status Confirmation Reports (SCRs) must be submitted periodically to the guarantee agency in accordance with the award agreement (34 CFR 682.610).

Suggested Audit Procedures

- Review and evaluate the procedures for preparing and submitting the required reports.
- Test selected reports for completeness and reasonableness and trace data to supporting documentation.

E. Special Tests

Compliance Requirements (Capital Contributions)

The institution must maintain a separate fund account for the Federal Capital Contributions (FCC), Institutional Capital Contributions (ICC), and Federal Capital Loans. Requests for new FCC must only be made when needed. Any idle Perkins Loan (PL) cash including any interest earned must be deposited in an income-producing account. All excess cash must be returned to the Department of Education (34 CFR 674.8, 674.47).

Suggested Audit Procedures

- Review and evaluate the institution's procedures for estimating the capital needed to operate its PL Loan program.
- Determine whether the school has set up a separate fund account for FCC, ICC and the Federal Capital Loans.
- Test expenditure and related records and determine whether all cash including interest earned in PL funds was deposited in an interest-bearing bank account or invested in low-risk income producing securities.
- Determine whether excess PL cash, if any, was returned to the Department of Education.

Compliance Requirements (Student Payments)

The institution may not make a payment to a student prior to registration for the payment period. Credit to a registered student's account may not be made more than three weeks before the first day of classes. Payment to a student directly may not be made more than 10 days before the first day of classes. Under certain circumstances, the institution may credit a student's account for any amount owed

for the award period if a check is not picked up by the student. The institution must observe cut-off dates for accepting Student Aid Reports (SARs) (34 CFR 690.61, 690.78, and 668.60).

Student loans may be paid to or on behalf of student borrowers in installments considered appropriate by the school, except that a school may not pay to on behalf of any borrower more than the school determines the student needs for any given installment period (e.g., semester, term, or quarter). No payment may be made from a fund if at the time of the payment the borrower is not a full-time student (HPSL, 42 CFR 57.209; NSL, 42 CFR 57.309). Compliance requirements for PL payments are covered in 34 CFR 674.13, 674.16 and 668.2, except that PLs can be made to less than full-time students. Each student loan must be evidenced by a properly executed student note (HPSL, 42 CFR 57.208; NSL, 42 CFR 57.308; HEAL, 42 CFR 60.8, 60.41).

GSL checks are sent to the institution by the lender. The institution must follow prescribed procedures for processing and applying loan proceeds which vary depending on whether the student does or does not enroll and whether the check is made out to the student only or jointly to the student and the institution (34 CFR 682.604).

Each school must notify the holder of the HEAL loan of any change in the student's enrollment status within 30 days following the change in status (42 CFR 60.53). The specifications for lender/guarantee agency notifications of student status for GSL appear in 34 CFR 682.610. If a refund results, a participating school must pay the portion of a refund that is allocated to a HEAL loan directly to the original lender or a subsequent holder of a note. The borrower must be notified by the school of such action (42 CFR 60.54).

The school must comply with the responsibilities outlined in 42 CFR 60.61(a). These responsibilities include conducting entrance and exit interviews with each HEAL loan recipient, maintaining documentation of the criteria used to develop the school standard student budget, and notifying the lender or its assignee of any changes in the student's name, address, status, or other information pertinent to the HEAL loan (42 CFR 60.61(a)).

Suggested Audit Procedures

- Review and evaluate the controls designed to ensure that the school makes payments in accordance with the applicable regulations, enrollment status changes are promptly re-

ported to lenders and guarantee agencies and prompt refunds are made.

- Review student files and determine whether prescribed procedures were followed.

Compliance Requirements (Refunds)

A school shall have a fair and equitable refund policy under which the school shall make a refund of unearned tuition fees, room and board and other charges to a student who received a Stafford or SLS program loan or whose parents receive a PLUS loan on behalf of the student. The school pays directly on behalf of the student. The school pays to the original lender (or subsequent holder, if the loan has been transferred and the school knows the new holder's identity) the portion of the refund that is allocable to the loan. Refund checks should be promptly processed.

The refund policy should provide for a refund of at least the larger of the amount provided by: (1) State law, (2) the standards established by the schools' nationally-recognized accrediting agency and approved by the Secretary, (3) the specific refund policy standards contained in Appendix A to 34 CFR 682 or (4) the standards set by another association of institutions of postsecondary education and approved by the Secretary (34 CFR 682.606, 682.607).

For all schools with a default rate in excess of 30 percent and for schools with a default rate in excess of 20 percent which have chosen a default management plan which includes adopting a pro rata refund policy, the requirements of the policy are as follows: The school's policy must conform with the pro rata refund calculation and applicability guidelines as described in 34 CFR 682.606 for a student whose withdrawal date is before the earlier of the halfway point (in time) for the student's program of study or six months after the commencement of the student's program (34 CFR 682.606, effective for student whose last recorded date of attendance is on or after October 1, 1989).

Refunds due to the SFA program are required to be deposited to the SFA accounts or returned to the Stafford, SLA or PLUS lenders within 60 days of the withdrawal date as determined by the institution or (for GSL) 30 days following the expiration of a leave of absence.

The date used to calculate the student's refund or repayment is the date the student officially notifies the school that he or she is withdrawing from the program. If the student leaves school without giving notice, the school must use the "drop-out date." The

withdrawal and drop-out dates can be the same date, but could differ. For example, the student may drop out on September 20, but not notify the school until October 10. September 20 falls within the school's refund period, and thus there is a Title IV refund. However, the 60-day period to return the funds to the lender or Title IV accounts does not start until October 10.

If a student who receives Title IV funds other than CWS is due a refund, the institution must return a portion of the refund to the Title IV program(s) by using the following formula:

Total amount of Title IV (minus CWS earnings) awarded for the Student \times *prepayment period* refund
Total amount of aid awarded (minus earnings) for the payment period

The same formula is used to calculate the student's repayment. However, CWS and GLS funds are excluded from the refund calculation.

As described above, certain institutions are subject to a pro rata refund policy for students who receive a Stafford or SLS loan or whose parents received a PLUS loan. This policy will affect the amount of the student's refund (34 CFR 668.21, 668.22, 682.606, 682.607, 682, Appendix A).

Suggested Audit Procedures

- Review and evaluate refund policy and procedures for conformity with applicable standards.
- Review student drop out files to determine if prescribed procedures were followed and allowances for administrative fees and equipment cost charged to the student were reasonable.
- Review and evaluate procedures for calculating refunds and allocating refunds to the various ED programs and/or Stafford, SLS, or PLUS lenders.
- Review related records for a sample of withdrawals and determine whether prescribed procedures were followed and if refunds were promptly deposited in SFA accounts or were returned to the Stafford, SLS, or PLUS lenders within 60 days of the withdrawal date determined by the institution or 90 days following the expiration of a leave of absence.
- Review and evaluate the school's procedures to identify those students who qualify for a pro rata refund and determine if the school should be making pro rata refunds based on the school's GSL default rate.

STUDENT LOAN REPAYMENTS

Compliance Requirement (Student Loan Repayment)

Each student loan, including accrued interest, will be repayable in equal or graduated periodic installments in amounts calculated on the basis of a 10 year repayment period. Except as required in 42 CFR 57.210(a), repayment of a HPSL loan must begin one year after the student ceases to be a full-time student. For a NSL loan, repayment must begin 9 months after the student ceases to be a full-time or half-time student, except as required in 42 CFR 57.310(a). For a PL loan, repayment requirements are set forth in 34 CFR 674.31(b)(2) and 674.33.

Institutions must exercise due care and diligence in the collection of loans (PL, 34 CFR 674.32, 674.34a, and Subpart C). Grace periods, deferment provisions and due diligence requirements vary depending on when the loan was made (HPSL, 42 CFR 57.210(b)(1), (2), (3), (4), and .211; NSL, 42 CFR 57.310(b)(1), (2), (3), (4) and 57.311).

Suggested Audit Procedures

- Review and evaluate whether the institution's procedures for the following comply with the applicable requirements:
 - Establishing a repayment plan for the student.
 - Tracking the enrollment status of borrowers.
 - Commencing repayment.
 - Conducting exit interviews.
 - Maintaining contact with borrowers.
 - Billing borrowers.
 - Processing deferment and cancellation requests and payments.
 - Referring accounts to collection agencies or performing collection activities on its own, litigating loans and assigning loans to the Federal Government.
 - Communicating with and monitoring and collecting funds from a billing service and or collection agency (if applicable).
- Review loan accounts and determine whether the school followed established procedures and applicable requirements.

Compliance Requirements (Defaults)

NSL and HPSL Programs

- On each June 30, the school must have a default rate as calculated in accordance with

HPSL, 42 CFR 57.216a or NSL, 42 CFR 57.316a of not more than 5 percent. Any school that has a default rate greater than 5 percent on June 30 of any year will be required to reduce its default rate by 50 percent by the close of the following six-month period until the default rate reaches 5 percent (HPSL, 42 CFR 57.216a(b), NSL, 42 CFR 57.316a(b)).

Failure to comply will result in the school receiving no new funds and could result in termination (HPSL, 42 CFR 57.216a(c); NSL 42 CFR 57.316a(c); HPSL, 42 CFR 57.216a(d); 42 CFR 57.316a(d)).

GSL Program

On June 5, 1989, the Department of Education published revised regulations designed to reduce defaults by Stafford, PLUS, and SLS borrowers. These compliance requirements and the related effective dates are shown below:

All institutions except correspondence schools shall conduct counseling with each first time Stafford and SLS borrower at that school prior to the release of the first disbursement of loan proceeds. The school shall ensure that an individual with SFA expertise is available after counseling to answer borrowers' questions. Correspondence schools shall provide borrowers with written counseling materials by mail prior to releasing those proceeds. Schools shall also provide for exit counseling for borrowers. The school shall maintain documentation of its compliance with these requirements in the student borrower's file (34 CFR 682.604(f), effective 8/24/89).

For schools with a fiscal year default rate between 20.1 and 40 percent, a default management plan approved by the Department of Education must be implemented and on file.

For schools with a fiscal year default rate between 30.1 and 40 percent, the school must also perform the following requirements:

- The school must delay certification of loan applications for first time Stafford loan borrowers to ensure that loan proceeds are not delivered or credited until the borrower has attended 30 days during the period of enrollment for which the loan was made. This requirement applies to Stafford loan applications certified on or after October 1, 1989, and must be implemented 60 days after a school receives notice from the Department of its rate (34 CFR 682.603(c)).

- The school must also adopt a pro rata refund policy for its GSL recipients whose withdrawal date is before the earlier of the halfway point (in time) for the student's program of study or six months after the commencement of the student's program. The school's policy must conform with the pro rata refund calculation and applicability guidelines as described in 34 CFR 606. This requirement applies to all GSL loan applications certified on or after November 21, 1989, and must be implemented 60 days after a school receives notice from the Department of its rate.
- A school with a fiscal year default rate of 30 percent or above cannot certify any SLS loans to an undergraduate student. This requirement is effective December 19, 1989, and applies to all loans certified on or after January 1, 1990, and must be implemented immediately upon receipt of notification from the Department that the school's default rate is 30 percent or more.

For schools with a fiscal year default rate above 40 percent, a default management plan is not required to be submitted to the Department for approval. However, schools are expected to implement Appendix D of 34 CFR 668 in its entirety. These schools are also expected to delay certification and adopt a pro rata refund policy. SLS loan restrictions will also apply (Public Law 101-299).

On September 2, 1991, Department of Education regulations made effective Section 3004 of the Omnibus Budget Reconciliation Act of 1990, which requires that an institution lose its eligibility to participate in the GSL programs if its cohort default rates for each of three consecutive fiscal years exceed thresholds established by the new law (35 percent for determinations made in fiscal years 1991 and 1992, 30 percent for determinations made in subsequent fiscal years). It permits the Secretary to withdraw an institution's loss of eligibility if there are exceptional mitigating circumstances that would make the loss of eligibility inequitable. These regulations define the "exceptional mitigating circumstances." They also describe the procedures for appealing the accuracy of the rates and whether the institution satisfies the exceptional mitigating circumstances standard.

HEAL Program

If the Secretary finds that the school did not comply with the applicable HEAL statute and regulations, or its written agreement with the

Secretary, the Secretary may seek reimbursement from any school for the amount of a loan in default on which the Secretary has paid an insurance claim. The Secretary may excuse certain defects if the school satisfies the Secretary that defect did not contribute to the default or prejudice the Secretary's attempt to collect the loan from borrower (42 CFR 60.61(c)).

Suggested Audit Procedures

NSL and HPSL

- Review and evaluate the school's entrance and exit counseling procedures.
- Determine if the school's default rate is more than 5 percent; if so, determine what steps the school is taking to reduce the default rate.
- Review borrower files and determine that established procedures were followed and that counseling documentation is maintained.

GSL

- Review and evaluate the school's entrance and exit counseling procedures.
- For correspondence schools, determine that the institution has adequate procedures for providing borrowers with written counseling materials by mail prior to releasing loan proceeds.
- Determine the school's default rate. If it is between 20 and 40 percent, review the approved default management plan and deter-

mine whether it is being followed. If the default rate is above 40 percent, determine if the school has implemented the measures contained in Appendix D of 34 CFR 668. In addition, if the default rate is above 30 percent, determine if the school has complied with the above requirements concerning delaying loan certifications for first-time Stafford loan borrowers, adoption and implementation of a pro rata refund policy and the prohibition on certifying SLS loans.

Compliance Requirements (Other)

CWS students may be employed by the institution, a Federal, State or local agency, a private not-for-profit organization or a private for-profit organization to do work the employer normally pays to have done. The institution must enter into a written agreement with any agency or organization providing employment under the CWS program. Regardless of the employer, the student must be supervised. If a student is employed by a private for-profit organization, the work that the student performs must be academically relevant to the student's educational program.

Suggested Audit Procedures

- Review the written agreement with employers and determine whether the work performed was allowable, relevant to the student's educational program, and was adequately supervised.

Part 4. AGENCY PROGRAMS

Section A. DEPARTMENT OF AGRICULTURE

PAYMENTS TO 1890 LAND-GRANT COLLEGES AND TUSKEGEE UNIVERSITY

10.205

I. PROGRAM OBJECTIVES

The objectives of the payments to the 1890 Land-Grant Colleges and Tuskegee University are to support continuing agricultural research and to promote efficient production, marketing, distribu-

tion, and utilization of products of the farm as essential to the health and welfare of people and to promote a sound prosperous agricultural and rural life.

II. PROGRAM PROCEDURES

The Cooperative State Research Service (CSRS) provides funds for the 1890 land-grant colleges and Tuskegee University to plan and conduct agricultural research in cooperation with each other and such agencies, institutions, and individuals as may contribute to the solution of agricultural problems under the following legislation:

(a) Section 1445 of the National Agricultural Research, Extension, and Teaching Policy Act of 1977;

(b) Public Law 95-113;

(c) Public Law 95-547;

(d) Public Law 97-98; and

(e) Public Law 99-198.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Moneys appropriated pursuant to Public Law 95-113, Section 1445, shall be used for expenses of conducting agricultural research, printing, disseminating the results of such research, contributing to the retirement of employees subject to the provisions of the Act of March 4, 1940, administrative planning and direction, and purchase and rental of land and the construction, acquisition, alteration, or repair of buildings necessary for conducting agricultural research.

Suggested Audit Procedures

- Test financial records and related data to determine accuracy and completeness.
- Review expenditures to determine that they are in compliance with the provisions of OMB Circular A-21 and the administrative manual for Evans-Allen Cooperative Agricultural Research.

Compliance Requirement

Under provisions of an Act of March 4, 1940, employer contributions to university or state retirement systems from Evans-Allen funds are limited to 5 percent of that portion of the salaries of employees that are paid from Evans-Allen funds. Contributions from Evans-Allen funds may not exceed those contributions from non-Federal sources made by or on behalf of the individual concerned.

Suggested Audit Procedure

For federally supported positions, review the employer contribution to university or state retirement system to determine that the amount to the university/state from Federal funds does not exceed contributions from non-Federal sources and that the contributions from non-Federal sources and that the contribution from Evans-Allen funds does not exceed 5 percent of the amount of the employee's salary paid for under the 1890's Research Program.

B. Eligibility

There are no eligibility requirements.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions***Compliance Requirement***

Evans-Allen Research funds are expected to be expended in the fiscal year of appropriation, but an amount up to 5 percent of the eligible institution's fiscal year allotment may be carried forward to the succeeding fiscal year.

Suggested Audit Procedure

Review fund balances carried over beyond the year of appropriation to ensure that they do not exceed 5 percent.

INTERMEDIARY RELENDING PROGRAM

10.439

I. PROGRAM OBJECTIVE

The objective of the Intermediary Relending Program is to provide funds to intermediaries that establish programs to provide loans to ultimate

recipients for business facilities and community development projects in rural areas.

II. PROGRAM PROCEDURES

Loans are made by FmHA directly to public or private nonprofit organizations (intermediary) to establish revolving loan funds.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Service Allowed or Unallowed

Compliance Requirement

All funds must be relented to ultimate recipients for business or community development. Payment of administrative expenses of the intermediary is not an eligible loan purpose. (7 CFR 1948.109 and 110).

Suggested Audit Procedure

Test for authorized use of FmHA loan funds.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

IRP funds cannot be used to finance more than 75 percent of the cost of an ultimate recipient's project. (7 CFR 1948.110(a)(9))

Suggested Audit Procedure

Test for total cost of project and percent provided by IRP funds.

D. Special Reporting Requirements

Compliance Requirement

The intermediary must submit complete financial statements for FmHA annually. (7 CFR 1948.118(b)(4))

Suggested Audit Procedure

Test the financial statements for completeness and accuracy.

E. Special Tests and Provisions

There are no special tests or provisions.

CHILD AND ADULT CARE FOOD PROGRAM

10.558

I. PROGRAM OBJECTIVE

The objective of the Child and Adult Care Food Program is to assist States to initiate, maintain or expand nonprofit food service programs for chil-

dren and eligible adults in nonresidential child care and Adult Day Care (ADC) institutions.

II. PROGRAM PROCEDURES

Food and Nutrition Service (FNS) generally administers this program through grants to State agencies, generally State educational agencies. The State agencies, in turn, enter into agreements with local institutions for the operation of the program. FNS furnishes program funds to state agencies by letter of credit. The State agency's funding level is the product obtained by multiplying the number of meals served under the programs of each category and type by a corresponding payment rate (called the "national average payment factor"). State agencies use these funds to reimburse institutions under their oversight for meals served and, in

certain cases, administrative costs. In addition to cash assistance, FNS furnishes donated foods or cash in lieu thereof, to States on the basis of the projected numbers of lunches and suppers to be served in participating institutions. State agencies distribute such commodities (or disburse the cash in lieu thereof) to institutions on the basis of annually adjusted per-meal values. In some cases, FNS administers the program because State law or policy precludes a State agency from doing so. In such a case, a FNS regional office would perform the duties otherwise performed by a State agency.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirements

- Four types of meal service are authorized in the program: breakfasts, lunches, supplements (snacks) and suppers. The agreement between an institution and the State agency (or FNS where applicable) specifies which of these types the institution will serve. Subject to the agreement, an institution may receive reimbursement payments for any two meals (breakfast, lunch, or supper) and one supplement or two supplements and one meal, for each child or eligible adult in attendance each day of operation. In addition, child care centers, but not ADC institutions may be approved to receive assistance for three meals and one supplement or two meals and two supplements for any child maintained in day care for each house.
- All meals that an institution reports to the State agency (or FNS where applicable) for reimbursement must: (1) be authorized in the

institution's agreement with the State agency or FNS; (2) contain the food components prescribed by program regulations; (3) be supported by accurate meal counts and records; (4) be served to eligible persons; and (5) in ADC centers, not have been claimed for reimbursement under Part C of Title III of the Older Americans Act of 1965. (See "Recipient Eligibility," below.) (7 CFR 226.2, 226.15(e), 226.20(a), 226.19a(b))

- If authorized in its agreement with the State agency (or FNS where applicable), an institution may receive reimbursement payments for administrative costs relating to the program. Reimbursement payments claimed for such costs must: (1) not exceed amounts approved in the agreement; (2) be supported by source documents and other records; and (3) be for items that conform to the allowable cost rules described in the General Requirements section of this compliance supplement.

Suggested Audit Procedures

- Examine the institution's procedures for preparing claims for reimbursement. Determine whether such procedures contain controls providing reasonable assurance that all meals and sponsor administrative costs reported to the State agency (or FNS where applicable) for reimbursement satisfy the conditions described in the foregoing compliance requirements.

B. Eligibility***Compliance Requirement (Institutional Eligibility)***

- The State agency (or FNS where applicable) may disburse program funds only to non-residential public and nonprofit private child care and ADC centers, to family day care home sponsors, to proprietary Title XX child care centers, and to proprietary Title XIX and Title XX ADC centers. The State agency (or FNS where applicable) must make the program available to any such institution that applies. (7 CFR 226.2, 226.4, 226.6, 226.15-19)

Suggested Audit Procedure

Inspect documents on file at the institution to determine whether it is eligible to operate the program. Such documents may include notification of tax-exempt status issued by the Internal Revenue Service, licenses issued by applicable regulatory agencies, etc. (7 CFR 226.15)

Compliance Requirements (Recipient Eligibility)

- The following classes of persons enrolled in eligible child care institutions are eligible to receive meals under the program: (1) any child who has not reached his/her 13th birthday, (2) any dependent of a migrant farm worker who has not reached his/her 16th birthday, and (3) a physically or mentally handicapped person (as defined by the State) of any age enrolled in an eligible child care facility, where the majority of enrollment consists of persons 18 years of age and under. (7 CFR 226.2)
- The following classes of persons enrolled in eligible ADC institutions are eligible to receive meals under the program: (1) any adult over 60 years of age, and (2) functionally impaired

adults over 18 years of age; except that any adult who is a resident of an institution is not eligible to receive a meal under the program. (7 CFR 226.2)

- To qualify an eligible child or adult for meals served free or at reduced price under the program, the person's family must submit an application to the institution. The application must be approved and maintained on file. The application establishes the person's family income and size and determines if he/she is within income eligibility standards issued by the State agency in accordance with guidelines published by FNS. In family day care homes, applications must be filed only for the provider's children.

Suggested Audit Procedures

- Examine the institution's procedures for processing applications for free and reduced price meals. Determine whether procedures provide reasonable assurance that only persons meeting the income eligibility standards issued by the State agency (or the FNS guidelines where applicable) will be approved to receive meals free or at reduced price. To perform this procedure, it will be necessary to obtain the applicable income eligibility standards or guidelines.
- Select a sample of applications on file at the institution. Inspect them, and determine whether the institution's prescribed procedures for processing applications are being followed.

C. Matching, Level of Effort, and/or Earmarking Requirements

- There are no matching, level of effort, or earmarking requirements.

D. Special Reporting Requirements***Compliance Requirement***

There are no special reporting requirements.

E. Special Tests and Provisions

There are no special tests or provisions.

Section B. DEPARTMENT OF COMMERCE

SEA GRANT SUPPORT PROGRAM

11.417

I. PROGRAM OBJECTIVES

The National Oceanic and Atmospheric Administration (NOAA) operates the Sea Grant Support Program to support the establishment of major

university centers for marine research, education, training and advisory services.

II. PROGRAM PROCEDURES

The Sea Grant Support Program is comprised of 29 core Sea Grant colleges and institutions who in turn operate through a total network of over 200 participating university and marine research institutions throughout the nation. NOAA funds the program through competitive grant awards to Sea Grant applicants who may be universities, colleges,

technical schools, institutes, laboratories, corporations, partnerships, other associations, states or individuals. NOAA specifies the program functions recipients are to perform in the grant awards and uses Sea Grant technical specialists to systematically monitor and evaluate the program.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Sea Grant Support Program funds may be used for research and development, education and training, and advising services or activities specified in the grant agreement. However funds cannot be used to purchase or contract ships or facilities.

Suggested Audit Procedures

- Review grant agreement to determine the activities for which Federal funds can be expended.
- Test expenditures and related records and determine if expenditures were made for authorized purposes.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

Recipients are generally required to provide at least 1/3 of total project costs from non-federal cash or in-kind contributions.

Suggested Audit Procedures

- Review grant award to determine the amount of funds to be provided by the recipient.
- Test expenditures and related records to determine whether the recipient has met the matching requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

Suggested Audit Procedure

Review the financial and performance reports and determine if grantee filed the reports and they are complete and properly supported.

E. Special Tests and Provisions

There are no special tests or provisions.

PUBLIC TELECOMMUNICATIONS FACILITIES PROGRAM

11.550

I. PROGRAM OBJECTIVES

The Public Telecommunications Facilities Program (PTFP) expands and improves the public telecommunications services of the United States by providing grants for dissemination of equipment. The major objective of the PTFP is to extend the

delivery of quality public telecommunications services to as many areas of the United States as efficiently as possible. The majority of PTFP's funding is directed to public radio and public television facilities.

II. PROGRAM PROCEDURES

PTFP is a competitive grant program which reviews applications based on some fifteen criteria outlined in the PTFP regulations. A series of reviewers (PTFP staff, engineering consultants and independent reviewers) evaluate the technical, financial and programmatic aspects of the application. PTFP then consults with a National Advisory Panel of outside experts about the applications. The Director forms a tentative slate and presents the slate to the Assistant Secretary for final selection. The

processing time from receipt of applications until approval of a final slate is approximately 150 days. However, many projects proposed for PTFP funding require licensing authorization from the Federal Communications Commission (FCC). The FCC review process is very complex and often requires 180 days to be able to clear PTFP applications. PTFP continues to process applications and forwards applications to the Office of Federal Assistance for processing while waiting for final FCC clearance.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

PTFP funds can be used for the planning and construction of public telecommunications facilities, and equipment specified in the grant agreement. Some matching grants are awarded for the apparatus necessary for production, dissemination, interconnection, reception of noncommercial education, cultural radio and television program, and related noncommercial instructional or informational material. Costs associated with filing for Federal assistance, installation costs, and other pre-operational costs are eligible to be included in request for matching funds. Costs for buildings, renovations of buildings, land, operational expenses and indirect costs are ineligible.

Suggested Audit Procedures

- Review grant agreement to determine the costs for which grant funds can be expended.
- Test expenditures and related records and determine if expenditures were made for authorized purposes.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

The Administrator of the National Telecommunications and Information Administration (NITA) may provide up to 100 percent of the funds necessary for the planning of a public telecommunications facility. The maximum amount of Federal grant for the construction of a public telecommunication facility is 75 percent of the total eligible project costs.

Suggested Audit Procedures

- Review the grant agreement to determine if any costs are designated for the construction of a telecommunication facility.
- Tests expenditures and related records and determine if the matching requirements were met.

D. Special Reporting Requirements

Compliance Requirement

During construction, quarterly progress reports must be submitted. Because the Federal government maintains a 10 year reversionary interest in the use of the facilities from the date of completion, annual reports must be submitted before April 1st of each year during such period.

Suggested Audit Procedure

Review quarterly progress and annual reports and determine if they are complete, accurate, and filed on timely basis.

E. Special Tests and Provisions

Compliance Requirement

PTFP is an equipment grant program and the Federal government has a vested interest in the equipment for a period of ten years after completion of the project. Proper tagging of equipment, insurance on equipment, lien, FCC license, and leases and site rights all must be current.

Suggested Audit Procedures

- Review the grant agreement and determine the equipment for which funds can be expended.
- Review inventory records to determine if the equipment is properly identified, is adequately insured, and accounted for.
- Ascertain if a physical inventory of property is taken every two years in accordance with Attachment N, Circular A-110.

Compliance Requirement

Projects must be completed within a reasonable period of time, generally, 1 to 2 years, or as specified in the grant award. Although, extensions may be requested, they must be approved by the Grants Officer.

Suggested Audit Procedures

- Review the grant agreement and determine the project completion date and approved extensions, if any.
- Review quarterly and final progress reports and determine if grant agreements have been met.

MINORITY BUSINESS DEVELOPMENT CENTER (MBDC) PROGRAM

11.800

I. PROGRAM OBJECTIVES

The Minority Business Development Agency (MBDA) operates the Minority Business Development Center (MBDC) program to provide business

development services to minority firms and individuals interested in entering, expanding, or improving their effort in the competitive marketplace.

II. PROGRAM PROCEDURES

MBDA operates the MBDC program through a national network of approximately 100 MBDCs located throughout the country in areas with the largest minority populations. MBDA funds the MBDCs through competitive cooperative agreements which specify the following six program functions the MBDCs are required to perform: (1) management and technical assistance, (2) advocacy, (3) outreach, (4) inventorying, (5) brokering, and (6) quality control. The functions are explained in the cooperative agreement.

MBDC applicants may be individuals, nonprofit organizations, private firms, state and local gov-

ernments, American Indian tribes, or educational institutions. MBDC counselors provide management, marketing, and technical assistance to minority individuals wishing to start, expand, or improve their businesses. The counselors provide assistance in such areas as accounting, inventory control, bid estimating, bonding, personnel management, contract negotiations, and marketing.

MBDA systematically monitors the MBDCs through its network of six regional offices and periodically evaluates MBDC performance through a specific set of established standards.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

MBDA funds to MBDCs can be expended only for management and technical assistance to minority clients located in designated Metropolitan Statistical Areas (MSAs).

Suggested Audit Procedures

- Review cooperative agreements to determine the functions for which federal funds can be expended.
- Test expenditures and related records and determine if expenditures were made for authorized purposes.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirement

Compliance Requirement

MBDCs are required to provide a minimum of 15 percent of total project costs through cash contributions, client fees, or in-kind contributions.

Suggested Audit Procedures

- Review cooperative agreements to determine the amount of funds to be provided by the MBDC.
- Test expenditures and related records to determine whether the MBDC has met the matching requirements.

D. Special Reporting Requirements

Compliance Requirement

MBDCs are required to submit quarterly and annual narrative reports and quarterly statistical (business development) reports.

Suggested Audit Procedure

Examine selected reports to determine whether they are complete and agree with the supporting records.

E. Special Tests and Provisions

There are no special tests or provisions.



Section C. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

RENTAL AND COOPERATIVE HOUSING FOR LOWER INCOME FAMILIES

(Section 236 and Rental Assistance Payments)

14.103

I. PROGRAM OBJECTIVES

The objectives of the Section 236 program are to provide affordable housing for lower income persons through the provision of mortgage insurance (except for non-insured, State Agency financed

projects), mortgage interest reduction payments, and in certain cases, rental assistance payments for qualified tenants.

II. PROGRAM PROCEDURES

The Department insures mortgages made by private lending institutions and makes periodic interest reduction payments to help finance multi-family rental or cooperative housing for lower income households. Rental Assistance Payments may be made to owners on behalf of tenants whose income is too low to permit them to pay the approved Gross Rent with 30% of their Adjusted Monthly Income.

The functions of the non-profit owner of a project assisted under this program are to : (1) properly certify and recertify tenant income; (2) provide for management of the property satisfactory to HUD and (3) abide by HUD regulations and instructions regarding rents and charges. The non-profit's performance is monitored by HUD or the Contract Administrator, which reviews and approves rents and monitors the physical and financial condition of the property.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed and Unallowed

Compliance Requirement

In accepting assistance under this section, mortgagors agree to be regulated as to rents, charges and methods of operation. Project funds may be used only for expenses that are reasonable and necessary to the operation of the project.

Suggested Audit Procedures

- Review the project agreement for the project objective and allowed costs.
- Review and evaluate the controls to ensure that rents are collected and expenses paid are allowable and in accordance with the agreement.

- Test revenues, expenditures, and related records and determine that all rents are collected and expenses paid are allowable and in accordance with the agreements.

B. Eligibility

Compliance Requirement

Section 236 projects must comply with the tenant eligibility requirements set forth in HUD Handbook 4350.3: "Occupancy Requirements of Subsidized Multi-family Housing Programs."

Suggested Audit Procedures

- Review and evaluate procedures followed in determining and certifying tenant eligibility.

- Test related records and determine that eligibility was determined properly.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort, or earmarking requirements.

D. Special Reporting Requirements

Compliance Requirements

Owners of 236 projects receiving Rental Assistance Payments are responsible for certifying tenant eligibility for assistance. When requesting payments each month, owners must report to HUD or the Contract Administrator on the certifications and, as appropriate, on the financial condition of the project. Additionally, project with mortgages insured or held by HUD are required to establish and

maintain their books and records in accordance with HUD's Uniform Chart of Accounts and comply with all other applicable requirements set forth in HUD Handbook 4570.2: "Financial Operations and Accounting Procedures for Insured Multi-family Projects."

Suggested Audit Procedures

- Review and evaluate the accounting system and determine whether it is in accordance with HUD's Uniform Chart of Accounts.
- Review financial reports and determine whether they are complete, and agree with the supporting records and are filed timely.

E. Special Tests and Provisions

There are no special tests or provisions.

MORTGAGE INSURANCE FOR HOSPITALS (Section 242)

14.128

I. PROGRAM OBJECTIVES

The object of the Section 242 program is to assist, through the provision of Federal mortgage insurance, in the development or rehabilitation of urgently needed hospitals for the care and treatment

of persons who are acutely ill or who otherwise require medical care and related services of the kind customarily furnished only (or most effectively) by hospitals.

II. PROGRAM PROCEDURES

HUD insures mortgages made by private lending institutions (mortgagee) to facilitate financing of hospitals (mortgagors). Hospital project must be approved by the appropriate State agency and receive a Certificate of Need or its equivalent. The facility must meet Federal, State and local licensing, certification, and occupancy standards. The Department of Health and Human Services (HHS)

processes and reviews all applications for mortgage insurance under this program.

The basic functions of the non-profit as owner of a hospital insured under this program are to ensure compliance with the appropriate regulations and to properly maintain the facility. The owner's management performance is monitored by HHS, while HUD oversees the financial condition of the facility.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed and Unallowed

Compliance Requirement

In accepting mortgage insurance under this section, mortgagors agree to provide allowable services including health (medical, dental, nutrition, and mental health), education, and patient supportive services that are consistent with and conform to Federal and State laws and codes. Mortgagors agree to be regulated accordingly. They must also adhere to a Section 242 Regulatory Agreement and to the Covenants and Conditions set forth by the HHS. Project funds may be used only for expenses that are reasonable and necessary in the development and operation of the project.

Suggested Audit Procedures

- Review the Regulatory Agreement and determine allowable costs.
- Review and evaluate the procedures used to control receipt of funds for the project.
- Review and evaluate procedures for review, approval, and payment of costs and processing of change orders and amendments to contracts and project line items.

- Test expenditures and related records and determine if funds are made only for allowable purposes.

B. Eligibility

Compliance Requirements

HUD and HHS regulations require the mortgagor to secure and maintain all required State and local licenses, certifications and accreditations.

Suggested Audit Procedures

- Review mortgagor records to determine that all required licenses, certifications, and accreditations are current.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort, or earmarking requirements.

D. Special Reporting Requirements

Compliance Requirements

Projects must establish and maintain their books and records in accordance with the American

Hospital Association's Uniform Chart of Accounts and comply with all other applicable requirements set forth in HUD Handbook 4370.2: Financial Operations and Accounting Procedures for Insured Multi-family Project." Mortgagors of projects insured under this program must submit to HUD and HHS an annual financial statement.

Suggested Audit Procedures

- Review and evaluate the accounting system to determine whether it is in accordance with applicable requirements.
- Review financial reports and determine whether they are complete and agree with the supporting records and are filed timely.

E. Special Tests and Provisions

Compliance Requirements

Hospitals insured under this program are governed by a Regulatory Agreement, which requires, among other things, that the facility be management and maintained in a manner satisfactory to HUD and HHS. Hospitals are also subject to State and local regulations with respect to management and operations.

Suggested Audit Procedures

- Review the Regulatory Agreement(s) and determine the specific requirement(s), if any, that apply to the project.
- Review related records and determine if the project is being maintained in accordance with the specific requirement(s).

NURSING HOMES, INTERMEDIATE CARE FACILITIES, AND BOARD AND CARE HOMES (Section 232)

14.129

I. PROGRAM OBJECTIVES

The objective of the Section 232 program is to provide mortgage insurance for the construction or substantial rehabilitation (including acquisition) or

nursing homes, intermediate care facilities and board and care homes.

II. PROGRAM PROCEDURES

Under Section 232 of the National Housing Act, HUD insures mortgages made by HUD-approved private lenders to eligible private, profit-motivated or non-profit mortgagors to finance the construction or substantial rehabilitation of nursing homes, intermediate care facilities and board and care homes. Nursing homes and intermediate care facilities must include at least 20 beds and board and care homes must have a minimum of five bedrooms or units. Depending on the type of the facility, facilities may

offer a range of services from skilled nursing care to continuous protective oversight.

The non-profit mortgagor may be a private corporation or association, but must be organized for purposes other than making a profit for itself or for its officers or members. Therefore, it must not be controlled or directed in any way by persons or firms seeking to derive profit from the facility.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed and Unallowed

Compliance Requirement

In accepting mortgage insurance under this section, mortgagors agree to be regulated subject to a regulatory agreement. A corporation mortgagor may also be regulated by charter provision. The insured facility must be located in a State which requires a certificate of need or is in compliance with 1616(e) of the Social Security Act (Key Amendment). The facility must meet Federal, State and local licensing, certification, occupancy, and operating standards. HUD relies on the various agencies to enforce their licensing and operating standards. Project funds may be used only for expenses that are reasonable and necessary to the operation of the project.

Suggested Audit Procedures

- Review and evaluate internal control procedures for collecting resident charges and Medicaid (State) and Medicare (Federal) reimbursements.

- Test related records/statements and determine that funds were expended for allowable purposes.
- Obtain copies of Medicaid and Medicare cost reports and review for overpayments or disallowances.

B. Eligibility

Compliance Requirements

Eligibility is established by Health Care Financing Administration (HCFA) or the Medicaid State Agency or its sub-contractor (County Social Service or Blue Cross/Blue Shield).

Suggested Audit Procedures

- Review and evaluate the entity's procedures to ensure its compliance with provider agreements and HCFA requirements.
- Review financial and related records and determine whether compliance with the requirements and agreements was met.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort, or earmarking requirements.

D. Special Reporting Requirements

Compliance Requirements

Facilities insured under Section 232 must establish and maintain their books and records in accordance with accounting and reporting standards under the health care industry audit and accounting guide (Providers of Health Care Services). Mortgagors of projects insured under this program must submit to HUD annual financial statements.

Suggested Audit Procedures

- Review and evaluate the accounting system and determine whether it complies with requirements.

E. Special Tests and Provisions

Compliance Requirements

Facilities that receive government funds (Medicare and Medicaid) must comply with Section 483 of the Omnibus Budget Reconciliation Act of 1987 (OBRA). Facilities must provide medical services in accordance with HCFA standards and state licensing and certification standards. Insured facilities are also governed by the Regulatory Agreement, which requires, among other things, that the facility be managed and maintained in a manner satisfactory to HUD.

Suggested Audit Procedures

- Review and evaluate the policies and procedures to ensure compliance with HCFA and state licensing and certification standards.
- Review the HUD Regulatory Agreement and determine if there are any specific requirements.
- Review related records and required reports and determine whether the specific requirements were complied with.

MULTIFAMILY RENTAL HOUSING FOR MODERATE-INCOME AND DISPLACED FAMILIES (Section 221(d)(3))

14.135

I. PROGRAM OBJECTIVES

The objective of the Section 221(d)(3) program is to assist private industry in the development of housing projects designed to meet the needs of

moderate-income and displaced families by providing mortgage insurance.

II. PROGRAM PROCEDURES

The Department insures mortgages made by private lending institutions to help finance construction or substantial rehabilitation of multi-family rental or cooperative housing for moderate-income or displaced families.

The functions of the non-profit as sponsor of a housing project under this program are to: (1)

ensure compliance with the appropriate regulations; (2) properly maintain the property; and (3) operate the project in accordance with the project's Regulatory Agreement. The non-profit's performance is monitored by HUD, which reviews then approves rent and monitors the financial condition of the project.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed and Unallowed

Compliance Requirement

HUD insures lenders against loss on mortgages for market rate rental projects. Insured mortgages may be used to finance construction or rehabilitation of or rental or cooperative detached, semidetached, row, walkup, or elevator-type rental housing containing 5 or more units. The program has statutory mortgage limits which vary according to the size of the unit, the type of structure, and the location of the project. There are also loan-to-replacement cost and debt service limitations.

In accepting mortgage insurance under this section, mortgagors agree to be regulated as to rents, charges and methods of operation. Project funds may be used only for expenses that are reasonable and necessary to the operation of the project.

Suggested Audit Procedures

- Review the project agreement for the objective and allowable services.
- Review and evaluate the controls to ensure that rents are collected and project expenses are allowable and in accordance with the project agreements.

- Test revenues, expenditures, and related records to determine that all rents are collected and expenses paid are allowable and in accordance with the agreements.

B. Eligibility

Compliance Requirement

Section 221(d)(3) Below Market Interest Rate projects must comply with the tenant eligibility requirements set forth in HUD Handbook 4350.3: "Occupancy Requirement of Subsidized Multi-family Housing Programs."

Suggested Audit Procedures

- Review and evaluate procedures for determining and certifying tenant eligibility.
- Test related records and determine that eligibility was properly determined.

C. Matching, Level of Effort, and/or Earmarking Requirement

There are no matching, level of effort, or earmarking requirements.

D. Special Reporting Requirements

Compliance Requirements

Projects must establish and maintain their books and records in accordance with HUD's Uniform Chart of Accounts and comply with all other applicable requirements set forth in HUD Handbook 4370.2: "Financial Operations and Accounting Procedures for Insured Multi-family Projects." Mortgagors of projects insured under this program must submit to HUD an annual financial statement.

Suggested Audit Procedures

- Review and evaluate the accounting system and determine whether it is in accordance with HUD requirements.
- Review financial reports and determine whether they are complete and agree with the supporting records and are filed timely.

E. Special Tests and Provisions

Compliance Requirement

Section 221(d)(3) projects are governed by a Regulatory Agreement, which requires, among

other things, that the project be managed and maintained in a manner satisfactory to HUD.

Suggested Audit Procedures

- Review and evaluate the accounting system and determine whether it is in accordance with HUD requirements.
- Review financial reports and determine whether they are complete and agree with the supporting records.

E. Special Tests and Provisions

Compliance Requirement

Section 221(d)(3) projects are governed by a Regulatory Agreement, which requires, among other things, that the project be managed and maintained in a manner satisfactory to HUD.

Suggested Audit Procedures

- Review the Regulator Agreement(s) and determine the specific requirement(s), if any, that apply to the project.
- Review related records and determine if the project is being maintained in accordance with the specific requirement(s).

RENT SUPPLEMENT

14.149

I. PROGRAM OBJECTIVES

The objectives of the Rent Supplement Program are to provide rental assistance to lower income

families and to assist in the operation of projects housing lower income families.

II. PROGRAM PROCEDURES

HUD may pay rent supplements on behalf of eligible tenants to certain private owners of multi-family Farmers Home Administration insured or state financed housing. The payment makes up the difference between 30 percent of the tenant's adjusted income and the fair market rent determined by HUD. However, the subsidy may not exceed 70 percent of the HUD-approved rent for the specific unit. The functions of the nonprofit under

the rent supplement program are to: (1) properly certify and recertify tenant income; (2) provide for quality management of the property; and (3) abide by HUD regulations and instructions regarding rents and charges. The nonprofit is monitored by HUD (or a Contract Administrator in the case of a non-insured, State agency financed project) which reviews and approves rents and Rent Supplement payments.

III. COMPLIANCE REQUIREMENT AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed and Unallowed

Compliance Requirements

HUD makes payments to owners of approved HUD-insured and non-insured multifamily rental housing projects to supplement the partial rental payments of eligible tenants. Rental projects were required to be part of an approved workable program for community improvement or be approved by local government officials. Assistance covers the difference between the tenant's payment and the basic market rental, but may not exceed 70 percent of the market rental. The tenant's payment is between 25 and 30 percent of monthly adjusted income or 30 percent of market rental, whichever is greater. For projects with an insured or HUD-held mortgage, project funds must be used in accordance with the project's Regulatory Agreement.

Suggested Audit Procedures

- Review the project agreement.
- Review and evaluate the controls to ensure that rents are collected and project expenses are allowable and in accordance with the project agreements.
- Test revenues, expenditures, and related records and determine that all rents are collected

and expenses paid are allowable and in accordance with the agreements.

B. Eligibility

Compliance Requirements

Rent Supplement projects must comply with the tenant eligibility requirements set forth in HUD Handbook 4350.3: "Occupancy Requirements of Subsidized Multifamily Housing Programs."

Suggested Audit Procedures

- Review and evaluate procedures followed in determining and certifying tenant eligibility.
- Test records and determine that eligibility was properly determined.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort or earmarking requirements.

D. Special Reporting Requirements

- Review procedures for preparation and submission of month billings and evaluate for adequacy.
- Test selected records.

Compliance Requirements

Owners of projects receiving assistance under the Rent Supplement program are responsible for certifying tenant eligibility for assistance. When requesting payments each month, owners must report to HUD or the Contract Administrator on the

Certifications and, as appropriate, on the financial condition of the project.

E. Special Test and Provisions

There are no special tests and provisions.

SUPPLEMENTAL LOANS FOR MULTI-FAMILY PROJECT AND HEALTH CARE FACILITIES (Section 241)

14.151

I. PROGRAM OBJECTIVES

The objective of the Section 241 program is to facilitate improvements to HUD-insured multi-family rental housing and health care facilities by providing federal loan insurance.

II. PROGRAM PROCEDURES

The program insures loans made by private lending institutions to pay for additions or improvements to apartment projects, nursing homes, intermediate care facilities, board and care homes, hospitals, or group practice facilities that already carry HUD-insured mortgages. Improvements may include energy conserving improvements, solar energy systems and individual utility meters that are in conformity with standards prescribed by the

Secretary. Loans to health care facilities may also be used to purchase equipment to be used in the operation of such facilities.

The functions of the non-profit receiving assistance under Section 241 are to ensure that the expenditure of funds is in accordance with the loan agreement and with HUD regulations and instructions.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed and Unallowed

Compliance Requirements

Loan proceeds may be used only to finance additions or improvements, solar energy systems and individual utility meters that are in conformity with standards prescribed by the Secretary, and, in the case of health care facilities, purchase equipment to be used in the operation of such facilities.

Suggested Audit Procedures

- Review and evaluate procedures for ensuring funds are expended only for allowable purposes.
- Test expenditures and related records and determine that funds were expended only for allowable purposes.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort, or earmarking requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

There are no special tests or provisions.

LOWER INCOME RENTAL ASSISTANCE (Section 8)

14.156

I. PROGRAM OBJECTIVES

The objectives of the Section 8 are to provide rental assistance to lower income persons and to

assist in the development and/or operation of projects housing lower income persons.

II. PROGRAM PROCEDURES

HUD makes up the difference between what a low and very low-income household can afford and the approved rent for an adequate housing unit. Eligible tenants must pay the highest of either 30% of adjusted income, 10% of gross income or portion of welfare assistance designated to meet the housing costs. Housing thus subsidized by HUD must meet certain standards of safety and sanitation.

The function of the non-profit under the Section 8 program are to: (1) properly certify and recertify tenant income; (2) maintain the project in accordance with HUD's Housing Quality Standards; and (3) abide by HUD (or a Contract Administrator in the case of non-insured projects) which (1) reviews tenant certifications and recertifications; (2) periodically inspects the property; and (3) approves rents and assistance payment.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed and Unallowed

Compliance Requirement

Lower Income Rental Assistance Program payments are used to make up the difference between the approved rent due to the owner for the dwelling unit and the occupant family's required contribution towards rent. Assisted families must pay rent which equals the highest of 30 percent of their adjusted family income, 10 percent of gross family income, or the portion of welfare assistance designated for housing. For projects with insured or HUD-held mortgages, project funds must be used in accordance with the projects' Regulation Agreement.

Suggested Audit Procedures

- Review the project agreement.
- Review and evaluate the controls to ensure that rents collected and project expenses are allowable and in accordance with the project agreement.
- Test revenues, expenditures, and related records and determine that all rents are collected and expenses paid are allowable and in accordance with the agreements.

B. Eligibility

Compliance Requirement

Section 8 projects must comply with the tenant eligibility requirements set forth in HUD Handbook 4350.3: "Occupancy Requirements of Subsidized Multi-family Housing Program."

Suggested Audit Procedures

- Review and evaluate procedures for determining and certifying tenant eligibility.
- Test related records to determine that eligibility was properly determined.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort, or earmarking requirements.

D. Special Reporting Requirements

Compliance Requirement

Owners of projects receiving Section 8 assistance are responsible for certifying tenant eligibility for assistance. When requesting payments each month, owners must report to HUD or the contract administrator on the certification and, as appropriate, on the financial condition of the project.

Suggested Audit Procedures

- Review and evaluate procedures followed in the preparation and submission of payment requests.
- Test related records and determine whether the certifications are properly prepared and submitted timely.

E. Special Tests and Provisions***Compliance Requirements***

Section 8 projects are governed by a Housing Assistance Payments (HAP) Contract, which, among

other things, requires that the project be maintained in accordance with HUD's Housing Quality Standards and that rents and charges be established in accordance with HUD requirements.

Suggested Audit Procedures

- Review the HAP Contract and determine the specific requirement(s), if any, that apply to the project.
- Review related records and determine if the project is being maintained in accordance with the specific requirement(s).

HOUSING FOR THE ELDERLY OR HANDICAPPED (Section 202)

14.157

I. PROGRAM OBJECTIVES

The objective of the Housing for the Elderly or Handicapped Program is to stimulate the development of rental or cooperative housing facilities specially designed to serve the elderly (62 years of age and over) or the handicapped (between the ages of 18 and 62) by awarding direct Federal loans to private, non-profit corporations or consumer co-

operatives to finance the new construction or substantial rehabilitation of such facilities. Loans also may be made for the purchase of existing structures with or without moderate rehabilitation to provide group homes for the handicapped who are physically disabled, mentally disabled or chronically mentally ill.

II. PROGRAM PROCEDURES

Nonprofit organizations make annual applications to the local HUD Field Office. The successful applicants are awarded fund reservations based on a formula in determining the loan amount. The applicants are then sent a notification of selection letter which states the terms and conditions for the fund reservation and invites them to submit an application for conditional commitment. The conditional commitment applications provide a more detailed plan of the proposed housing. If approved, HUD will instruct the borrower to submit a firm commitment application, generally within 90 days of issuance of the conditional commitment.

HUD and the borrower will prepare for the initial closing of the loan and the start of construction once there has been approval on the firm commitment application (which includes the final plans and specifications of the project) and the borrower has obtained a building permit. The first draw-down of the loan covers the cost of the land and reimburses the borrower for all preconstruction expenses incurred, such as architectural design fees, consultant fees, attorney fees, and preliminary site engineering costs. The subsequent loan disbursements, which generally occur monthly, go primarily to the

general contractor. At completion of the project, all construction funds have been generally disbursed except a 10 percent holdback which is retained to induce the general contractor to complete the cost certification process.

During construction, the borrower may submit requests for change orders to cover any additional costs associated with unanticipated changes in construction. During various stages of construction, the project is inspected by a HUD Field Office staff inspector and by the locality's inspectors to assure compliance with local codes.

Upon completion of construction, a cost certification is required. When a negotiated construction contract is used, this involves an itemized certification by the general contractor and the borrower as to costs incurred during the construction period. After a final inspection of the project is made, completion of costs certification, and issuance of an occupancy permit by the local authority, HUD and the borrower conduct a final loan closing, in which the final disbursement of local proceeds is released to the borrower.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Federal funds in the form of loan proceeds and project revenues can only be used in accordance with the Firm Commitment, Requisition for Loan Disbursement, Building Loan Agreement, Mortgage,

Note, Regulatory Agreement, and Housing Assistance Payment Contract. The handling of Federal funds must be in conformance with the Department's November 4, 1988, policy directive on prohibited conflict/identity of interest transactions in the Section 202 program. Loan repayment must

be made in accordance with the Mortgage, Note and Regulatory Agreement.

Suggested Audit Procedures

- Review the project and loan agreements for the project objective and allowable use of proceeds.
- Test expenditures and related records to determine that terms of the agreements were met.

B. Eligibility

Compliance Requirement

Residents of Section 202 projects must be "elderly or handicapped families consisting of two or more persons, the head of which (or his spouse) is 62 years of age or over or is handicapped. Residents receiving Section 8 assistance must meet that program's income eligibility requirements.

Suggested Audit Procedures

- Review and evaluate the procedures for admission of residents.
- Test related records and determine whether eligibility was determined properly.

C. Matching, Level of Effort, and/or Earmarking Requirements

Section 202 borrowers must put up a minimum capital investment of 1/2 of 1 percent of the loan amount, not to exceed \$10,000, at the time of initial loan closing. This investment is returned at the end of a three-year escrow period if not need to cover any operating deficits. Section 202 loans are intended to cover 100 percent of the development costs. In some instances, however, borrowers must contribute some front-end money to cover a mortgage short-fall.

Suggested Audit Procedures

- Review the project agreement and determine if there are any additional matching requirements.
- Review related records and determine whether the matching requirements have been met.

D. Special Reporting Requirements

Compliance Requirements

Projects with direct mortgage loans under this program must establish and maintain their books and records in accordance with HUD's Uniform Chart of Accounts and comply with all other

applicable requirements set forth in HUD Handbook 4570.2: "Financial Operations and Accounting Procedures for Insured Multi-Family Projects." Some Section 202 residents, particularly those with a disability, require additional supportive services, such as housekeeping assistance and personal care attendants to help them to remain in their units. The funding for these services are not covered by the mortgage or project budget. Usually funds for supportive services are provided by the states on a short-term basis. The borrower must provide evidence of its ability to cover the costs of any supportive services, either through its own funds or with state or private funding.

Suggested Audit Procedures

- Review and evaluate the accounting system and determine whether it is in accordance with HUD requirements and procedures are in place to ensure the financial reports are filed timely.
- Review financial reports and determine whether they are complete, agree with the supporting records and are filed timely.
- Review funding commitments to cover supportive services to determine adequacy of commitment in relation to level of disability and future prospects for continued funding.

E. Special Test and Provisions

Compliance Requirements

Section 202 projects are governed by a Regulatory Agreement, which requires, among other things, that the project be managed and maintained in a manner satisfactory to HUD.

Suggested Audit Procedures

- Review the Regulatory Agreement(s) and determine the special requirement(s), if any, that apply to the project.
- Review related records and determine if the project is being maintained in accordance with the specific requirement(s).
- Review and evaluate the controls to ensure that rents are collected and project expenses are paid properly and in accordance with the project agreements.
- Test revenues, expenditures, and related records and determine that all rents are collected and expenses paid are allowable and in accordance with the agreements.

FLEXIBLE SUBSIDY

14.164

I. PROGRAM OBJECTIVES

The objective of the Flexible Subsidy program is to provide Federal aid for financially troubled, subsidized multi-family housing projects. The program assists in restoring or maintaining the financial

and physical soundness of privately owned, federally assisted multi-family housing projects; improving their management; and maintaining them for low and moderate income persons.

II. PROGRAM PROCEDURES

Flexible Subsidy provides cash for correcting project problems including: (1) deferred maintenance (2) replacement of failed components, e.g., roofs, heating and air conditioning, windows, doors, and flooring (3) under funded Reserve for Replacement account (4) accounts payable and (5) operating deficits caused by vacancies during repairs. The assistance is conditioned on the project owner's ability and willingness to carry out the management activities included in the Management Improvement and Operating (MIO) Plan. The MIO Plan is generally prepared by HUD with major input from the owner/management agent, and is approved by HUD.

Responsibilities of the owner/sponsor receiving assistance under this program are to ensure that the terms of MIO Plan and the loan agreement are being met. HUD has the responsibility to carefully monitor the implementation of the MIO Plan. This includes desk monitoring of monthly accounting statements and site monitoring of the physical improvements and the management improvements set forth in the Plan. Physical inspections should occur when the MIO Plan is being developed, during key steps in the repair program, and when the repairs are complete. The nonprofit is monitored by HUD, expenditures of funds received under this program, as well as annual financial statements submitted by the mortgagor.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirements

Assistance provided under this program must be used for the purpose outlined in the MIO Plan, which is incorporated in the loan agreement.

Selected Audit Procedures

- Review and evaluate for adequacy the non-profit's controls for ensuring that funds are spent in accordance with MIO Plan.
- Test expenditures and related records determine compliance with the MIO Plan.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirements

There are no specific dollar matching requirements for non-profits, however, there may be requirements for "sweat equity" or other "in kind" contributions.

Suggested Audit Procedures

- Review MIO Plan and Loan Agreement and determine type and level of contribution required from non-profit project owner.
- Review project records and determine that required contributions are being made.

D. Special Reporting Requirements

Compliance Requirements

Projects receiving Flexible Subsidy assistance are required to prepare and submit monthly accounting reports to HUD. These reports must show all project income and expenses and account for the expenditure of Flexible Subsidy funds. Additionally, projects with mortgages insured by HUD must establish and maintain their books and records in accordance with HUD's Uniform Chart of Accounts and comply with all other applicable requirements set forth in HUD Handbook 4370.2: "Financial Operations and Accounting Procedures for Insured Multi-family Projects," including preparation and submission of annual financial statements.

Suggested Audit Procedures

- Review and evaluate controls in place to ensure that the required monthly reports are submitted timely and accurately.
- Review the financial reports for completeness and accuracy, and determine if they agree with the supporting records and are submitted timely.
- Review and evaluate the accounting system and determine whether it is in compliance with HUD requirements.

E. Special Tests and Provisions

There are no special tests or provisions.

TWO-YEAR OPERATING LOSS LOANS (Section 223(D))

14.167

I. PROGRAM OBJECTIVES

The objective of the Section 223(d) 2-Year Operating Loss Loan Program is to provide reimbursement for out-of-pocket expenses incurred

by owners of HUD insured projects during the first two years following project completion.

II. PROGRAM PROCEDURES

HUD insures market rate loans to fund short-falls covered by owner contributions during the first two years following project completion. Mortgagors may request loans pursuant to Section 223(d) of the national Housing Act and HUD regulations for the Section of the Act under which the project is

insured. Operating Loss Loan processing instructions are contained in HUD Handbook 4470.1 REV and include the definition of operating losses and determination of the loss period, loan terms, requirements for loan approval and application submission requirements.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Operating losses are operating costs in excess of project income. Allowable expenses are taxes, interest, maintenance, salaries, supplies and other expenses for project operations. Payments to mortgage principal, depreciation, deposits to the reserve for replacement account, projected or anticipated losses of fees and charges incurred in applying for an operating loss loan are not allowable expenses.

Suggested Audit Procedures

- Review mortgagor's determination of operating loss loan amount to determine that only eligible costs were included.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, or Earmarking Requirements

There are no matching, level of effort, or earmarking requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

There are no special tests or provisions.

SUPPORTIVE HOUSING DEMONSTRATION—TRANSITIONAL HOUSING

14.235

I. PROGRAM OBJECTIVES

To develop innovative approaches to providing housing and support services to help homeless persons make the transition to independent living.

Eligible applicants are States, metropolitan cities, urban counties, government entities and private nonprofit entities.

II. PROGRAM PROCEDURES

Applicants are required to provide assurance that they will have site control within six months of funding award notification and can change the site after the award is made. Applicants will have one

year from the time they receive Federal funds to secure a site. The extent to which the applicant or project sponsor has site control is a funding selection factor.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed and Unallowed

Compliance Requirements

Assistance provided may include:

- advances, up to \$400,00 (in areas with high acquisition and rehabilitation cost) and for half of the aggregate cost of acquisition and/or rehabilitation of existing structures for use as temporary shelter for the homeless.
- grants for moderate rehabilitation, not in excess of \$200,000 or one of the cost of the rehabilitation.
- up to 50 percent of annual operating costs.
- certain on-site and off-site employment assistance programs for residents.
- technical assistance in establishing or operating the housing and providing support services.

Assistance may be provided for operating costs and technical assistance without receiving funds for acquisition and/or rehabilitation. Applicants may also receive both program advances and moderate rehabilitation grants.

Suggested Audit Procedures

- Review grant award and determine the allowable services.
- Test expenditures and related records and determine whether funds were expended for only allowable services.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

Recipients must match advances for acquisition/substantial rehabilitation, advances for new construction and grants for moderate rehabilitation with an equal amount of funds from nonfederal sources. The Community Development Block Grant and the Community Services Block Grant funds are considered nonfederal sources for these purposes. The recipient must demonstrate that it has resources to pay the percentage of operating costs, supportive service costs, and employment assistance costs not funded by HUD in grants for such costs. HUD will include in the matching calculation the time and service contributed by volunteers.

Suggested Audit Procedures

- Review grant award and determine the matching requirement.
- Review related records and determine if the matching requirement has been met.

D. Special Reporting***Compliance Requirements***

The reporting requirements will be specified by HUD in the grant award.

Suggested Audit Procedures

- Review the grant award and determine the reporting requirements.

- Review the required reports and determine if they are complete, agree with the supporting records and are submitted timely.

E. Special Tests and Provisions

There are no special test or provisions.

Section D. DEPARTMENT OF JUSTICE

BUREAU OF JUSTICE ASSISTANCE DRUG CONTROL AND SYSTEM IMPROVEMENT—DISCRETIONARY GRANT PROGRAM

16.580

I. PROGRAM OBJECTIVES

The objective of the Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grant Program is to enhance State and local

efforts to control drug use and drug related crime and to improve the functioning of the criminal justice system.

II. PROGRAM PROCEDURES

The Bureau of Justice Assistance (BJA) provides discretionary grant funds to educational and other non-profit organizations for the purpose of promoting innovative and successful demonstration programs. Activities for the promotion of programs include the evaluation of programs to determine whether they have been effective, as well as for

technical assistance and training to achieve widespread implementation of successful programs. Funded programs are designed to be closely interactive with BJA formula grant programs by providing examples of effective programs and replication assistance.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Federal funds can be expended only for functions specified in the grant or cooperative agreement, i.e., for training of criminal justice personnel, technical assistance to State and local units of government and implementation of programs under the Anti-drug Abuse Act of 1988 (Public Law 100-690) that are national or multi-jurisdictional in scope.

Grant funds shall not be used for land acquisition or construction projects.

Suggested Audit Procedures

- Review and evaluate the internal controls designed to ensure that expenditures are made only for allowable services.
- Test expenditures and related records to determine whether the amounts reported are consistent with the approved budget.

- Test expenditures and related records to determine whether the recipient has complied with any special conditions contained in the grant award.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are not matching, level of effort, and/or earmarking requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

There are no special tests or provisions.

Section E. DEPARTMENT OF LABOR

LABOR JOB TRAINING PARTNERSHIP ACT MIGRANT AND SEASONAL FARMWORKERS JTPA (Section 402)

17.247

I. PROGRAM OBJECTIVES

Migrant and Seasonal Farmworker grantees are funded under Title IV, Section 402 of the JTPA. Both public agencies and private non-profit organizations are eligible to receive funds under this section. The funds are to be used to provide job training,

employment opportunities, and other services for those individuals, and their dependents, who suffer chronic seasonal unemployment and underemployment in the agricultural industry.

II. PROGRAM PROCEDURES

At least 94 percent of Section 402 funds shall be allocated for Farmworker programs in individual States based on the best available data on the total Farmworker population. Up to six percent of the funds may be set aside for the national account to

be used for technical assistance and special projects. (20 CFR 633.105)

Section 402 grantees shall administer programs that will provide related assistance and supportive services. (20 CFR 633.302)

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirements

- Under Section 402, farmworkers and their dependents may be offered services such as classroom training, on-the-job training, work experience, job development, job placement and relocation assistance, education assistance, health services, and other supportive services.
- Allowable costs for Section 402 programs shall be charged to the four cost categories of administration, training, training related supportive services, and non-training related supportive services. (20 CFR 633.304(a)).
- The following program limitations are in effect:
 - Participation in Work Experience (WE) programs is limited to 1,000 hours per year. (20 CFR 633.302(d))
 - No Federal funds may be used for contributions on behalf of any participant to retirement systems or plans. (20 CFR 633.306)

— Payments to employers for on-the-job (OJT) training shall not, during the period of such training, average more than 50 percent of the wages paid by the employer to such participants. (Section 141(g) of JTPA).

- Section 402 grantees have the following limitations on costs: (20 CFR 633.304(b)).
 - Administrative costs shall not exceed 20 percent of grant funds.
 - Non-training-related supportive services shall not exceed 15 percent of the total amount of the grant.
 - Training costs shall be no less than 50 percent of the total amount of the grant.

Suggested Audit Procedures

- Review and evaluate controls designed to ensure that expenditures are made only for allowable services and do not exceed limitations in the We and OJT programs.
- Test expenditure and related records to determine if services are allowable, charged to the

appropriate JTPA categories, and do not exceed the limitation.

- Determine if any costs were charged for retirement benefits on behalf of participants.

B. Eligibility

Compliance Requirements

- Eligibility for participation in Section 402 programs is limited to an individual who has during the eligibility determination period (any consecutive 12-month period within the 24-month period preceding application for enrollment): (20 CFR 633.107)

- (1) been a seasonal Farmworker or migrant Farmworker:

— Migrant Farmworker shall mean a seasonal Farmworker who performs or has performed farm work during the eligibility determination period which requires travel to locations where the worker is unable to return to his/her domicile (permanent place of residence) within the same day.

— Seasonal Farmworker shall mean a person who during the eligibility determination period was employed at least 25 days in farm work or earned at least \$400 in farm work; and who has been primarily employed in farm work on a seasonal basis, without a constant year round salary.

- (2) Received at least 50 percent of total earned income or been employed at least 50 percent of total work time in farm work; and
- (3) Been identified as a member of a family which receives public assistance, or whose annual family income does not exceed the higher of either the poverty level or 70 percent of the lower living standard income level. (20 CFR 633.107)

Dependents of the above individuals are also eligible.

The 24-month period preceding application for enrollment shall be extended for persons who have been in the armed forces, incarcerated at any Federal or State facility, hospitalized, or physically or mentally disabled. (20 CFR 633.312) The extended period of time shall be not more than 24 months plus the amount of time the person was in the armed

forces, incarcerated, detained physically or mentally disabled.

- Participants must be:
 - (1) Citizens or nationals of the United States; or
 - (2) Lawfully admitted permanent resident aliens, or
 - (3) Lawfully admitted refugees and parolees, or
 - (4) Registered for military service, if required by law.

A participant enrolled in another JTPA program may be transferred to a Section 402 program, if eligible for 402 at time of enrollment in the other program.

Suggested Audit Procedures

- Review and evaluate controls for identifying and selecting participants and for determining eligibility.
- Review selected participant files to determine the appropriateness of eligibility determinations.
- Determine that ineligible participants were terminated immediately.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort or earmarking requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

Compliance Requirement

Recipients are required to establish a system to assure subrecipients: (1) adhere to applicable laws and regulations; (2) maintain effective control and accountability over all funds, property and other assets; and, (3) maintain and make available for review all records pertaining to the operations of the program. (20 CFR 633.312)

Suggested Audit Procedures

- Review and evaluate the adequacy of the system for assuring that subrecipients comply with the Act.
- Review audit reports and determine whether appropriate action has been taken when weaknesses were identified.

EMPLOYMENT SERVICES AND JOB TRAINING PILOT AND DEMONSTRATION PROGRAM

17.249

I. PROGRAM OBJECTIVE

The objectives of the National Activities is to provide job training programs or services as authorized under any other provision of the Job Training Partnership Act (JTPA), which are most appropriately administered at the national level and operate in more than one State. There are several programs which are most appropriately administered at the national level such as:

- (1) Programs addressed to industry-wide shortages;
- (2) Programs designed to train workers for employment opportunities located in another State;
- (3) Regional or nationwide efforts to develop a labor force with skills that promote the use of renewable energy technologies; energy conservation, and the weatherization of home occupied by low-income families;
- (4) Programs designed to develop information networks among local program with similar objectives under this Act; and
- (5) Programs which require technical expertise available at the national level which serve specialized needs of particular client groups.

II. PROGRAM PROCEDURES

Section 451 authorizes Multistate Programs that are otherwise authorized under any other provision of the Act. The programs may be unique to address specifically identified needs of targeted participants. The compliance features for the Multistate Program awards are the same as for other awards operating under Titles I, II, III, IV-B.

Section 453 authorizes Pilot Projects. Funds are provided to States, local governments, and private non-profit organizations on submission and approval of an application to provide the types of programs described above. Special consideration will be given to grant applications received from broad based

organizations such as community based organizations, labor unions and trade associations that address nationwide concerns through programs operating in more than one State. Many of the awards are customized to the expectations of the Secretary, with full descriptions included in the award document.

If compliance requirements of the Act are waived in the award document, the auditor must test the compliance requirements of the individual awards. The recipient is expected to closely follow the terms of the award.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirements

- Title I and II programs funded under Section 451 are authorized to expend funds for training, administration, and participant support in accordance with guidelines on allowable costs applicable to the recipient organization. To be allowable, a cost must be necessary, reasonable, and applicable to the program (20 CFR 629.57-59).
- Title I and II-A or III programs funded under Section 451 cannot be used for public service employment (20 CFR 629.2).
- Subject to the exclusions contained in 20 CFR 629.59 (b), (d)-(g):
 - Title I and IIA programs funded under Section 451 are required to have not less than 70 percent of the funds expended for training costs (20 CFR 629.59(c)(1)).

Training costs include costs associated with on-the-job training services, employer outreach necessary to obtain job listings or job training opportunities; salaries, fringe benefits, and equipment and supplies of personnel directly engaged in provided training (including remedial education); job search assistance, including preparation for work and labor market orientation; books and other teaching aids; equipment and materials used in providing training to participants; classroom space and utility costs; tuition and entrance fees that represent instructional costs that have a direct and immediate impact on participants; 50 percent of the costs of a limited work experience program; and 250 hours of youth tryout employment training costs (20 CFR 629.38(e)(1)).

- Title III programs funded under Section 451 are required to have not less than 50 percent of the funds expended for retraining services (20 CFR 631.14(c)).
- Title I and IIA programs funded under Section 451 limit administrative costs to 15 percent of the available funds (20 CFR 629.39(a)(2)).
- Income generated under any JTPA program shall be used to further program objectives and may be retained by that program (20 CFR 629.32).

Suggested Audit Procedures

- Review and evaluate controls designed to ensure that (1) expenditures are made only for allowable services and do not exceed the program limitations and (2) program income has been used to further program objective or returned.
- Review the guidelines on allowable costs applicable to the recipient organization to determine allowable costs.
- Test expenditure and related records to determine if costs are allowable and charged to the appropriate JTPA cost categories.

B. Eligibility

Compliance Requirements

- Each administrative entity is responsible for the eligibility of those persons enrolled in its programs. Administrative entities may delegate the responsibility for eligibility determination if the delegation and related safeguards are

included in the grant awards (JTPA Section 141(i)).

- Each grant award shall provide employment and training opportunities to individuals who are most likely to benefit from and are most in need of such services (JTPA Section 141 (a)).
- Except as provided in Section 123(c)(3) and 203(a)(2) of JTPA, Title II participants must be economically disadvantaged. Eligibility requirements for activities authorized under Title II are found at Sections 123, 124, 203, 205(c)(1), and 254 of JTPA. Eligibility for dislocated workers under Title III is defined in Section 301 (a) of JTPA (20 CFR 629.1)

Suggested Audit Procedures

- Review and evaluate controls designed to ensure that the grantee properly determines participant eligibility.
- Review participant files and determine whether eligibility was properly determined and those participants determined to be ineligible were immediately terminated.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort, and/or earmarking requirements.

D. Special Reporting

Compliance Requirements

- Title I, II and III programs funded under Title IV-D shall be required to report no more frequently than semiannually. Reports shall be submitted within 45 calendar days after the end of the report period ((JTPA Section 165(a)(2), (20 CFR 629.36 and 631.15))
- The (recipient) shall submit a separate audit resolution report documenting the disposition of reported questioned costs within a timely period after submission of the audit report (20 CFR 629.42(d)).

Suggested Audit Procedures

- Obtain and review the recipient's audit resolution report, tracing the report to supporting documentation.
- Review and evaluate the actions taken on subrecipient audits and trace disposition, including the disposition of any debts that were established.

- Obtain copies of reports and trace data in selected reports to supporting documentation and determine if they have been filed timely.

D. Special Tests and Provisions

Compliance Requirements

- Costs that are billed as a single unit charge do not have to be allocated or prorated among the several costs categories (training, Title III retraining services, administration, and participant support), but may be charged entirely to training or retraining services when the agreement is for training and is fixed unit price:
 - (1) with a stipulation that full payment of the full unit price will be made only on completion of training by a participant in unsubsidized employment in the occupation trained for and at not less than the wage specified in the agreement; or
 - (2) in the case of youth, commercially available training packages, including advanced learning technologies may be purchased for off-the-shelf prices without requiring a breakdown of the cost components of the package if such packages are purchased competitively and include performance criteria (Section 141(d)(3) of JTPA) if the training results in either placement in unsubsidized employment or the attainment of an outcome specified in section 106(b)(2) of JTPA (20 CFR 629.38(e)(2)).
- Employment and Training Administration (ETA) issued an official interpretation in the March 3, 1989, *Federal Register* on fixed unit price contracts written under 20 CFR 629.38(e)(2). ETA's official interpretation, which is effective July 1, 1989, provides in part that:
 - Training must consist of a core of either occupational training or basic skills, remediation training, or both.
 - All training must be designed for all participants to receive the core training.
 - Training packages must be designed for all participants to receive the core training.
 - Contracts are to be written in accordance with sound procurement practices and applicable codes.
 - Contracts for job search assistance only are not chargeable under 20 CFR 629.38(e)(2).
 - The costs of contracts not meeting all applicable requirements must be allocated among the normal cost categories of training, participant support, and administration.
 - Public or private non-profit contractor revenues in excess of costs ("profits") are to be treated as program income pursuant to 20 CFR 629.32 and used to further program objectives.
 - Sufficient record must be maintained to allow costs to be properly charged should the contractor fail to meet the provisions of 20 CFR 629.38(e)(2) or applicable State procurement policy.

Suggested Audit Procedures

- Review and evaluate controls designed to ensure that the contract amounts charged entirely to training comply with applicable requirements.
- Review fixed unit price contracts charged entirely to training for compliance with 20 CFR 629.38(e)(2) and ETA's March 13, 1989, interpretation.
- Determine whether: (a) individuals who were trained under the contracts were eligible to receive services, (b) payments to vendors were properly supported and justified and (c) contract amounts were properly chargeable to training. If contracts do not meet applicable requirements, question the entire contract amount.
- Determine if the net impact of the reallocation appears material and complies with the cost limitations. If records are not available to permit reallocation of costs for contracts not meeting applicable requirements, question the entire amount paid under the contracts.

JOB TRAINING PARTNERSHIP ACT NATIVE AMERICAN PROGRAM (JTPA Title IV)

17.251

I. PROGRAM OBJECTIVES

The objective of the Native American program (JTPA) is to provide job training and employment opportunities to Native Americans contained in the Job Training Partnership Act

II. PROGRAM PROCEDURES

Funds are provided to the grantees upon approval of a Comprehensive Annual Plan (CAP) by the Department of Labor (DOL) Grants Office through a signed notice of obligation. The funds are to be used for training, employment, supportive services

and other activities to be provided directly to eligible participants or indirectly through subgrants and contracts with other organizations as provided in the Act.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirements

- Funds must be expended for training, (e.g., classroom and on-the-job training (OJT) training assistance, (e.g., orientation, counseling, job referral and placement), employment supportive services and other activities. Training is limited to those occupations for which there is a demand in the area served, or in another area to which the participant is willing to relocate. Any employment and training activities that are conducted, but not listed in the regulations must be described in the CAP. With certain exceptions, grantees may modify their CAP without prior DOL approval (20 CFR 632.78, 632.79, 632.80).
- Twenty percent of the funds available during the program year may be used for administrative costs (20 CFR 632.174).
- Payments to employers for OJT shall not, during the period of such training, average more than 50 percent of the wages, excluding fringe benefits, paid by the employer to such participants (20 CFR 632.78(3)).
- Tryout employment in private-for-profit worksites is limited to 250 hours. Enrollees in tryout employment must be between 16 and 21 years old if the employment is with a private-for-profit employer (Section 141 (k) of JTPA and

Section 205(d)(3) of JTPA. (20 CFR 632.78(c)).

- Participants in the work experience program are limited to a maximum of 1,000 hours of work during any one year, which begins on the day of enrollment in either CETA or JTPA. This limitation does not apply for time spent by in-school youth or Title II-B participants enrolled in a work experience program. Further, the limitation may be waived by the Chief, Division of Indian and Native American Program (DINAP) (20 CFR 632.85(c)(2)).
- Participants in the Community Service Employment Program may not receive wages for more than 78 weeks of employment during a two-year period from initial enrollment in either the JTPA or the CETA program (20 CFR 632.85(b)).

Suggested Audit Procedures

- Obtain the CAP and review the activities undertaken.
- Review and evaluate the internal controls in place to ensure that expenditures are made only for allowable services and program limitations are not exceeded.
- Test expenditures and related records and determine whether the amounts were expended for allowable services and that the

limitations for administration and OJT costs are not exceeded.

- Test records for tryout employment enrollees and participants in the Work Experience and Community Services Employment Programs to determine that they have not exceeded the hour limits and are between the appropriate ages.

B. Eligibility

Compliance Requirements

- Recipients and any subrecipients assigned responsibility for the determination of participant eligibility must establish an eligibility determination and verification system. The system should reasonably ensure an accurate determination of eligibility based on the motion presented at the time of application and verification of the information should be made within 45 days for enrollment. Recipients are required to maintain the following records:
 - a completed application.
 - records of all actions taken to correct deficiencies in the eligibility determination process, including immediate termination of participants determined ineligible.
 - records transferring CETA eligible participants into JTPA.
 - records supporting registration with the Selective Service System, where applicable. (20 CFR 632.77 (a), (d), (e), (f), and (g)).
- To be eligible to participate in the program, the applicant must be an Indian, Native Alaskan or Native Hawaiian and economically disadvantaged, unemployed or underemployed.
- For upgrading, the applicant must be:
 - Operating at less than full skill potential.
 - Working for at least six months with the same employer in either an entry level, unskilled or semi-skilled position or in a position with little or not advancement opportunity.
- For retraining, the applicant must have:
 - received a bona fide notice of impending layoff.
 - been determined by the grantee as having little opportunity to be reemployed in the same or equivalent occupation. (20 CFR 632.172)

Suggested Audit Procedures

- Review and evaluate the internal controls to ensure that eligibility is properly determined.
- Review participant files and related records and determine (a) whether eligibility was properly determined, (b) that a review was performed within 45 days of enrollment, (c) whether participants transferred from one program to another or concurrently enrolled in programs were eligible for both programs at the time of enrollment, and (d) whether participants determined to be ineligible were immediately terminated.
- Review participant files and related records and determine whether eligible participants had obtained full-time permanent unsubsidized employment within 45 days of the date of application.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort or earmarking requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Procedures

Compliance Requirement

Recipients are required to establish a system to assure subrecipients: (1) adhere to applicable laws and regulations; (2) maintain effective control and accountability over all funds, property and other assets; and, (3) maintain and make available for review all records pertaining to the operations of the program (20 CFR 632.35(c)).

Suggested Audit Procedures

- Review and evaluate the procedures for assuring that subrecipients comply with the Act.
- Review audit reports and determine whether appropriate action has been taken when weaknesses were identified.

Compliance Requirement

- Wages paid to Community Service Employment participants shall be limited to a full-time rate of \$10,000 per year or higher rate in effect on September 30 1982, where applicable, unless adjusted by the Secretary (20 CFR 632.81(b)).
- Allowances paid to regulatory enrolled classroom training or services participants shall not

exceed the higher of the State or Federal minimum wage (20 CFR 632.81(c)).

Suggested Audit Procedures

- Review and evaluate procedures for limiting Community Service Employment participants to the applicable full-time wage rate and

participants enrolled in classroom training or receiving services to a rate not to exceed the higher of the Federal or State minimum wage.

- Test expenditures and related records to determine whether wages and allowances are paid at the allowable rate.

Section F. ENVIRONMENTAL PROTECTION AGENCY

ASBESTOS HAZARDS ABATEMENT (SCHOOLS) ASSISTANCE

66.702

I. PROGRAM OBJECTIVES

The objective of the Asbestos Hazards Abatement (Schools) Assistance Program is to provide financial assistance in the form of loans and/or grants for the

abatement of serious asbestos hazards in Local Educational Agencies (LEAs) which have financial need.

II. PROGRAM PROCEDURES

Loans and/or grants are provided by the Office of Pesticides and Toxic Substances to Local Educational Agencies (LEA) for (a) abating serious health hazards to building occupants; (b) replacing the asbestos materials removed from school buildings with other appropriate building materials; and (c) restoring school buildings to conditions comparable to those existing before abatement activities were

undertaken. LEAs must submit applications to the Governor who then may establish a priority list of LEAs within the State based on the nature and magnitude of the existing or potential exposure to asbestos materials. The Governor submits the applications for review to EPA, who grants and/or makes loans to the LEAs on a project-by basis.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Federal funds can be expended only for allowable activities specified in the grant or loan award. Unallowable activities are any activities not reasonable and necessary for the abatement, replacement, and restoration activities or for reduction of the risk of exposure to building materials that contain asbestos.

Suggested Audit Procedures

- Review the grant or loan award to determine allowable and unallowable activities, and any portions of work designated as ineligible for Federal participation.
- Review and evaluate controls and test expenditures and related records and ascertain whether any unallowable or ineligible activities have been charged to the project.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

Grants made under Public Law 98-577 or Public Law 101-637 provide for Federal participation of up to 50 percent of eligible project costs. No matching requirements are necessary for a loan.

Suggested Audit Procedures

- Review the grant award and determine the matching requirements.
- Test expenditures and related records and determine whether the matching requirement was met for the costs chargeable to the grant.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

There are no special tests or provisions.

Section G. ACTION

FOSTER GRANDPARENT PROGRAM

72.001

SENIOR COMPANION PROGRAM

72.008

I. PROGRAM OBJECTIVES

The Senior Companion Program (SCP) is intended to create part-time stipend volunteer community services opportunities for low income persons age 60 and over and provide supportive person-to-person services to assist adults having exceptional needs, developmental disabilities or

other special needs for companionship. The Foster Grandparent Program (FGP) is similar except that the services of the stipend volunteers are intended to help alleviate the physical, mental or emotional problems of children having special or exceptional needs.

II. PROGRAM PROCEDURES

Both SCP and FGP programs promote the use of older persons as community volunteers. ACTION awards project grants only to local public agencies and private nonprofit organizations which have the capability to administer such grants. Program grant sponsors are legally responsible for all programmatic

and fiscal aspects of the project and may not delegate or contract this responsibility to another entity.

Each grant project is monitored on a regional basis through ACTION's responsible state office.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Federal funds can only be expended in support of activity as specified in the Notice of Grant Award. (Grant Management Handbook Number 2650.2, Chapters).

Suggested Audit Procedures

- Review Notice of Grant Award to determine allowable activities.
- Test expenditures and related records to ensure that expenditures were made for allowable activities.

B. Eligibility

Compliance Requirement

Seniors and foster Grandparents must be 60 years of age, or older, have a low income (based on the

Department of Health and Human Services Poverty Income Guidelines), and must be physically, mentally, and emotionally capable of serving on a person-to-person basis.

Suggested Audit Procedures

- Review and evaluate the procedures for determining participant eligibility.
- Review participant files to ensure adherence to prescribed procedures.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

At least 10 percent of the total approved budget must be met by the applicant unless the Grant Award specifies a lower percentage.

Suggested Audit Procedures

- Review Grant Award to determine the matching requirements.
- Determine the amount of grantee expenditures and compare with the grant award.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

There are no special tests or provisions.

RETIRED SENIOR VOLUNTEER PROGRAM

72.002

I. PROGRAM OBJECTIVES

The objectives of the Retired Senior Volunteer Program (RSVP) is to provide a variety of opportunities for retired persons aged 60 or older to

participate more fully in the life of their communities through significant volunteer service.

II. PROGRAM PROCEDURES

This program promotes the use of older persons as community resources in planning for community improvement and in delivery of volunteer services. The program is facilitated by a coordinated use of the resources of ACTION, the RSVP sponsors and the community.

ACTION will award project grants only to local public agencies and private nonprofit organizations

in the United States that have the authority to accept and the capability to administer such grants. The RSVP sponsor is legally responsible for all programmatic and fiscal aspects of the project and may not delegate or contract this responsibility to another entity. RSVP advisory councils must be established to advise and assist the individual project sponsors and staff.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Federal funds can only be expended in support of activity as specified in the Notice of Grant Award. (Grant Management Handbook Number 2650.2., Chapter 5).

Suggested Audit Procedures

- Review Notice of Grant to determine allowable expenditures.
- Test expenditures and related records to ensure that expenditures were made for allowable purposes.

B. Eligibility

Compliance Requirement

Volunteers must be aged 60 or older.

Suggested Audit Procedures

- Review and evaluate the procedures for determining participant eligibility.

- Review participant files to ensure adherence to prescribed procedures.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

Matching and ratio funds must meet the requirements of the Grant Award.

Suggested Audit Procedures

- Review and Grant Award to determine the matching and ratio requirements.
- Determine the amount of RSVP sponsor expenditures and compare with grant award requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

There are no special tests or provisions.

Section H. FEDERAL EMERGENCY MANAGEMENT AGENCY

DISASTER ASSISTANCE

89.516

I. PROGRAM OBJECTIVES

The objective of the Disaster Assistance Program is to provide supplemental assistance to States, local governments and selected non-profit organizations under the Public Assistance Program for the

alleviation of suffering and hardship resulting from major disasters or emergencies declared by the President.

II. PROGRAM PROCEDURES

Following Presidential declaration of a major disaster or an emergency, grants for public assistance are provided to States or Indian Tribal governments. The State or the Tribe may use the funds to restore

its own disaster damaged projects or to provide subgrants to local governments and selected private non-profit organizations.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Disaster assistance funds can be expended only on allowable services and at approved rates specified in the approved grant agreement. Following a Presidential declaration of an emergency, disaster assistance may include, (a) removal of wreckage and debris and (b) performance of emergency protective measures. Following a Presidential declaration of major disaster, assistance may include, in addition to the above, (a) performance of emergency protective measures on public and private lands, (b) emergency transportation, (c) emergency communication, (d) repair, restoration or replacement of damaged/destroyed public and certain private nonprofit facilities and (e) loans to local governments suffering substantial loss of tax and other revenue. Disaster assistance funds cannot be used for expenditures funded by other Federal programs (44 CFR Part 206 Subpart H).

Suggested Audit Procedures

- Review approved grant agreement.

- Test expenditure and related records to determine if unallowable costs were charged to the program.

Compliance Requirement

Funds from insurance settlements, salvage, or other sources from specific losses must be deducted by the grantee from its claim (44 CFR 13.22).

Suggested Audit Procedure

Review and analyze revenue records to ascertain if any income was received from any insurance settlements or sales of salvage.

Compliance Requirement

Funds authorized under an improvement project can only be used as a contribution for the construction of larger or improved facilities that restore at least the pre-disaster capacity of the damaged or destroyed facility (44 CFR 206.205).

Suggested Audit Procedures

- Review damage survey reports for damaged or destroyed facilities.
- Review agreements for amounts authorized for improvement projects.

- Review records for costs of new facilities and determine that the facility restored at least the pre-disaster capacity of the damaged or destroyed facility.

Compliance Requirement

Funds authorized for an "alternate project" can be used only for alternate projects specifically approved by FEMA. While the grantee or subgrantee have flexibility to propose the type and size of "alternate projects" which they wish to construct, FEMA must review such proposed projects to ensure compliance with environmental and other special concerns (44 CFR 206.203).

Suggested Audit Procedures

- Review the terms of the approved alternate project on which the claim was based.
- Test expenditures and related records for the costs incurred for the alternate projects to ensure that total cost of such projects equal or exceeds the Federal, State and local share.

Compliance Requirement

As a condition of receiving Federal assistance for restoration of certain facilities, grantees and subgrantees are required to obtain and maintain specified types and extent of insurance (44 CFR 206.253).

Suggested Audit Procedures

- Review the projects for which insurance commitments are required.
- Review the insurance for the type and extent of insurance obtained and determine whether it is being maintained.

Compliance Requirement

Projects must be completed within time limits established under 44 CFR 206.204.

Suggested Audit Procedure

Review projects to determine whether they were completed within approved time limits.

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

Costs must be on a shared basis as specified in the Federal-State agreement (Public Law 93-288, 43 USC 5121 et. seq., 44 CFR 206.203).

Suggested Audit Procedures

- Review the Federal-State agreement and determine the cost sharing requirements.
- Review the financial and other records and determine the amount and nature of the State and local government's share.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

Compliance Requirement

All costs of administering the public assistance program at the subgrantee level are covered by a statutorily established percentage allowance and no other administrative costs should be included in a subgrantee's claim.

At the grantee level, a statutorily established percentage allowance covers the extraordinary administrative costs, including overtime pay and per diem and travel expenses of employees. Other direct administrative costs of the grantee shall be paid in accordance with 44 CFR 13.22. Indirect costs of the grantee are eligible in accordance with 44 CFR Part 13 and OMB Circular A-87.

Suggested Audit Procedure

Review the claim to assure that costs covered by the statutorily established administrative expenses percentage are not claimed under the public assistance program.

FOOD AND SHELTER PROGRAM

83.523

I. PROGRAM OBJECTIVES

To supplement and expand ongoing efforts to provide food, shelter, and supportive services for needy families and individuals.

II. PROGRAM PROCEDURES

Since funds are initially distributed to jurisdictions based on either a National Board formula or recommendations from State Set-Aside Committees, there is no application process for jurisdictions. All jurisdictions are considered within the National Board formula and all jurisdictions in an individual State may be considered by the State Set-Aside Board for either initial or additional (if jurisdiction had previously been selected by the National Board funding).

Stewart B. McKinney Homeless Assistance Act, Title III, Section 301-316, Public Law 100-77 as amended by Public Law 100-628 directs that Local Boards, which manage the program at the local level, shall "determine which private nonprofit organizations or public organizations of the local government in the individual locality shall receive grants to act as service providers." This program is intended to supplement, not replace, ongoing programs and allow them to extend and expand upon their existing services.

The program employs a Local Recipient Organization Certification Form. This certifies an applicant's status (i.e. that it is a nonprofit capable of delivering eligible services), that it will abide by the program guidelines (both on eligible spending and reporting requests) and comply with other fiscal and program rules so stipulated.

At the local level, following award notification, a local board is formed. That board then advertises the availability of the funds to local service providers. The local board decides the manner and form of application. The Emergency Food and Shelter Program only requires that potential Local Recipient

Organization (LROs) sign the Local Recipient Organization Certification Form.

By law, FEMA establishes and chairs the Emergency Food and Shelter Program National Board. This Board decides on the distribution of funds as well as the promulgation of the Program Guidelines. Through the use of a formula based on the most current unemployment and poverty data available on a nationwide basis, down to the jurisdictional level, the National Board selects jurisdictions across the country for awards. The award amounts are determined by a per capita rate set by the National Board.

The jurisdictions selected are notified of their awards to alert them to assemble their local boards and begin advertising the availability of supplemental funding. Simultaneously, the National Board contacts State Set-Aside Boards and informs them of the amount of funds they have to work from (this is determined by applying the per capita to the universe of unemployed by individuals not covered by the National Board awards), and the jurisdiction already selected by the National Board.

The State Set-Aside Committee recommends high need jurisdictions along with suggested award amounts. The State Board has 25 working days to notify the National Board in writing of its selections and the appropriate contact person in each of those selected areas.

The above actions, by the National Board and the State Set-Aside Committee, result in the notification of local boards across the country. The local boards then advertise the program to solicit interested groups and make the decision as to the most effective use of the jurisdiction's allocation.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Emergency Food and Shelter (EFS) funds can be used for food and feeding related expenses, such as (a) transportation of the food and food preparation and serving equipment, (b) utility assistance and limited repairs to feeding and sheltering facilities, (c) mass shelter and other shelter, such as hotels and motels, and rent and/or mortgage assistance for one month only. EFS funds can not be used for (a) rental security deposits or deposits of any kind, (b) cash payments of any kind, (c) lobbying efforts, (d) purchases or improvements of an individual's private property, (e) telephone costs, (f) repairs to government-owned or profit-making facilities and (g) any payments for services not incurred.

- Test expenditures and related records to determine whether any unallowable or ineligible services have been charged to the project.

B. Eligibility

The auditor is not expected to perform tests for eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort, or earmarking requirements for the auditor to review.

D. Special Reporting Requirements

Compliance Requirement

Local Boards are expected to monitor the expenditure of funds in their respective jurisdictions. It is for this reason that requests for second checks (all awards are divided into a minimum of two payments) must be made by the Local Boards. Along with the request for the second check, the National Board receives an interim report on eligible spending during that phase. A Final Report also must be filed by each Local Recipient Organization with its Local Board. The Local Board then compiles all the Final Reports within its jurisdiction and submits them (along with any requested documentation) to the National Board. Failure of a Local Recipient Organization to file a Final Report will result in its award being held in escrow the succeeding year.

Suggested Audit Procedures

- Review and evaluate procedures for preparing reports.
- Trace information to supporting documentation.

E. Special Tests and Provisions

There are no special tests or provisions.

Section I. DEPARTMENT OF EDUCATION

GUARANTEE STUDENT LOAN PROGRAM—GUARANTEE AGENCIES

84.032

I. PROGRAM OBJECTIVES

Nonprofit and state guarantee agencies are established to guarantee loans and perform certain administrative and oversight functions under the GSL, PLUS, Consolidation and SLS programs. (See

also the description contained in Appendix A of the Student Financial Aid Programs section of Part 3 of this Supplement.)

II. PROGRAM PROCEDURES

To participate in the GSL, PLUS, SLS and the Consolidation Loans Programs and to receive various payments and benefits incident to that

participation, a guarantee agency enters into agreements with the Department of Education.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

The compliance requirements and suggested audit procedures for allowed and unallowed services are presented separately in Section E, Special Tests and Provisions.

B. Eligibility

Compliance Requirement

- A guarantee agency enters into several agreements with the Department of Education (ED): the basic agreement, the reinsurance agreement, and the agreement on Federal advances for claim payments.
- In the basic agreement, the guarantee agency assures ED that its student loan program meets all applicable Federal requirements as provided by 34 CFR 682.401. The reinsurance agreement contains additional terms and conditions that the Department of Education finds necessary to promote the purpose of the programs and funds necessary to protect the purpose of the programs and to protect the United States from unreasonable loss (34 CFR 682.404). The Federal advances for claim payments agreement contains terms and conditions which State guarantee agencies and private non-profit

guarantee agencies must meet to receive Federal advances (34 CFR 682.403).

Suggested Audit Procedures

- Review the agreements between the guarantee agency and ED.
- Review and evaluate the guarantee agency's policies and procedures and determine if they meet the requirements of the agreements.

C. Matching, Level of Effort and/or Earmarking Requirements

Compliance Requirement

A guarantee agency that applies for and receives advances for reserve funds subsequent to June 30, 1968 under Section 422(a) of the Higher Education Act, as amended, must match the advances with an equal amount from non-Federal sources (34 CFR 682.403(3)).

Suggested Audit Procedures

Determine whether the guarantee agency has received advance funds subsequent to June 30, 1968; and, if so, determine the amount and source of funds used to match the advances.

D. Special Reporting Requirements

Compliance Requirement

The agency must submit reports to the Secretary upon request concerning the status of its reserve funds and the operations of its loan insurance program (34 CFR 682.414).

Suggested Audit Procedures

- Review and evaluate the guarantee agency's policy and procedures to ensure that data in the reports are complete and accurate.
- Test the data in the reports and determine whether they are complete and agree with supporting records.

E. Special Tests and Provisions

Compliance Requirements

- The guarantee agency shall establish and maintain a reserve fund to which it shall credit, in addition to other funds, federal advances obtained under Sections 422 (a) and 422 (c) of the Act. The assets of the reserve fund may be used only to (1) guarantee loans, (2) pay default claims, (3) pay death, disability, and bankruptcy claims, (4) refund overpayments of insurance premiums, (5) pay the Secretary's equitable share of borrower payments, and (6) repay advances made by the Secretary. The agency may also use insurance premiums, administrative cost allowances, investment earnings, and funds from gifts or grants to pay administrative costs of the program (34 CFR 682.410).
- The guarantee agency shall account separately for the Federal advances obtained under Section 422(c) and use these funds, and related investment earnings, only to pay default claims (34 CFR 682.410; 682.403).
- The guarantee agency may charge an insurance premium to the lender which must be deducted proportionately from each disbursement (34 CFR 682.401).

Suggested Audit Procedures

- Review and evaluate the guarantee agency's policies and procedures to ensure that a reserve fund is maintained and used only for allowable purposes.
- Review expenditures and related records and determine if they were made for allowable purposes.

- Review and evaluate the guarantee agency's procedures for assuring that insurance premiums were deducted proportionately from loan disbursement and test to determine whether established procedures were followed.

Compliance Requirement

A guarantee agency may invest the assets of the reserve fund only in low-risk securities and shall exercise the level of care in that investment required of a fiduciary charged with the duty of investing the money of others (34 CFR 682.410).

Suggested Audit Procedures

- Review and evaluate the guarantee agency's investment policies and procedures.
- Review investments to determine if they are low-risk.

Compliance Requirement

The Secretary pays to a guarantee agency having a basic program agreement, a primary administrative cost allowance and to an agency having a reinsurance agreement, a secondary administrative cost allowance. Payments for any fiscal year, for each cost allowance, equal one-half of one percent of the total principal amount of loans guaranteed by the agency during that year. Payments for costs incurred may be used only for the administrative costs of promotion of commercial lender participation, collection of loans, pre-claim assistance for default prevention, secondary preclaims, monitoring the enrollment and repayment status of students, and costs relating to the student loan insurance program subject to such agreement (Section 428(f), 968 Amendments; 34 CFR 682.407).

Suggested Audit Procedures

- Determine that the amount received by the guarantee agency for administrative costs did not exceed the allowable amount.
- Test expenditures and related records to determine whether administrative costs charged to the loan insurance program and accumulated in the accounting system were allowable and reasonable.

Compliance Requirement

If a guarantee agency uses administrative cost allowances to pay for a portion of an asset it buys and the agency subsequently sells or converts the asset to non-GSL use, the agency shall promptly repay to the Secretary a pro-rata share of the share

proceeds or fair market value of the asset (34 CFR 682.407).

Suggested Audit Procedures

- Test expenditures and related records to determine whether costs of acquiring assets were charged to the loan insurance program.
- Determine if those assets are still held and used for GSL or PLUS program purposes and if assets were sold or converted to non-GSL use.
- Determine if the agency repaid the Secretary for a pro rata share of sale proceeds or fair market value.

Compliance Requirements

- The Secretary makes a reinsurance payment on a loan to a guarantee agency only if:
 - (a) The lender exercised due diligence in making, disbursing and servicing the loan, as prescribed by rules of the agency.
 - (b) 1) The loan check was cashed within 120 days after disbursement or 2) The loan proceeds disbursed by electronic funds transfer in accordance with Section 682.207(b)(1)(B) have been released from the restricted account maintained by the school on or before that date.
 - (c) The lender exercised due diligence in collecting the loan through collection efforts meeting the requirements of Section 682.411.
 - (d) The loan was in default before the agency paid a default claim filed thereon.
 - (e) The lender filed a default claim thereon with the guarantee agency within 90 days of default.
 - (f) Pursuant to policies and procedures established by the agency, the lender satisfied all conditions of guarantee coverage set by the agency unless the agency reinstated guarantee coverage on the loan following the lender's failure to satisfy such a condition.
 - (g) The agency paid a default claim filed by the lender within 90 days of the date the lender filed the claim.
 - (h) The agency submitted a request for the payment no earlier than 90 days following default.

- (i) The agency and lender complied with all other Federal requirements with respect to the loan.

Suggested Audit Procedures

- Review and evaluate the guarantee agency's procedures for receiving, reviewing, and paying lenders' default claims.
- Test defaulted loans and determine if the amount paid is accurate.
- Review defaulted loans on which reinsurance was paid to determine if the loan met the conditions of reinsurance and determine whether the agency required lenders to refund interest and a special allowance when the loan did not meet all the conditions of reinsurance.

Compliance Requirement

A guarantee agency which has entered into a reinsurance agreement with the Secretary shall pay to the Secretary during each fiscal year a reinsurance fee in an amount equal to 0.25 percent of the total principal amount of the loans upon which insurance was issued during such fiscal year. For any fiscal year that the default claims reimbursed by the Secretary exceeds 5 percent the reinsurance fee should be equal to 0.5 percent of the total principal amount of the loans upon which insurance was issued by the agency if the default claims reimbursed by the Secretary exceeds 5 percent. Note that Consolidation Loans and refinanced SLS and PLUS loans are exempt from the requirement that a guarantee agency pay a reinsurance fee to the Secretary (Section 428(a)(9) of the Higher Education Act, as amended).

Suggested Audit Procedures

- Determine the total principal amount of loans for which insurance has been issued for the fiscal year.
- Determine if the default rate for the fiscal year exceeds 5 percent of the loans in repayment for the end of the prior fiscal year and determine whether the reinsurance fee paid to the Secretary is correct.

Compliance Requirement

The guarantee agency must exercise due diligence, including litigation as appropriate, in collecting loans on which default claims have been paid (34 CFR 682.410).

Suggested Audit Procedures

- Review and evaluate the guarantee agency's policies and procedures for collecting defaulted loans.
- Test defaulted loan accounts to verify adherence to prescribed policies and procedures.

Compliance Requirement

The Secretary reimburses the guarantee agency for death, disability and bankruptcy claims paid to lenders (34 CFR 682.402, 682.404(a)(3)(i)).

Suggested Audit Procedure

Test bankruptcy, disability and death claims to determine whether the claims met the requirements for insurance coverage.

Compliance Requirements

- The guarantee agency must pay the Secretary an equitable share of any payment made by a defaulted borrower after reinsurance has been paid. The Secretary's equitable share is equal to the portion of payment remaining after deducting 1) the complement of the reinsurance percentage (10 percent if defaults exceed 5 percent or 20 percent if defaults exceed 9 percent and 2) an amount equal to 30 percent (or 35 percent if a State enforces a garnishment law that complies with Section 428(E)(A)(ii) of the Higher Education Act, as amended) of such payments (Section 428(c)(6) of the Higher Education Act, amended).
- Unless the Secretary approves otherwise, the guarantee agency must submit the "Secretary's equitable share" of borrower payments within 60 days of the receipt of the payment by the agency or its service (34 CFR 682.404(e)(4)).

Suggested Audit Procedures

Review the records of collections to ascertain if the "Secretary's equitable share" was determined correctly.

- Test borrower payments to verify that remittances were made to the Secretary within the required 60 days.

Compliance Requirement

A guarantee agency with a supplemental Federal reinsurance agreement receives 100 percent of loan losses while its default rate is 5 percent or below. If the default rate in a year exceeds 5 percent of the amount of loans which were in repayment at the end of the preceding fiscal year, reimbursement for

defaults is limited to 90 percent. When the default rate at the end of the preceding fiscal year exceeds 9 percent, the reimbursement is limited to 80 percent (34 CFR 683.405; 430(m)(1)(N) of the Higher Education Act (HEA), as amended).

Suggested Audit Procedures

- Review and evaluate the system established by the guarantee agency to determine the amount of loans in repayment.
- Test the system to assure that the default rate and related reinsurance percentages are based on accurate and complete data.

Compliance Requirement

A guarantee agency shall take measures to ensure enforcement of all Federal, State and guarantee agency requirements and at a minimum conduct biennial on-site program reviews of such lenders and schools whose loan volumes exceed certain standards. A guarantee agency is also required to adopt procedures for identifying fraudulent loan applications and undertaking or arranging for the prompt and thorough investigation of criminal or other programmatic misconduct by its program participants. It is responsible also for promptly reporting all of the allegations and indications having a substantial basis in fact and the scope, progress and results of the Agency's investigations (34 CFR 682.410(c)).

Suggested Audit Procedures

- Review and evaluate the guarantee agency's procedures for selecting lenders and schools to visit.
- Review the procedures used to perform program reviews and determine the adequacy of the procedures for determining lenders' and schools' compliance with the various requirements.
- Review and evaluate the guarantee agency's procedures for identifying fraudulent applications and for initiating investigations.
- Determine whether the guarantee agency reported to ED in a timely manner the results of all allegations having a substantial basis in fact and the scope, progress and results of such investigations.

Compliance Requirement

For loan applications signed after July 1, 1987, the maximum insurance premium a guarantee agency can charge a lender is 3 percent of the principal amount of the loan (HEA, Section 428(b)).

Suggested Audit Procedure

Test loans made to borrowers who applied after July 1, 1987 and determine that the insurance premium did not exceed 3 percent.

Compliance Requirement

As a condition for receiving a reinsurance payment on a defaulted loan, a guarantee agency must require that a lender submit with its default claim, proof that reasonable attempts were made to locate a borrower whose location is unknown. If the location of the borrower becomes known, the lender must submit proof of contact with the borrower. A certification by the lender that it has complied with this requirement does not constitute proof (HEA, Section 428(c)).

Compliance Requirement

In the event of default, an organization or entity that had performed, under contract, supplemental preclaim assistance for a guarantee agency can not then perform collection activities on the same loans. The entity is permitted to collect on those loans for which it did not provide supplemental preclaim assistance (HEA, Section 428 (c)).

Suggested Audit Procedure

Determine if the guarantee agency uses the services of a contractor to provide either supplemental preclaims assistance or collection services. If so, determine from contract documents and guarantee agency records whether the services being performed are in conflict with one another.

Compliance Requirement

Each guarantee agency, eligible lender, and subsequent holder of a guaranteed loan are required to report to credit bureau organizations certain information on any loan not repaid by the borrower. Guarantee agencies are required to report to all national credit bureau organizations (HEA, Section 430A). (34 CFR 682.410(b)(3)).

Suggested Audit Procedure

Determine whether the guarantee agency has entered into agreements with the appropriate national credit bureau organizations and if so, review reports and determine if the information agrees with supporting documentation.

Section J. DEPARTMENT OF HEALTH AND HUMAN SERVICES

FAMILY PLANNING SERVICES

93.217

I. PROGRAM OBJECTIVES

The objectives of grants for family planning services are to assist in the establishment and operation of voluntary family planning projects. These projects shall consist of the planning projects.

These projects shall consist of the educational, comprehensive medical and social services necessary to aid individuals in freely determining the number and spacing of their children.

II. PROGRAM PROCEDURES

Grantees request funds through a grant application which contains a budget and a narrative plan. After review and approval of the grant application, a Notice of Grant award is prepared by the grants management office.

The annual Notice of Grant Award specifies funds to be provided for the year and indicates the length

of time Health and Human Services (HHS) intends to support the project without requiring reapplication for funds. This period, called the project period, will usually be for 3 to 5 years. If during the grant year, conditions change, the grantee should notify the Administrator and a revised Notice of Grant Award may be prepared.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirements

- Funds are to be used:
 - to provide for (1) medical services related to family planning including physician's consultation, examination, prescription, continuing supervision, laboratory examination, and contraceptive supplies, and necessary referral to other medical facilities when medically indicated, and (2) the effective usage of contraceptive devices and practices.
 - to provide for social services related to family planning including counseling, referral to and from other social or medical services agencies, and any ancillary services which may be necessary to facilitate clinic attendance.
 - to provide for information and educational programs designed to (1) achieve community understanding of the project, (2) inform the community of the availability of services,

and (3) promote continued participation in the project by persons to whom family planning services may benefit. In addition, funds may be used to provide for coordination and use of referral arrangements with other providers of health care services including but not limited to local health and welfare departments, hospitals, voluntary agencies and health services projects supported by other Federal programs (42 CFR 59.5).

- Funds may not be used:
 - to provide pregnancy care (including obstetric or prenatal care) (42 CFR 59.2).
 - to provide counseling concerning the use of abortion as a method of family planning or provide referral for abortion as a method of family planning (42 CFR 59.8).
 - for expenditures to encourage, promote or advocate abortion as a method of family planning (42 CFR 59.10).

- for expenditures that are contrary to the applicable cost principles prescribed in Subpart Q of 45 CFR Part 74.

Suggested Audit Procedures

- Review and evaluate the internal control systems designed to ensure expenditures are only made for allowable services
- Test expenditures and related records to determine whether expenditures were made only for allowable services.

B. Eligibility

Compliance Requirement

Any public or non-profit private entity in a State may apply for a grant (42 CFR 59.3).

Suggested Audit Procedure

Review the incorporation documents or related records and/or the most recent Internal Revenue Service List of tax-exempt organizations as defined in Section 501(c)(3) of the Internal Revenue Code.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

There is no matching, level of effort or earmarking requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

Compliance Requirements

- The grantee should maximize non-grant revenue.

- The grantee should secure payment from clients for services in accordance with the schedule of discounts based on the ability to pay (42 CFR 59.5(a)(7).
- If a third party is authorized or legally obligated to pay for services, the grantee should make all reasonable efforts to obtain third party payment without application of any discounts (42 CFR 59.5(a)(8).

Suggested Audit Procedures

- Review and evaluate the grantee's policies and procedures for billing and collection, including use of the schedule of discounts.
- Test client charges to determine whether they were properly recorded based on the schedule of discounts.
- Test accounts receivable records to determine that collections are maximized.
- Test selected bad debts to determine whether collection could have been made on the account.

Compliance Requirement

There are three options regarding the use of the grant-related income allowed by 45 CFR 74 Subpart F. The grant award document will specify which option is allowed.

Suggested Audit Procedure

- Review and evaluate the internal controls in place to account for program income in accordance with grant award.
- Test records to determine whether program income is accounted for in accordance with the grant award.

COMMUNITY HEALTH CENTERS (Section 330)

93.224

I. PROGRAM OBJECTIVES

The objective of the Community Health Centers Program is to support the development and operation of community health centers which

provide primary health services, supplemental health services and environmental health services to medically-undeserved populations.

II. PROGRAM PROCEDURES

Any public or nonprofit private entity is eligible to apply for these funds.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Disallowed

Compliance Requirement

The program receives funds which may be used for the cost of planning, development, and operation of community health centers.

Suggested Audit Procedures

Review and evaluate internal controls designed to ensure that expenditures are made only for services of the approved project.

B. Eligibility

Compliance Requirement

Any public or nonprofit (42 CFR 51c.102(f) private entity is eligible to apply for a grant (42 CFR 51c.103).

Suggested Audit Procedures

- Determine if the Grantee is a governmental entity or is identified in the most recent Internal Revenue Service list of tax-exempt organizations as defined in Section 501(c)(3) of the IRS Code.
- Examine a certified copy of the Grantee's certificate of incorporation or similar document that clearly establishes the nonprofit status of the entity.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

The following funds for centers must be accounted for as being expended during the budget period for the approved project prior to the use of grant funds: a) all State, local, and other operational funding received by or allocated to the approved project, and b) all fees premiums, and third-party reimbursements accrued after adjustments for uncollectible up to and including the amount expected for the budget period [42 CFR Part 51c.303(r)]. The "amount expected" is the amount of fees, premiums, and third-party reimbursements in the non-Federal share of the final approved budget for the budget period.

Fees, premiums, and third-party reimbursements above the amount expected for the budget period must be used as needed when the costs of the center's operation during the budget period exceed the total of the amounts cited in a) and b) in the preceding paragraph and the section 330 grant.

Suggested Audit Procedures

- Identify, study and evaluate the controls designed to insure that all applicable non-grant funds are used before grant funds.
- Determine whether all applicable non-grant funds were used for the approved project prior to use of the grant funds.
- Determine whether fees, premiums, and third-party reimbursements above the amount ex-

pected for the budget period were used for costs of the center's operation.

D. Special Reporting Requirements

Compliance Requirement

The BCHS Common Reporting Requirements (BCRR) Report will be required annually beginning with reports for calendar year 1991. Table 6 of the BCRR Report is an accrual basis report of all costs associated with the approved project.

Suggested Audit Procedures

- Reconcile accounting records with Table 6 of the BCRR Report.
- Verify that the BCRR report is being accurately prepared.

E. Special Tests and Provisions

Compliance Requirement

Audited financial statements are to be prepared in accordance with Generally Accepted Accounting Principles [Public Health Service Act Section 330 (h)(I)].

Suggested Audit Procedure

Determine whether the financial statements and results of financial operations are reported in accordance with generally accepted accounting principles and identify any departures as a compliance violation.

Compliance Requirement

The Grantee shall secure payments from patients for services in accordance with the schedule of fees and discounts which has been adjusted on the of the patient's ability to pay (42 CFR 51c.305 (f)).

Suggested Audit Procedures

- Review and evaluate policies and procedures for 1) identifying the patient's ability to pay, 2) using sliding fee schedules to adjust rates based on ability to pay and 3) properly recording and adjusting patient fees.

- Review and evaluate policies and procedures for 1) maximizing revenues from third parties such as insurance maximizing revenues from third parties insurance, Medicare and Medicaid and 2) maximizing collection of charges, including use of collection agencies, where appropriate.
- Test fees to determine if they were properly recorded based on ability to pay and adjusted based on the sliding fee schedule.
- Test selected accounts receivable records and bad debts to determine that collections were maximized.

Compliance Requirement

The center must use excess program income to: (I) expand and improve its services; (II) to increase the number of persons (eligible to receive services from such a center); (III) construct, expand, and modernize its facilities; (IV) improve the administration of its service programs; or (V) establish the financial reserve for the furnishing of services on a prepaid basis. Without the approval of the awarding authority, not more than one-half of the excess program income from a given budget period may be used for construction and modernization (see purpose II in the preceding statement) of the center's facilities.

Excess program income is the amount of fees, premiums, and third-party reimbursements accrued from center operations during the budget period, which is not needed for the actual costs of the approved project and exceeds the expected amount of fees, premiums, and third-party reimbursements for the budget period.

Suggested Audit Procedures

- Review and evaluate internal controls designed to ensure that excess program income is used only for authorized purposes and that the grantee obtained prior review and/or approval of the use as appropriate.
- Test expenditures and related records.

Section K. DEPARTMENT OF STATE

U.S. REFUGEE ADMISSIONS PROGRAM

(No Catalog Number)

I. PROGRAM OBJECTIVES

The U.S. Refugee Admissions Program provides resettlement opportunities in the United States for refugees who cannot safely return to their homelands or resettle in other countries or countries of

first asylum, and persons who are of special humanitarian concern to the United States Government.

II. PROGRAM PROCEDURES

Through cooperative agreements with private voluntary agencies and a memorandum of understanding with the International Organization for Migration (IOM), the Bureau for Refugee Programs (RP) provides screening for refugees abroad, English Language and Cultural Orientation training, medical examinations, and transportation for refugees to the United States. Voluntary agencies also provide reception and placement services to refugees after they arrive in the United States.

The Office of Refugee Admissions develops guidance for the program and maintains liaison with posts, IOM voluntary agencies, and the Department of Justice's Immigration and Naturalization Service. The Office of Refugee Admissions also establishes and monitors policy and procedure implementation for refugee admissions, whereas the Office of

Reception and Placement develops and implements policy for refugee reception and placement.

The Office of the Comptroller executes terms and conditions of cooperative agreements and the memorandum of understanding. Additionally, the Comptroller maintains accounting records and controls, analyzes financial reports and program operations, and oversees the implementation of audit recommendations to improve financial operations. Refugee Coordinators at U.S. embassies and post abroad assist in administering the refugee admissions program.

Compliance requirements vary by geographic area and activity (screening, training, and medical exams) identified in cooperative agreements. The Migration and Refugee Assistance Appropriation provides funding for the U.S. Admissions Program.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Admissions funds should be used for activities specified in cooperative agreements.

Suggested Audit Procedures

- Review cooperative agreements to identify the activities allowed.
- Review and evaluate controls and test expenditures and related records to determine whether funds were expended for allowable activities.

B. Eligibility

Compliance Requirement

The eligibility requirements are specified in the cooperative agreements or a memorandum of understanding.

Suggested Audit Procedures

- Review cooperative agreements for specific eligibility requirements.
- Review and evaluate controls and test related records to ensure that refugees are eligible.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching, level of effort or earmarking requirements.

D. Special Reporting Requirements

There are no special reporting requirements.

E. Special Tests and Provisions

Compliance Requirement

There may be unique compliance requirements within each cooperative agreement that the entity would need to follow.

Suggested Audit Procedures

- Review cooperative agreements for any specific compliance requirements.
- Review related records and determine whether the grantee had complied with the specific compliance requirements.

Section L. AGENCY FOR INTERNATIONAL DEVELOPMENT

FOREIGN ASSISTANCE PROGRAMS

(For Private, Nonprofit Organizations Including Educational Institutions)

(No Catalog Number)

I. PROGRAM OBJECTIVES

The objective of the assistance programs for private, nonprofit organizations and educational institutions is to enable these organizations to conduct programs to help the poor majority of people in developing countries to participate in a process of equitable growth through productive

work and to influence decisions that shape their lives, with the goal of increasing their incomes and their access to public services which will enable them to satisfy their basic needs and lead decent lives with dignity and hope.

II. PROGRAM PROCEDURES

Funds are provided to private, nonprofit organizations and educational institutions to carry out activities in support of the broad purpose stated above, with emphasis on those activities that effectively involve the poor in by expanding their access to the economy through services and institutions at the local level, increasing their participation in the making of decisions that affect their lives, increasing labor-intensive production and the use of appropriate technology, expanding

productive investment and services out from major cities to small towns and rural areas, and otherwise providing opportunities for the poor to improve their lives through their own efforts. The Agency for International Development provides funds to private, nonprofit organizations and educational institutions which have submitted proposals to carry out programs and activities in support of these other broad development policy goals.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirement

Funds are to be used for activities authorized by AID assistance agreement to help the poor majority in developing countries in accordance with the terms of these agreements.

Suggested Audit Procedures

- Read assistance agreements, including standard provisions.
- Identify the authorized activities and any specific limitations on activities.
- Test financial and related records to determine that only authorized activities were funded and

the recipient complied with any specific limitations.

Compliance Requirement

Direct costs charged to AID agreements must be charged in accordance with OMB Circulars A-21, A-122 and applicable award documents.

Suggested Audit Procedures

- Determine if direct costs are properly documented and supported.
- Determine if direct cost (salaries, allowances, fringe benefits, travel costs, consultant costs and other direct costs, including costs incurred in foreign locations) charged to AID agreements are reasonable, allocable and allowable

as prescribed by the appropriate cost principles.

B. Eligibility

The auditor is not expected to perform tests for eligibility unless eligibility requirements are specified in the award.

C. Matching, Level of Effort, and/or Earmarking Requirements

Compliance Requirement

The recipient must meet the requirements for cost sharing or matching provided for in the assistance agreement, if any.

Suggested Audit Procedures

- Examine the assistance agreement and ascertain the amount of funds to be provided by the recipient.
- Test the financial records and determine the amount and source of cost sharing/matching funds.
- Determine if the amounts used for sharing/matching were determined in accordance with the requirements in AID's optional standard provisions "Cost Share (Matching)" and the applicable cost principles.

D. Special Reporting Requirements

Compliance Requirement

The assistance agreement may require financial reports to AID in addition to those required by OMB Circular A-110.

Suggested Audit Procedures

- Identify any financial reporting requirements in addition to those contained in OMB Circular A-110.
- Obtain copies of submitted reports and review for completeness and timeliness of submission.

- Trace data in selected reports to supporting records to determine if reports contain information that is supported by books and records from which the basic financial statements have been prepared.

E. Special Tests and Provisions

Compliance Requirement

All goods and services procured with funds from the assistance agreement shall satisfy the requirements in the assistance agreement, including standard provisions, "AID Eligibility Rules for Goods and Services" and "Local Cost Financing."

Suggested Audit Procedures

- Review a representative sample of expenditure records for purchases of goods and services.
- Determine whether any goods purchased fall within the restricted or ineligible categories.
- Determine the source and nationality of all tested transactions.
- Review waivers and justifications for exceptions to authorized source and other eligibility requirements.

Compliance Requirement

All international travel carried out under the assistance agreement shall be done on U.S. flag carriers except as otherwise provided for in the assistance agreement in the standard provisions, "Air Travel and Transportation." [Fly America Act]

Suggested Audit Procedures

- Review an adequate sample of international air travel documentation to determine whether U.S. flag carriers were used.
- Review all justifications for exceptions to flying U.S. flag carriers in international travel to determine whether they meet the criteria in the standard provision.

APPENDIX A

DESCRIPTIONS OF STUDENT FINANCIAL AID PROGRAMS

STUDENT FINANCIAL AID PROGRAMS

PELL GRANTS 84.063

Program Description

The objective of the Pell Grant program is to make grants to eligible undergraduate students and is intended to provide a foundation of financial aid.

The program is administered by the Department of Education and postsecondary educational institutions. Students send applications to a central processor, which provides Student Aid Reports (SARs) to applicants. Students then take the SARs to their institution which determines award amounts by using a Payment Schedule bases on the cost of attendance, the Student Aid Index and the student's enrollment status. The Department of Education provides funds to the institution based on actual and estimated Pell expenditures. The institution's responsibilities for administering the Pell are to determine student eligibility and verify application data, to make accurate award computations and disbursements, to collect overpayments, and to report the use of Pell funds.

PERKINS LOAN (PL) 84.038

INCOME CONTINGENT LOAN (ICL) 84.226

HEALTH PROFESSIONS STUDENT LOAN (HPSL) 93.342

NURSING STUDENT LOAN (NSL) 93.364

Program Description

The objective of the PL, ICL, HPSL, and NSL programs is to provide long-term, low interest loans to students who demonstrate the need for financial aid to pursue their course of study at postsecondary educational institutions.

Revolving loan funds are established and maintained at institutions through applications to participate in the PL, ICL, HPSL, and NSL programs. The funds are started with the Federal Capital Contribution (FCC) and a matching Institutional Capital Contribution (ICC).

Repayments of principal and interest are deposited in the funds. New FCC and ICC may also be

added. The institution, in turn, is fully responsible for administering the program (i.e., approving, disbursing and collecting the loans). For undergraduates Pell eligibility must be determined as a condition for a Perkins Loan.

COLLEGE WORK STUDY 84.033

Program Description

The objective of the College Work Study (CWS) program is to provide part-time employment to a student who needs the earnings to help meet costs of postsecondary education. The program is also intended to broaden the range of worthwhile job opportunities for qualified students.

The objective of the Job Location and Development (JLD) program is to encourage the development and expansion of off-campus part-time or full-time employment opportunities for all students, regardless of their financial need, who are enrolled in eligible institutions and who desire to work.

The objective of the Community Services Learning (CSL) program is to encourage the development and expansion of community service programs for low income individuals or families through the employment of students paid by CWS wages. The objective of the Community Services Job Location Development (JLD) program is to locate and develop community service jobs for students qualifying as eligible students under the CWS program.

Funds are provided to institutions upon submission of an annual application, FISAP, and in accordance with statutory and regulatory formulae. Federal CWS funds are matched with institutional funds. Students apply directly to and are selected by the institution. The institution decides the award amount, places the student in a job, and pays the student or contracts to have the student paid. The institution may use a portion of CWS funds for a JLD program or CSL program. JLD and CSL funds are available only through a CWS allocation to the institution.

SUPPLEMENTAL EDUCATION OPPORTUNITY GRANT 84.007

Program Description

The objective of the Supplemental Education Opportunity Grant (SEOG) program is to provide grants to eligible undergraduate students.

Funds are provided to institutions upon submission of an annual application, Fiscal Operations Report and Application to Participate (FISAP) and in accordance with statutory and regulatory formula. Students apply directly to the institution on the basis of need. Priority is given to Pell recipients who have the lowest expected family contributions. The institution decides the amount of the grant, which can be up to \$4,000 but not less than \$100, for an academic year.

GUARANTEED STUDENT LOAN 84.032 (Including Stafford, SLS and PLUS)—Institutions of higher education

Program Description

The objective of the Stafford Loans and Supplemental Loans for Students (SLS) program is to make low interest loans available to students to pay for the cost of attending postsecondary educational institutions.

The objective of the PLUS program is to make loans available to the parents of dependent students to enable the parents to pay for the student's cost of attending postsecondary educational institutions.

The loans are made by lending institutions and guaranteed by State or not-for-profit guarantee agencies. The Federal Government reinsures the guarantee agencies. Postsecondary institutions are responsible for completing portions of the loan applications, verifying student eligibility, filing (SCR), refunding money to lenders, when appropriate, and handling loan checks when they are sent to

the educational institution rather than to the borrower. For undergraduates Pell eligibility must be determined as a condition for a Stafford loan.

Tests of the compliance requirements are not expected to be made at the lending institutions when auditing institutions of higher education (e.g., banks, credit unions).

A separate compliance supplement for audits of guarantee agencies is included in the Department of Education section of this compliance supplement.

HEALTH EDUCATION ASSISTANCE LOANS (HEAL) 93.108

Program Description

The program objective of HEAL is to encourage lenders to provide loans to students enrolled in eligible educational programs in the health professions at participating institutions.

Annual awards are made to participating health professionals schools. Each school determines the eligibility of student applicants and makes awards to eligible students.

SCHOLARSHIP PROGRAM FOR FIRST-YEAR STUDENTS OF EXCEPTIONAL FINANCIAL NEED (EFNS) 93.820

Program Description

The program objective of the EFNS is to encourage those needy students, who might otherwise be reluctant to do so, to pursue a career as a health professional. These scholarships are awarded without a service or financial obligation to health professional students of exceptional financial need.

Annual scholarship awards are made to participating health professions schools. Each school determines the eligibility of student applicants and awards the scholarship to eligible students.

APPENDIX B

FEDERAL STUDENT FINANCIAL ASSISTANCE PROGRAMS

STUDENT ELIGIBILITY COMPLIANCE REQUIREMENTS

| Requirement | PELL | CWS | PL | ICL | SEOG | GSL | HEAL | HPSL | NSL | EFNS |
|--|------|-----|----|-----|------|-----|------|------|-----|------|
| 1. A regular student enrolled or accepted for enrollment in an eligible program (34 CFR 668.7, 690.75, 674.9, 673.22, 676.9, 42 CFR 57.206(a), 57.306(a), 57.2804(a), 57.608(b)) | X | X | X | X | X | X | X | X | X | X |
| 2. Enrolled as at least a half-time student in a course of study necessary for enrollment in an eligible program for no longer than one 12-month period (34 CFR 668.7, 673.22, 674.9-10, 676.9-10) | X | X | X | X | X | X | | | | |
| 3. In need of a loan (scholarship) to pursue a course of study at the school (HEAL, 42 CFR 60.5h; HPSL, 42 CFR 57.206(a); NSL, 42 CFR 57.306(a), 57.2804) | | | | | | | X | X | X | X |
| 4. High School Diploma or GED (34 CFR 668.7, 690.75, 675.9, 674.9, 673.22, 676.9) | X | X | X | X | X | X | | | | |
| 5. Student agrees loan funds will be used for tuition, educational, living and transportation expenses (42 CFR 60.5(g)) | | | | | | | | X | | |
| 6. Non-student borrowers (42 CFR 60.6) | | | | | | | | X | | |
| 7. Special requirements for students enrolled in pharmacy, medical, dental or osteopathic programs (42 CFR 60.5(e)(f)) | | | | | | | | X | | |
| 8. Above the age of compulsory school attendance in the State in which the institution he or she is attending is located (34 CFR 668.7, 690.75, 675.9, 674.9, 673.22, 676.9, 682.201) | X | X | X | X | X | X | | | | |
| 9. Ability to Benefit (34 CFR 668.7, 690.75, 675.9, 674.9, 673.22, 676.9) | X | X | X | X | X | | | | | |
| 10. U.S. Citizen or National (34 CFR 668.74, 690.75, 675.9, 673.22, 676.9, 682.203(a); HEAL, 42 CFR 60.56; HPSL, 42 CFR 57.206(a); NSL, 42 CFR 57.306(a); EFNS, 42 CFR 57.2804) | X | X | X | X | X | X | X | X | X | X |
| 11. Must maintain good standing or satisfactory progress (34 CFR 668.7, 690.75, 675.9, 674.9, 673.22, 676.9, 682.201; HEAL, 42 CFR 60.5(d)) | X | X | X | X | X | X | X | | | |
| 12. Does not owe a refund on a grant awarded under the Pell Grant, SEOG and SSI programs (34 CFR 668.7, 690.75, 675.9, 674.9, 673.22, 676.9, 682.201; HEAL, 42 CFR 60.51(d)) | X | X | X | X | X | X | X | X | X | X |

| Requirement | PELL | CWS | PL | ICL | SEOG | GSL | HEAL | HPSL | NSL | EFNS |
|---|----------------|-----|----|-----|------|-----|------|------|-----|------|
| 13. Not in default on any student loans (34 CFR 668.7, 690.75, 675.9, 674.9, 673.22, 676.9, 682.201, HEAL; 42 CFR 60.51(d))..... | X | X | X | X | X | X | X | | | |
| 14. Has signed a statement of educational purpose and Selective Service Registration Status..... | X | X | X | X | X | X | X | X | X | X |
| 15. Has Financial Need (34 CFR 668.7, 690.75, 675.9, 674.9, 673.22, 676.9, 42 CFR 57.2804(3)(b)(1), 42 CFR 60.51; HPSL, 42 CFR 57.206; NSL, 42 CFR 57.306(b); EFNS, 42 CFR 57.2804(3)(b)(1))..... | X | X | X | X | X | X | X | | | |
| 16. Less than half-time students with SAI of zero are eligible for Pell Awards. (411(b)(6) of HEA)..... | X ¹ | | | | | | | | | |
| 17. Signed Anti-Drug Abuse Act Certification on Back of SAR (34 CFR 85.630)..... | X | | | | | | | | | |
| 18. An undergraduate student has received for award year, a SAR or determination of eligibility or ineligibility for a Pell Grant (34 CFR 674.9, 675.14, 676.10, 682.201)..... | X | X | | | X | X | | | | |
| 19. Student is willing to repay the loan (34 CFR 674.9) | | | X | | | | | | | |
| 20. Less than full-time students (34 CFR 674.10, 676.10, 673.22)..... | | X | X | X | X | | | | | |
| 21. Students with the lowest expected family contributions who will also receive Pell Grants in award year (34 CFR 676.10)..... | | | | | X | | | | | |
| 22. Parents can receive a PLUS loan if conditions set forth in 34 CFR 682.201 are met..... | | | | | | X | | | | |
| 23. Exceptional financial need must be demonstrated (SEOG, 34 CFR 676.10; EFNS, 42 CFR 57.2804(b)(1))..... | | | | | X | | | | | X |
| 24. Cannot be recipient of a National Health Services Corps Scholarship under Section 751 of the Act, or an Indian Health Scholarship, under Section 757 of the Act (42 CFR 57.2804(3)(c))..... | | | | | | | | | | X |

¹ Does not apply beginning with the 1990-91 school year.

PCIE POSITION STATEMENT NO. 6

OMB CIRCULAR A-133

Questions and Answers

QUESTIONS AND ANSWERS

On

OMB Circular A-133

*(Audits of Institutions of Higher Education
and Other Nonprofit Institutions)*



May 1992

**PCIE Position Statement No. 6
President's Council on Integrity & Efficiency
Standards Subcommittee**

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PCIE Position Statement No. 6

ISSUE

Not-for-profit organizations, auditors, and Inspectors General need clarifications and additional guidance to effectively implement the Office of Management and Budget ("OMB") Circular A-133 ("A-133").

BACKGROUND AND DISCUSSION

A-133 was issued March 8, 1990, to implement the single audit concept for not-for-profit organizations. A-133 supersedes the audit provisions of OMB Circular A-110.

While preparing for and performing the first A-133 audits, not-for-profit organizations and their auditors have raised a number of questions to the Inspectors General. The following questions and answers have been prepared from questions frequently asked. The purpose is to provide clarifications and additional practical working guidance to those participating in A-133 audits.

POSITION

The Inspectors General should provide guidance to not-for-profit organizations and their auditors consistent with the following questions and answers. Also, Inspectors General should accept A-133 audits which they determine to be consistent with A-133 and the guidance in these questions and answers.

Issued by the President's Council on Integrity & Efficiency
Standards Subcommittee

PRESIDENT'S COUNCIL ON INTEGRITY & EFFICIENCY

Standards Subcommittee

(1991-1992)

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Implementation

1. **Effective Date and Implementation of A-133**

What is the effective date of A-133 and how is it being implemented?

A-133 is directed to Federal agencies with an effective date for fiscal years beginning on or after January 1, 1990. Each Federal agency must implement A-133 by regulation or contract. The effective date of implementation by the Federal agency will determine the effective date for the recipient.

In some cases States or other recipients have implemented A-133 early for their subrecipients. A-133 encourages early implementation and Federal agencies should now accept A-133 audits.

Circular A-110, Attachment F, sub-paragraph 2h requirements must be met until A-133 is implemented.¹

2. **Audits Before Federal Agency Implements A-133**

A not-for-profit organization receives Federal awards from two Federal agencies, one which has implemented A-133 in regulation and one which has not. Is the not-for-profit required to comply with A-133?

The not-for-profit should have an audit in accordance with A-133 and include the Federal awards from both agencies. An audit done in accordance with A-133 will meet the requirements of A-110.

3. **Status of PCIE Position Statement No. 5**

Does A-133 supersede PCIE Position Statement No. 5 ("PCIE No. 5")?

PCIE No. 5, issued September 1989, recommended using the Health and Human Services Guidelines for Audits of Federal Awards to Nonprofit Organizations ("HHS Guide") for A-110 audits. A-133 supersedes A-110 audit requirements and expands the audit and reporting requirements beyond those contained in the HHS Guide.

Because an audit conducted in accordance with the HHS Guide would not meet the requirements of A-133, PCIE No. 5 does not apply to A-133 audits. However, PCIE No. 5 remains in effect for A-110 audits performed prior to implementation of A-133.

¹ A-133 Paragraph 6.

4. Audit Guidance During A-133 Implementation

What guidance should auditors follow during the initial implementation of A-133?

Federal Inspectors General recognize that full guidance from the American Institute of Certified Public Accountants ("AICPA") and other sources may not be available for the first A-133 audits. The Federal agencies and their respective Inspectors General are available to provide guidance and technical advice and to otherwise encourage the prompt implementation of A-133.

The basic premise is that A-133 and A-128 both follow the same single audit concept. Therefore, until specific guidance is available, it is logical that auditors follow A-128 guidance which is not in conflict with A-133.

Guidance on A-128 audits is available in the AICPA Audit and Accounting Guide, Audits of State and Local Governmental Units, and Statements of Position ("SOP") 89-6 and 90-9 that amend the Audit Guide. In August 1991, the AICPA exposed a draft SOP titled Audits of Not-for-profit Organizations Receiving Federal Awards. When issued, this SOP will provide guidance for conducting and reporting on audits made in accordance with A-133.

In December 1991, the AICPA issued Statement on Auditing Standards ("SAS") No. 68, Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance. SAS No. 68 supersedes SAS No. 63 and includes auditor responsibilities under A-133.

Audit Requirements

5. When Audit Required - Program-Specific or Single Audit

What determines when an audit is required and whether a program-specific audit or A-133 single audit is required?

The determination of when an audit is required is based on the dollar value of total Federal awards received during the fiscal year under audit. The definition of "awards received" is discussed in question number 7.

The determination of when a program-specific audit may be elected is based on the dollar value of total awards received and the number of programs. The definition of a program-specific audit is discussed in question number 21 and the definition of a program is discussed in question number 24.

The following table shows when no audit is required, when a program-specific audit may be elected, and when the A-133 single audit is required.²

| <u>Total Federal Awards</u> | <u>One Program</u> | <u>More Than One Program</u> |
|-----------------------------|--|--|
| \$0 - \$24,999 | No Audit | No Audit |
| \$25,000 - \$99,999 | Program-Specific or A-133 Single Audit | Program-Specific or A-133 Single Audit |
| \$100,000 and More | Program-Specific or A-133 Single Audit | A-133 Single Audit |

6. Only Prior Year Loans

What are the A-133 audit requirements when the only Federal awards received by a not-for-profit organization are prior year outstanding loans or loan guarantees ("Loans")?

If the only Federal assistance is prior year Loans, then the not-for-profit may have an audit in accordance with the laws and regulations governing the Loans.³ However, the Loans may be one time financing with no continuing audit or other compliance

² A-133 Attachment, Paragraph 2.

³ A-133 Attachment, Paragraph 2a(1).

requirements except to make repayment. In cases such as this, when the only Federal awards are Loans and the Federal agencies providing the Loans do not require an audit, then A-133 would not require an audit.

7. Basis for Determining Awards Received

What basis is used to determine when a Federal award (Financial assistance or cost-type contract) is received?

The definition of receipt of Federal awards is based on how the not-for-profit organization recognizes and reports its revenue. Generally this means an entity has "received" Federal awards when it has obtained Federal cash, or it has incurred expenditures which will be reimbursed under a Federal award.⁴ Receipt of an award is not tied to when the contract or grant agreement is signed or awarded to the not-for-profit.

Since the Federal government is at risk for loans and loan guarantees ("Loans") until the debt is repaid, the balance of prior year Loans is considered current year financial assistance in each year they are outstanding. See question number 29 "SFA" and "General Schedule Presentation Guidance" for discussion of disclosure of Loans in the Schedule of Federal Awards.

For non-cash programs that involve the receipt of tangible assets (such as food stamps, food commodities, WIC program vouchers, and donated surplus property), "receives" should be based on when the revenue is recognized according to generally accepted accounting principles. For non-cash programs that do not involve the transfer of tangible assets (such as guarantee and insurance programs), "receives" should be based on the transaction or event which gives rise to the award.⁵

Determining the year in which an award is received is particularly important when a not-for-profit does not have an audit each year. For example, a not-for-profit may meet the dollar threshold requiring an audit in one year, but not in the next. In this case, the fiscal year audited should match the fiscal year when the related award activity (expenditure or non-cash transaction) occurs.

8. Medicare

Are Medicare funds paid to a not-for-profit provider for health care services considered Federal financial assistance subject to A-133 audits?

⁴ OMB A-128 Q&A, Question 8.

⁵ OMB A-128 Q&A, Question 8.

Medicare funds paid to a not-for-profit provider for health care services rendered to Medicare eligible individuals are not considered Federal financial assistance subject to A-133 audits.

9. Medicaid

Under what circumstances are Medicaid funds paid to not-for-profit organizations subject to A-133 audits?

Medicaid funds paid to a not-for-profit provider for health care services under a fixed price arrangement generally are not subject to A-133 audits.

However, under certain circumstances, Medicaid funds may be subject to A-133 audits. The following are the most likely circumstances:

- Because State and local funds are also part of the Medicaid program, the State may require the not-for-profit to have an audit in accordance with A-133 (or any other requirements) and/or require expanded coverage for a number of reasons.
- When Medicaid funds are paid to a not-for-profit to assist the State or local government in administering the Medicaid program, an A-133 single or program-specific audit would be required. The following are examples of a not-for-profit administering the Medicaid program:
 - The State contracts with a not-for-profit peer review organization to administer the Medicaid utilization review function.
 - The State contracts with a not-for-profit to handle the claims processing function.

10. If Receive Only SFA or R&D – Program-Specific Audit

When a not-for-profit organization receives awards of \$100,000 or more in only one category, either Student Financial Aid ("SFA") or Research and Development ("R&D"), may a program-specific audit be performed on the SFA or R&D category in lieu of the A-133 single audit?

SFA

The U.S. Department of Education ("Education") and U.S. Department of Health and Human Services ("HHS") have agreed to accept an SFA program-specific audit when the only awards are SFA. The current Education audit guide, Audits of Student Financial Assistance Programs, must be used and supplemented as necessary with the program requirements for SFA programs of other Federal agencies.

The basis for accepting a program-specific audit when there are only SFA category awards is the agreement between Education and HHS, who normally provide SFA; and the fact that not-for-profit organizations normally administer SFA programs through a central office of student financial aid.

R&D

An A-133 single audit is required when there are multiple R&D awards totaling \$100,000 or more. A program-specific audit is not acceptable for multiple R&D awards because R&D can be received from many Federal agencies and R&D often involves multiple offices or accounting systems within the not-for-profit organization.

An exception is that a program-specific audit of R&D is permitted when all of the following conditions are met:

- There are only R&D awards and all awards are received from a single Federal agency, or a single prime recipient in the case of a subrecipient.
- The Federal agency's Office of Inspector General, or prime recipient in the case of a subrecipient, approves in advance a program-specific audit. The approval process should include a determination that the program-specific audit will provide at least the same level of audit coverage over Federal funds as the A-133 single audit.
- The program-specific audit is performed in accordance with Government Auditing Standards and guidance provided by the Federal agency's Office of Inspector General, or prime recipient in the case of a subrecipient.

11. \$20,000 R&D and \$100,000 SFA

A not-for-profit organization annually receives \$20,000 from Research and Development Awards ("R&D") and \$100,000 or more in Student Financial Aid ("SFA"). Can the R&D and SFA each be audited as separate programs?

The A-133 single audit is required because total Federal Awards are \$100,000 or more and there is more than one program. Separate program-specific audits would not be allowed.⁶

⁶ A-133 Attachment, Paragraph 2a(1).

12. Matching Funds

Are non-federal matching funds considered Federal awards in determining whether or not an audit is required? For example, how would a \$20,000 Federal award with a \$5,000 matching requirement be considered in determining whether an audit is required?

Only the amount of the Federal award is considered in determining whether an audit is required. In this example, the \$20,000 award is added to any other Federal awards to determine whether an audit is required. However, once it is determined that an audit is required, the auditor must consider any audit procedures applicable to the matching funds.

13. Organization Associated with a Not-for-profit

When does a not-for-profit organization associated with a not-for-profit ("Associated Organization") need an audit under A-133?

Not-for-profit organizations often create Associated Organizations to perform certain functions for the not-for-profit (e.g., a university athletic association, a university association to provide dormitory housing, a not-for-profit creating a separate not-for-profit organization to hold real estate, or a national not-for-profit organization that sponsors local chapters). Common reasons for forming these Associated Organizations are for exemption from restrictions on the not-for-profit, to raise funds, or to further the purpose of the not-for-profit. In many cases the same individuals may hold offices in both organizations or the not-for-profit may otherwise exercise control over the Associated Organization.

When an Associated Organization receives Federal awards, either as a prime recipient or subrecipient, it would be subject to A-133 audit requirements.

When an Associated Organization is included in the not-for-profit's indirect cost plan, the not-for-profit's auditor may need to test transactions of the Associated Organization in procedures performed relative to indirect costs. Also, the auditor will need to consider any transactions between the not-for-profit and Associated Organization that affect Federal awards or otherwise need to be tested as part of the not-for-profit's A-133 audit. Question number 65 discusses the auditor's compliance responsibility for related party transactions.

An Associated Organization which meets all of the following conditions does not need to be audited under A-133:

- Receives no direct or indirect Federal Awards;
- Is not included in the not-for-profit's indirect cost plan; and
- Otherwise does not receive payments or benefits from the not-for-profit which are paid out of Federal funds.

14. Total Over \$100,000; Each Award Less Than \$25,000

A subrecipient not-for-profit receives over \$100,000 in Federal awards from eight cities for different programs. Each award is less than \$25,000. No city receives as much as \$25,000 in Federal assistance. What are the audit responsibilities of the subrecipient not-for-profit and the recipient cities?

The subrecipient not-for-profit is required to have an A-133 single audit because it received over \$100,000 in Federal awards and had more than one program.⁷ A copy of the audit report should be sent to each city.⁸

Since the cities received and provided less than \$25,000 of Federal assistance, they are not required to have an audit.⁹ They are subject to State and local audit requirements and are required to maintain and provide Federal agencies access to records.

15. Free Rent Over \$100,000

The only Federal award a not-for-profit organization receives is one program for free office space with an annual fair market rental value of \$100,000. Does the not-for-profit fall under A-133?

Free rent by itself would not require an audit under A-133. However, the not-for-profit would be subject to monitoring, audit, or other requirements if imposed by the Federal agency providing free rent.

In some cases, the free rent is received as part of a Federal award or other assistance to "carry out a program." In these cases, the free rent would fall under the definition of "other non-cash assistance" and would be included in the total amount awarded for the program.¹⁰

16. Foreign Not-for-profit Organizations

What are the audit requirements for foreign not-for-profit organizations?

A foreign not-for-profit, which is affiliated with or a sub-office of a U.S. based not-for-profit, should be included as part of the audit of the U.S. based operation and not considered a subrecipient.

⁷ A-133 Attachment, Paragraph 2a(1).

⁸ A-133 Attachment, Paragraph 15i.

⁹ A-128 Paragraphs 4c & 9.

¹⁰ A-133 Attachment, Paragraph 1e(1).

A foreign not-for-profit, which is a subrecipient of a U.S. based not-for-profit, would be subject to A-133. (See question number 5 concerning requirements for the A-133 single audit or a program-specific audit.)

A foreign not-for-profit receiving a Federal award directly from the U.S. government would be subject to the audit requirements of the terms and conditions of the award.

17. Additional Audit Requirements for Subrecipients

May prime recipients require not-for-profit subrecipients to obtain audits beyond the requirements of A-133?

Prime recipients have a responsibility to ensure that Federal awards passed through to subrecipients are expended in accordance with Federal laws and regulations. Prime recipients may also need to ensure that funds provided to subrecipients from non-federal sources meet applicable compliance requirements.

Prime recipients may, by agreement with the not-for-profit subrecipient, increase the requirements under A-133 or add other audit requirements. These additional audit requirements should not conflict with the subrecipient meeting the A-133 requirements. Also, audit fees for additional audit requirements related to non-federal programs should not be charged to Federal awards.

Audit Requirements - A-128 or A-133

18. Not-for-profit Subrecipient Previous A-128 Audit

A not-for-profit subrecipient was contractually required by a prime recipient to have an audit performed in accordance with A-128. Will the subrecipient now be required to have two audits; one in accordance with A-128 and one in accordance with A-133?

Before the promulgation of A-133, it was not uncommon for State and local government prime recipients to contractually require A-128 audits of their not-for-profit subrecipients.¹¹

The subrecipient should not need two audits. The subrecipient should clarify the matter with the prime recipient requiring an A-128 audit. Most likely, the contract can be changed to require an A-133 audit. New contracts with not-for-profit organizations should reference A-133 audit requirements.

19. Determining If Subrecipients Follow A-128 or A-133

Does the type of organization the prime recipient is or the type of organization the subrecipient is determine whether A-128 or A-133 applies to the subrecipient?

The type of organization the subrecipient is determines which circular is applicable. A-128 applies to State or local government subrecipients. A-133 applies to institutions of higher education or other not-for-profit subrecipients. (See the exception in question number 20 for State and local government institutions of higher education.)

20. Institution of Higher Education - A-128 or A-133

Is a State or local government institution of higher education, i.e., a college or university, subject to A-128 or A-133?

A State or local government can elect to include institutions of higher education in its A-128 audit. State and local government institutions of higher education excluded from the government's A-128 audit can be audited separately under A-128 or A-133.¹²

¹¹ OMB A-128 Q&A, Question 29.

¹² A-133 Attachment, Paragraph 1k; A-128 Paragraph 6c; OMB A-128 Q&A, Question 24.

Program-Specific Audits

21. Program-Specific Audit Definition

What is a program-specific audit?

A program-specific audit is an audit of one Federal program in accordance with Federal laws, regulations, or audit guides relative to that particular program.

By comparison, an A-133 single audit is an organization-wide audit that covers all Federal awards and requires an audit of the financial statements of the not-for-profit entity.

Note: See question number 10 concerning a program-specific audit if only SFA or R&D is received, question number 24 concerning the definition of a program, and question number 39 concerning audit period fiscal year.

22. Program-Specific Audit Reporting

What audit reporting is required for a program-specific audit?

In many cases a program-specific audit guide will be available to provide specific guidance on compliance testing, audit procedures, and reporting. The auditor should determine the availability of agency prepared supplements or audit guides. This can be done by reviewing the Program Audit Guide Survey (October 1991) ("Survey") prepared by the PCIE Standards Subcommittee. The Survey (order number PCIE-06-064) may be obtained by written request to the Treasury Office of Inspector General, Room 7210, ICC Building, 1201 Constitution Ave., N.W., Washington, D.C. 20220 or FAX 202-927-5418.

The auditor may also contact the appropriate Inspector General's Office to determine whether subsequent audit guides have been issued or to obtain a copy of an audit guide. When a current program-specific audit guide is not available, the auditor may obtain guidance from the program laws and regulations, grant agreements, and the compliance supplements.

Program-specific audits for which no current Federal agency audit guide is available must conform to the reporting required by Government Auditing Standards. The reporting will normally include an opinion on the financial statements of the program, a report on the program's internal controls, and a report on program compliance with laws and regulations. A schedule of findings and questioned costs, management letter, or report on illegal acts may also be required when applicable.

See Note at end of question number 21 for related questions.

23. Compliance Requirements in Program-Specific Audits

What guidance should the auditor use for general and specific compliance requirements in program-specific audits?

As discussed in question number 22, the auditor should determine whether a program-specific audit guide is available. When a current program-specific audit guide is available, it should be followed for guidance on general and specific compliance requirements and audit procedures.

When a current program-specific audit guide is not available, the auditor should use the following guidance for general and specific compliance requirements:

- General Requirements

The general requirements listed in the Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-profit Institutions (October 1991) ("A-133 Compliance Supplement") should be included as part of every audit that involves Federal financial assistance.¹³ The auditor should review the A-133 Compliance Supplement general requirements and consider these in planning the audit. In particular, Federal financial reporting, cash management, allowable costs/cost principles, and administrative requirements will usually apply to all programs.

- Specific Requirements

The specific requirements may be obtained from the compliance supplements (either the A-133 Compliance Supplement or the A-128 Compliance Supplement titled Compliance Supplement for Single Audits of State and Local Governments (Revised 1990)), program laws and regulations, grant agreements, and the funding agency. The auditor may also look to the compliance supplements for guidance on suggested audit procedures and the types of compliance requirements (i.e., types of services allowed or unallowed; eligibility; matching, level of effort, and/or earmarking requirements; special reporting requirements; and special tests and provisions). See question number 63 for additional guidance on specific compliance tests.

See Note at end of question number 21 for related questions.

¹³ Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions, October 1991, Part 2 General Requirements, Introduction.

Major and Nonmajor Programs

24. Program Definition

What constitutes a program when defining major programs in an A-133 single audit?

For other than Research and Development ("R&D") and Student Financial Aid ("SFA"), all awards under the same Catalog of Federal Domestic Assistance ("CFDA") number would constitute a program. For awards not assigned a CFDA number, all awards made for the same purpose would be combined as one program similar to how grants under the same CFDA number from multiple funding years are combined as one program. For example, if funds were expended during the audit period from both an original agreement and a separate award that renewed the original agreement, the two awards would be combined and considered as one program. When only one award is made, the individual award is considered as a program.

An exception to the statement that all awards under the same CFDA number constitute a program is when a State government combines different Federal awards into a combined program which is passed through to a not-for-profit subrecipient. In this case, the State government may require the subrecipient to treat the combined program as a single program for both major program determination and to determine whether a program-specific audit may be elected as discussed in question number 5.

The sum of expenditures from R&D awards received is considered a program and the sum of expenditures from SFA awards is considered a program.¹⁴ Under an A-133 single audit, expenditures for all R&D awards are tested as one program which may have different compliance requirements within the program. SFA is treated in a like manner.

Question number 25 provides guidance in determining a major program.

25. Major Program Test

What determines when a program is a major program?

The determination of whether a program is major or nonmajor is based on the dollar value of expenditures during the audit period. A program is a major program when total expenditures equal or exceed 3% of total Federal funds expended or \$100,000, whichever is greater. A program is nonmajor when expenditures are below this threshold.¹⁵

¹⁴ A-133 Attachment, Paragraph 1i.

¹⁵ A-133 Attachment, Paragraph 1i.

26. Loan and Loan Guarantee Programs

How is the value of assistance expended under loan and loan guarantee programs calculated for determining major programs?

The following guidelines should be used to calculate the value of assistance expended under Federal loan or loan guarantee programs for determining major programs:

- Value of new loans made or received during the fiscal year; plus
- Balance of loans for previous years for which the government is at risk; plus
- Any interest subsidy, cash or administrative costs allowance received.

Guaranteed Student Loans made by an institution of higher education ("Institution") should be calculated as described above. However, Guaranteed Student Loans that were not made by the Institution but were received by its students should be calculated as discussed in question number 27.

Including a large loan program may distort the base for determining other major programs. In this case the auditor should use judgment in determining major programs. When including a loan program significantly affects the number or size of other major programs, the loan program should be considered a major program, and the value attributed to the loan program should be excluded in determining other major programs.¹⁶

27. Guaranteed Student Loans Not Made by the Institution

How are Guaranteed Student Loan Programs valued when determining major programs at institutions of higher education ("Institution") when the Institution did not make the loan?

The value of Guaranteed Student Loans which were not made by the Institution but were received by its students would only be the new Guaranteed Student Loans made during the year.¹⁷ The Institution that did not make the loans would not include the balance of loans from previous years, interest subsidies, or other costs as discussed in question number 26 because the lender accounts for the prior balances and receives the interest subsidies or other cost allowances.

The value of these Guaranteed Student Loans, the value of other Federal student loans made by the institution computed as discussed in question number 26, and any other Federal Student Financial Aid ("SFA") would be added together to form the category of

¹⁶ OMB A-128 Q&A, Question 33.

¹⁷ OMB A-128 Q&A, Question 33.

SFA. The value of the SFA category total is then compared to the larger of three percent of total Federal funds expended or \$100,000, to determine whether SFA is a major program.¹⁸

28. R&D (SFA) Programs - Two Over \$100,000 & One Under

The only Federal awards a not-for-profit organization receives are three Research and Development Awards ("R&D"). Expenditures from two awards exceed \$100,000 and the other is under \$100,000. How many major and how many nonmajor programs does the not-for-profit have?

The not-for-profit has one major program which includes all three awards and no nonmajor programs. The definition of major programs groups all R&D into a single category that is then looked at to determine whether it meets the dollar threshold for major programs. The answer would be the same if the example had been for Student Financial Aid.¹⁹

¹⁸ A-133 Attachment, Paragraph li.

¹⁹ A-133 Attachment, Paragraph li.

Reporting

29. Schedule Presentation of R&D, SFA, Individual Awards

A-133 describes three categories of awards: (1) research and development ("R&D"), (2) student financial aid ("SFA"), and (3) individual awards not in the R&D or SFA category ("Individual Awards - Other"). At what level of detail should these three categories of awards be presented in the Schedule of Federal Awards ("Schedule")? For example, should they be presented as a separate line in the Schedule or should the Schedule show the total expenditures for each category?

A-133 could be literally read as permitting the total of R&D or SFA categories to be listed as one line item on the Schedule. However, more specific identification of Federal awards is needed in the Schedule because:

- The name of the Federal agency is needed for report distribution. Detailed information on programs is needed for internal report distribution within the Federal agency.
- R&D and SFA will often be provided from different Federal agencies and the individual agencies need to verify their funds were audited. Providing detail will reduce inquiries by Federal agencies to not-for-profit organizations and their auditors as to whether certain awards were included in the audit and not overlooked.
- The individual dollar amounts of awards within R&D and SFA categories may be significant or material.
- Federal agencies may have close out or other audit responsibilities; therefore, detailed information is needed to rely upon the A-133 audit.
- The Bureau of Census, Single Audit Clearinghouse plans to use the Schedule to compile Federal assistance by the Catalog of Federal Domestic Assistance ("CFDA") number.

R&D

Where practical, each individual R&D award should be listed as a separate line in the Schedule. However, in some cases, such as a large not-for-profit organization with many R&D awards, it may not be practical to list each award. In this case, total expenditures may be listed by each Federal agency and major subdivision within each Federal agency. For example, in the Department of Health and Human Services, a major subdivision would be the National Institutes of Health.

SFA

Where practical, each individual SFA program should be listed as a separate line in the Schedule by CFDA number. It will normally be practical to list each individual SFA program, however, if individual programs are not listed, totals by Federal agency should be provided.

For loan programs any interest subsidy, administrative costs, or other expenses paid from Federal funds to the not-for-profit organization should be included in the Schedule. The value of new Federal loans made during the fiscal year plus the balance of Federal loans for previous years should be shown in the Schedule or a footnote. For Guaranteed Student Loans received by students of an institution of higher education ("Institution") which were not made by that Institution, the amount would only be new loans made during the year (See question number 27).

Individual Awards - Other (Major)

Each Individual Award - Other, which is a major program, should be listed as a separate line in the Schedule by CFDA number.

Individual Awards - Other (Nonmajor)

Each individual nonmajor award should be listed as a separate line in the Schedule by CFDA number under the caption "Other Federal Assistance." Where individual listing is not practical, the cognizant or oversight agency should be contacted for advice.

General Schedule Presentation Guidance

As general guidance on schedule presentation:

- The entity and period covered by the Schedule should be the same as the entity and period covered by the financial statements.²⁰
- While the same program (e.g., same CFDA number) from different program years may be combined on one line, where feasible, presenting different program years separately may make the Schedule more useful.
- Major programs should be specifically identified as being major.²¹
- The existence and value of Federal loans, loan guarantees, or insurance programs at the end of the fiscal year should be disclosed in the Schedule or a footnote.

²⁰ PCIE Statement No. 1.

²¹ A-133 Attachment, Paragraph 15c(1).

Any interest subsidy or administrative cost allowance received under a Federal loan or loan guarantee program should be included in the Schedule.²²

- Federal non-cash assistance such as free rent, interest subsidies, food stamps, food commodities, WIC program vouchers, or donated property should be shown in either the Schedule or footnotes and valued at fair market value at the time of receipt. WIC program vouchers may be valued at either maximum allowed redemption value or average redeemed value.
- Federal funds passed through from other recipients should be identified as pass-through funds and include the name of the awarding organization, the program identifying number, and the CFDA number.
- As a general rule, the more detailed the listing of programs in the Schedule, the fewer the follow-up calls from Federal agencies to identify the programs audited.
- While not required, it is recommended that where feasible, the not-for-profit provide additional requested information which will make the Schedule easier for Federal agencies to use. Examples are identification of matching funds, funds passed through to a subrecipient, individual grant numbers or amounts, and program income.

30. Audit Reporting Required by A-133

What audit reports are required to comply with an A-133 single audit?

An A-133 single audit requires the auditor to report on the following:

Financial

1. General purpose or basic financial statements ("Financial Statements").
2. Supplementary Schedule of Federal Awards (with auditor's opinion in relation to Financial Statements).

Internal Control

3. Entity-wide internal control matters based on the auditor's understanding of the internal control structure and the assessment of control risk, made as part of the financial statement audit. [*Yellow Book requirement*]
4. Internal controls (accounting and administrative) designed to provide reasonable assurance of compliance with laws and regulations applicable to Federal awards. [*A-133 requirement*]

²² OMB A-128 Q&A, Question 33.

Compliance

5. Compliance which may be material to the financial statements. [*Yellow Book requirements*]
6. Opinion on compliance with laws and regulations applicable to each major Federal Program and a statement of positive assurance on those items that were tested under A-133 for compliance and negative assurance on those items not tested. [*A-133 requirements*]

In single audit practice, auditors have interpreted these requirements to be met with the following three reports:

- a. Report on compliance with general requirements (opinion disclaimer with positive/negative assurance). {Applicable for all A-133 single audits}
- b. Opinion on compliance with specific requirements applicable to each major program. The opinion should include whether **Federal financial reports** and claims for advances and reimbursements contain information supported by books and records; and whether amounts claimed or amounts used for matching are in accordance with **allowable costs/cost principles** (see question number 64).²³ {Applicable only when there are major programs}
- c. Report on compliance with requirements tested for nonmajor programs (opinion disclaimer with positive/negative assurance). {Applicable only when nonmajor programs are tested}

Other Reports (If Prepared)

7. Schedule of Reportable Conditions (including material weaknesses) for internal control findings and a Schedule of Findings and Questioned Costs for compliance findings (if not included in the internal control or compliance reports).
8. Management letter.
9. Separate communication of nonmaterial findings relative to Federal programs.
10. Report of illegal acts.

The auditor should reference AICPA guidance for specific reporting language and other guidance.

²³ A-133 Attachment, Paragraph 13c(5) & 15c(3).

The not-for-profit organization is responsible for preparing a written corrective action plan.²⁴ Question numbers 41 through 45 provide additional information on audit findings and their resolution.

31. Combined Audit Reports

Is it acceptable for auditors to combine the Government Auditing Standards ("GAS") and A-133 internal control reports or the GAS and A-133 compliance reports?

It is acceptable to use one internal control report to meet the internal control reporting requirements of both GAS and A-133. Similarly, one compliance report and one financial report would be acceptable. In combining reports, care should be taken to ensure that all required items are included in the combined report.

The three parts of the audit report (Financial, Internal Control, and Compliance) may be bound into a single document, or presented at the same time as separate documents.²⁵

Specific concerns about reporting format may be discussed with the cognizant or oversight agency.

32. Including Additional Schedule with Audit Report

A Federal agency has requested its recipients to include additional schedules with their audit reports (e.g., Schedule of Indirect Costs). Does the A-133 single audit require recipients to include additional schedules requested by grantor agencies?

The specific reporting required by A-133 is described in question number 30. The A-133 single audit does not require recipients to provide additional schedules such as a Schedule of Indirect Costs.²⁶

Although not required, the recipient may include any additional information which will make the A-133 audit reports more useful to the Federal agencies. For example, a Federal agency may need a Schedule of Indirect Costs to use in lieu of performing a separate audit. In this case, it may be mutually beneficial for the not-for-profit organization to include the schedule as part of the audit.

²⁴ A-133 Attachment, Paragraph 15h.

²⁵ A-133 Attachment, Paragraph 15d.

²⁶ A-133 Attachment, Paragraph 15c(1).

33. Audit Due Date

When is the A-133 audit report due?

The audit is required to be completed within 12 months after the end of the not-for-profit organization's fiscal year. Prime recipients may by contract require earlier reporting by subrecipients. The audit report is due to Federal grantor agencies and prime recipients 30 days after being received by the not-for-profit organization. The 30 days after report receipt are to give the not-for-profit organization time to prepare the corrective action plan (if needed) and submit the report.²⁷

For example, an audit for a June 30, 1991 year end with report received October 31, 1991, would be due on or before November 30, 1991. The latest due date for an audit of a June 30, 1991 year end would be audit completion by June 30, 1992, and report submission by July 30, 1992.

34. Distribution of Audit Reports

What is the responsibility to distribute the audit reports?

The not-for-profit organization is responsible to submit **all** reports (See list of reports in question number 30) to each Federal agency that provides direct Federal funds. Also, subrecipients must distribute copies of reports to all prime recipients that provide them Federal funds. The report distribution requirements are met when the report is distributed by either the not-for-profit or its auditor.²⁸

The not-for-profit should include with the report submission a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings.²⁹ See question number 44 which describes management's responsibility to respond to audit findings.

Both recipients and subrecipients receiving Federal awards over \$100,000 are required to send a copy of the report to the central clearinghouse designated by Office of Management and Budget.³⁰ The address is:

Federal Audit Clearinghouse
Bureau of the Census
1201 E. 10th Street
Jeffersonville, Indiana 47132

²⁷ A-133 Attachment, Paragraph 15i; OMB A-128 Q&A, Question 52.

²⁸ A-133 Attachment, Paragraph 15i.

²⁹ A-133 Attachment, Paragraph 15h.

³⁰ A-133 Attachment, Paragraph 15j.

35. Audits in Addition to A-133 Requirements

If a not-for-profit organization has received unqualified reports with no findings under an A-133 audit, is it still subject to audits from the various Federal granting agencies?

A not-for-profit is still subject to other audits because A-133 does not limit Federal authority to make additional audits or reviews. Any additional auditing should build upon the A-133 audit.³¹ The Federal agency shall perform or arrange funding for additional audits.³²

36. Reporting Expenditures in Excess of Award

Should the Schedule of Federal Awards ("Schedule") show only those expenditures within the award or should it show total expenditures, even if total expenditures exceed the award?

Expenditures may exceed awards when additional non-federal sources provide support not required by the award. The Schedule should separately identify Federally funded expenditures but may also show non-federal expenditures as separate amounts on the Schedule or in a footnote.³³

A-133 requires not-for-profit organizations to identify in their accounts all Federal funds received and expended and the programs under which they were received.³⁴ Therefore, when Federally funded expenditures cannot be separately identified, the auditor should have a finding recommending that the not-for-profit separately identify Federal funds in subsequent periods.

When expenditures in excess of current awards represent additional amounts the not-for-profit intends to bill a Federal program, the amount and circumstances concerning the excess should be disclosed in a footnote.

37. GAAP Statements

Does an A-133 single audit require the not-for-profit organization's basic financial statements be prepared in conformity with generally accepted accounting principles ("GAAP")?

³¹ A-133 Attachment, Paragraph 6a.

³² A-133 Attachment, Paragraph 6e.

³³ OMB A-128 Q&A, Question 38.

³⁴ A-133 Attachment, Paragraph 13c(2).

An A-133 single audit does not require GAAP statements. For various reasons, such as convenience or legal or regulatory requirements, some not-for-profit organizations prepare their financial statements on a basis of accounting other than GAAP (for example, the cash basis).³⁵

GAAP statements may be mandated by program statutes and therefore would be required. For example, Section 330 of the Public Health Act requires Community Health Centers to adhere to GAAP in their financial statements.

In all cases, the auditor is required to report whether or not the financial statements are in conformity with GAAP.³⁶

38. Program-Specific Audit vs. Single Audit Reporting

For A-133 single audits, must the auditor report additional information required in program-specific audit guides? For example, the U.S. Department of Education Audit Guide, Audits of Student Financial Assistance Programs requires a separate "Schedule of Student Financial Aid Expenditures" and the "lead auditor's name."

An A-133 single audit does not require the additional reporting in program-specific audit guides.

39. Audit Period Fiscal Year

Should the audit period be the not-for-profit organization's fiscal year or the award fiscal year?

For an A-133 single audit the audit period should be the not-for-profit's fiscal year.³⁷

A program-specific audit may cover either the not-for-profit's fiscal year or the award year depending upon the requirements of the Federal agency providing the awards. However, for first time audits or changes to existing audit periods, the auditor should contact the Federal agency's Office of Inspector General or review the program-specific audit guide, laws, and regulations concerning the proper audit period.

Stub periods may occur when converting from one type of audit to another or when changing audit periods. Arrangements should be made to meet audit requirements for Federal expenditures during the stub period. This is usually done either as a separate

³⁵ OMB A-128 Q&A, Question 35.

³⁶ A-133 Attachment, Paragraphs 12b(1) & 15c(1).

³⁷ A-133 Paragraph 6.

audit of the stub period or by including Federal expenditures during the stub period with the current audit. The cognizant, oversight, or grantor agency should be contacted for advice on audit procedures for stub periods.

40. CFDA Number Unknown or Not Available

How should expenditures be presented in the Schedule of Federal Awards ("Schedule"), if the Catalog of Federal Domestic Assistance ("CFDA") number is unknown or not available?

The CFDA number should be available for most domestic Federal financial assistance. Federal agencies and prime recipients are required to provide the CFDA number to recipients and subrecipients when awarding assistance. Not-for-profit organizations are required to identify in their accounts the programs under which funds are received.³⁸

When the CFDA number is not available, the not-for-profit should include in the Schedule (1) the awarding agency name and (2) the program name or other identifier obtained from the award documents when the program name is not available.

³⁸ A-133 Attachment, Paragraphs 1e(4) & 13c(2).

Audit Findings and Resolution

41. Audit Findings

What should the auditor include in audit findings?

Audit findings (including internal control findings, compliance findings, and questioned costs) should be presented in sufficient detail to allow for resolution of the finding and corrective action. This will generally include the elements of a finding as described in Government Auditing Standards as condition, criteria, effect, and cause.³⁹

So that Federal, State, local, and other officials can efficiently resolve findings, the following specific information should be included in findings:⁴⁰

- The award name, award number, grantor, Catalog of Federal Domestic Assistance ("CFDA") number, and grant year;
- The condition found, including facts relied on that indicate that noncompliance occurred;
- Specific requirement for which noncompliance is found, including regulatory, statutory, or other citation;
- Identification of the questioned costs and how they were computed;
- The cause of the noncompliance;
- Recommendation for corrective action to prevent future occurrences of noncompliance;
- Pertinent views of responsible officials of the audited entity concerning the findings and what corrective action is planned; and
- Other information necessary to determine the cause and effect in order to take proper corrective action.

Material findings should be presented in their proper perspective by relating the extent (number and dollar amount) of noncompliance to the number of cases examined, dollar amount tested, and the size of the universe.⁴¹

³⁹ Government Auditing Standards, Page 5-4, Paragraph 9 & Footnote 7; Page 5-9, Paragraph 23.

⁴⁰ PCIE Uniform Desk Review Guide for A-128 Single Audits (1991 Edition), Question 34.

⁴¹ A-133 Attachment, Paragraph 15c(3).

The auditor also should disclose the status of significant or material prior audit findings that have not been corrected.⁴²

42. Criteria for Nonmaterial Compliance Findings

A-133 Attachment, Paragraph 15e provides that nonmaterial findings need not be disclosed with the compliance report but should be reported in a separate written communication. What criteria should the auditor use to determine whether compliance findings are nonmaterial?

In determining whether a compliance finding is nonmaterial, the auditor should consider both quantitative (monetary value) and qualitative factors (cumulative effect and impact of nonmaterial items, objectives of the work, and use of information by grantors). Also in audits of government programs, the materiality level may be lower than in similar type audits in the private sector because of public accountability of the entity and the visibility and sensitivity of government programs, activities, and functions.⁴³

A quantitative factor indicating a nonmaterial compliance finding is the cost of reporting and recovery (assuming finding and amount are not disputed) exceeding the monetary value of the finding. Qualitative factors indicating a nonmaterial compliance finding are low risk of public or political sensitivity, a single exception with low risk of being pervasive, and the auditor's judgment and experience are that Federal agencies or prime recipients would normally not need to resolve or take follow-up action.

By separately reporting nonmaterial compliance findings, the auditor can focus the compliance report.

Even though nonmaterial findings may be excluded from the compliance report, the auditor should report them in writing to the not-for-profit and reference this separate communication in the compliance report.⁴⁴ The not-for-profit should forward all separate communications of compliance findings to the Federal agencies and prime recipients.⁴⁵ Since auditor judgment is exercised in determining whether a finding is nonmaterial, forwarding the separate communications allows the Federal agencies and prime recipients to review whether items reported as nonmaterial require additional follow-up action.

⁴² A-133 Attachment, Paragraph 15g; Government Auditing Standards, Page 3-16, Paragraph 41.

⁴³ Government Auditing Standards, Page 3-13, Paragraphs 33 & 34.

⁴⁴ Government Auditing Standards, Page 5-3, Paragraph 8.

⁴⁵ A-133 Attachment, Paragraph 15e.

43. Criteria for Reportable Conditions

What is the basis for determining whether an internal control finding for Federal programs is a reportable condition (including material weaknesses)? For example, is a reportable condition relative to total Federal awards, a major program, or a Federal program?

The determination of whether an internal control finding is a reportable condition (including material weaknesses) is relative to a Federal program. The reason for this is that the auditor must perform certain minimum internal control procedures (gain an understanding of internal controls and assess risk) for each Federal program. Since procedures must be performed for each program, the auditor's internal control report should include reportable conditions relative to a Federal program.

There may be separate systems related to Student Financial Aid ("SFA") and Research and Development ("R&D") which are treated as one program under an A-133 single audit. In this case, when evaluating whether a finding is a reportable condition, the auditor should consider the condition in relation to the system being reviewed as well as the overall program.

44. Management's Responsibility for Audit Findings

What is management's responsibility to respond to audit findings?

In summary, management should (1) promptly evaluate findings reported by auditors, (2) determine proper actions in response to audit findings, and (3) complete, within established time frames, all actions that correct or otherwise resolve the matters brought to management's attention.⁴⁶

Management should provide the auditor their views on findings so the auditor can include views of responsible officials with the finding.⁴⁷ This communication should occur prior to or at the close of the audit.

Also, management needs to prepare a written report on findings, referred to as a corrective action plan. This corrective action plan should include all findings in the auditor's reports. Although not required, it would be helpful in audit resolution if the corrective action plan also included nonmaterial findings communicated separately.

⁴⁶ Internal Control Standards Issued by the Comptroller General, Pursuant to the Federal Managers Financial Integrity Act of 1982, Audit Resolution Standard.

⁴⁷ Government Auditing Standards, Page 5-4, Paragraph 9; Page 5-9, Paragraph 23; Page 7-10, Paragraphs 43 through 47.

The corrective action plan has the following two parts:

1. Plan for corrective action

- Identify each finding as reported by the auditor
- Identify planned action:
 - State who will take what corrective action by what date, or
 - When management does not agree with the finding or believes corrective action by management is not required, management should provide an explanation and specific reasons (e.g., regulatory or legal requirements) why no corrective action is required.

2. Comments on the status of corrective action taken on prior findings

- Identify prior findings individually or by groupings where corrective action has been taken.
- Identify prior findings individually where corrective action has not been taken. Identify any changes in status from the original corrective action plan such as changes in who will take what action by what date. (Only a reference is needed when prior findings are included with current year findings and plan for corrective action.)

The corrective action plan should be submitted with the audit report, which is due within 30 days after the audit is received by the auditee.⁴⁸

45. Audit Findings Resolution

What is the process for Federal agencies resolving audit findings?

The Federal agencies responsible for audit resolution will evaluate the auditor's findings and recommendations along with the not-for-profit's corrective action plan. Each Federal agency responsible for audit resolution shall issue a management decision within six months of receipt of the audit report. The management decision is the Federal agency's response to the auditor's findings and not-for-profit's planned corrective action. A management decision can include additional actions necessary to resolve the findings.

Resolution normally occurs when the Federal agency responds with a management decision.⁴⁹ Upon learning of the finding, the not-for-profit should proceed with corrective action as rapidly as possible.⁵⁰

⁴⁸ A-133 Attachment, Paragraphs 15h & 15i.

⁴⁹ OMB Circular A-50 Paragraph 6b.

⁵⁰ A-133 Attachment, Paragraph 16b.

Resolution of findings that relate to the programs of a single Federal agency is the responsibility of that agency. Resolution of findings affecting programs of more than one Federal agency is coordinated by the cognizant agency.⁵¹ A prime recipient is required to ensure that appropriate corrective action is taken by a subrecipient.⁵²

Sanctions such as disallowed costs, or withholding or suspending awards are available to Federal agencies when proper corrective action on audit findings is not made in a timely manner.⁵³

⁵¹ A-133 Attachment, Paragraph 16a.

⁵² A-133 Attachment, Paragraph 5b.

⁵³ OMB Circular A-110, Attachment L; A-133 Attachment, Paragraph 8.

Subrecipient and Vendor

46. Distinguishing Between Subrecipient and Vendor

What distinguishes a subrecipient from a vendor?

A subrecipient is an entity that receives Federal assistance passed through from a prime recipient or another subrecipient to carry out or administer a program.⁵⁴ Distinguishing characteristics of a subrecipient include items such as:

- Determining eligibility for assistance;
- Performance measured against meeting the objectives of the program;
- Responsibility for programmatic decision making;
- Responsibility for applicable program compliance requirements; and
- Use of the funds passed through to carry out a program of the sub-entity as compared to providing goods or services for a program of the prime recipient.

A vendor is an entity responsible for providing generally required goods or services related to the administrative support of the Federal award.⁵⁵ These goods or services may be for the prime recipient or subrecipient's own use or for the use of beneficiaries of the program. Distinguishing characteristics of a vendor include items such as:

- Providing the goods and services within normal business operations;
- Providing similar goods or services to many different purchasers;
- Operating in a competitive environment; and
- Program compliance requirements do not pertain to the goods or services provided.

There may be unusual circumstances or exceptions to the distinguishing characteristics of a subrecipient and vendor listed above. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. The Federal cognizant, oversight, or grantor agency may be contacted for guidance in making these determinations.

Prime recipient monitoring and audit requirements for subrecipients are covered by A-133 (See question numbers 47 through 49). Grantee monitoring and audit requirements for vendors are based upon the grantee's responsibility to ensure compliance (See question numbers 57 and 58).

A not-for-profit may be a prime recipient, subrecipient, and/or a vendor. The awards received as a prime recipient or subrecipient would be subject to audit under A-133. The

⁵⁴ A-133 Attachment, Paragraph 1p; OMB A-128 Q&A, Question 22.

⁵⁵ A-133 Attachment, Paragraph 1q.

amounts received only to provide goods or services as a vendor would not be considered Federal awards.

47. Recipient Monitoring Responsibility for Subrecipient

What monitoring responsibilities do prime recipients have for subrecipients in addition to obtaining and acting on subrecipient audit reports?

The prime recipient is ultimately responsible for all Federal awards passed through to subrecipients. Prime recipients should monitor subrecipients during the grant period to ensure compliance with applicable Federal requirements and achievement of performance goals.

A good system of internal control by prime recipients should include provisions in contracts with subrecipients for appropriate sanctions when subrecipients fail to comply with program or audit requirements.

48. Recipient Auditor's Responsibility for Subrecipient

What is the prime recipient auditor's responsibility for auditing the subrecipient?

The prime recipient auditor's responsibilities are to determine whether:

- The prime recipient's system for monitoring subrecipients and obtaining and acting on subrecipient audit reports is adequate;³⁶
- The subrecipient has complied with A-128 or A-133 audit requirements, as applicable, and subrecipient audit reports are current; and
- Subrecipient questioned costs or compliance findings which may be material or otherwise require adjustment of the prime recipient records are properly reflected by the prime recipient.

The prime recipient auditor is not responsible for auditing the subrecipient. As long as the audit report of the subrecipient is current, it need not cover the same period as the prime recipient's audit.³⁷ See discussion in question number 51 when there is no subrecipient audit.

³⁶ A-133 Attachment, Paragraph 13b(2)(b).

³⁷ OMB A-128 Q&A, Question 25.

49. Recipient & Auditor's Responsibility over For-Profit Subrecipient

What are a prime recipient and its auditor's responsibilities when the subrecipient is a for-profit organization?

Prime Recipient

A prime recipient has the same responsibilities for funds passed through to for-profit subrecipients as not-for-profit subrecipients (See question numbers 47 and 48) except A-128 and A-133 do not establish for-profit subrecipient audit requirements.

Since audit requirements are not specified, the monitoring procedures over for-profit subrecipients are more important. The contract with the for-profit subrecipient should include applicable administrative, general, and specific compliance requirements.

Also, the prime recipient should consider establishing appropriate audit requirements and include them in contracts with for-profit subrecipients. Audit requirements a prime recipient may consider including in contracts with a for-profit subrecipient are:

- A single audit in accordance with the requirements of A-128 or A-133;
- A program-specific audit to determine compliance with applicable laws and regulations; and
- Audits and monitoring similar to when vendors are responsible for compliance as discussed in question numbers 57 and 58.

Prime Recipient's Auditor

The prime recipient's auditor may determine that the for-profit subrecipient was required to obtain an audit which provides adequate compliance assurances for the prime recipient's programs. In this situation the auditor's responsibilities are the same as those described in question number 48 except the audit obtained is substituted for the A-128 or A-133 audit.

When the for-profit subrecipient has not had an audit, the prime recipient's auditor is responsible to obtain reasonable assurance that the for-profit subrecipient materially complied with applicable laws and regulations. The auditor may obtain compliance assurances by either reviewing the not-for-profit's records and monitoring procedures, performing additional procedures to determine compliance such as testing the for-profit subrecipient's records, or a combination of procedures. In addition, the prime recipient's auditor is responsible to determine whether the prime recipient's system for monitoring subrecipients is adequate and whether subrecipient noncompliance necessitates adjustment of the prime recipient's records.

50. Subrecipient Audit Effect on Recipient Audit

How can a subrecipient's audit affect the prime recipient's audit?

Subrecipient audits may affect the prime recipient's audit in two ways. First, deficiencies in the prime recipient's system for monitoring subrecipients or acting on subrecipient audit reports could result in a prime recipient finding.⁵⁸

Second, results of subrecipient audits may necessitate adjustment of the prime recipient's records. For example, findings in subrecipient audits could be significant enough to require an adjustment in the prime recipient's basic financial statements or Schedule of Federal Awards.⁵⁹ In this example, the prime recipient report may include the subrecipient finding to help explain the adjustment.

51. Recipient Consequences When No Subrecipient Audit

What are the consequences to a prime recipient when a subrecipient is required to be audited, but refuses, goes out of business, or otherwise does not perform the required audit?

The prime recipient is required to ensure that subrecipients to whom it provides \$25,000 or more in Federal awards meet applicable audit requirements. Possible consequences for lack of subrecipient audits are modifications to the prime recipient's audit reports, disallowed costs, or other adverse actions by Federal agencies.⁶⁰

An alternative when a prime recipient is unable to obtain an audit for a subrecipient is to expand the prime recipient audit to include testing of subrecipient records for programs from the prime recipient. Even though the expanded testing could permit a clean prime recipient audit opinion and show proper accountability for Federal awards, there would still be a compliance finding for lack of subrecipient audits.

52. Recipient Program-Specific Audit of Subrecipient

May a prime recipient engage an auditor to perform a program-specific audit on a not-for-profit subrecipient in lieu of requiring an A-133 single audit?

If the subrecipient qualifies for a program-specific audit (See question number 5), then it would be appropriate for either the prime recipient or subrecipient to engage an auditor to perform the program-specific audit.

⁵⁸ A-133 Attachment, Paragraph 13b(2)(b).

⁵⁹ A-133 Attachment, Paragraph 5c; OMB A-128 Q&A, Question 25.

⁶⁰ A-133 Attachment, Paragraphs 5 & 8; OMB A-128 Q&A, Question 25.

When an A-133 single audit is required, separate program-specific audits will not meet the A-133 requirements.

53. Use of Internal Auditor to Audit Subrecipient

May a prime recipient use its internal auditor to perform the audit required under A-133 for a subrecipient?

A prime recipient government's internal auditor who is independent and otherwise meets the qualifications and standards prescribed by A-133 and Government Auditing Standards ("GAS") may perform the audit required by A-133 for a subrecipient. However, nongovernmental internal auditors could not perform subrecipient audits under A-133 because they are not included in the A-133 definition of independent auditor.⁶¹

A prime recipient internal auditor, either governmental or nongovernmental, may be used to monitor the subrecipient or assist the independent auditor.

54. Audit When Subrecipient Not Aware of Federal Award

If a prime recipient does not identify awards to subrecipients as Federal or require the subrecipient to have an A-133 audit, does this relieve the subrecipient of the audit requirements?

If the prime recipient does not inform the subrecipient that a Federal award is being passed through, and the subrecipient otherwise is not aware that the award is Federal or that an audit is required, then the prime recipient is responsible to make arrangements with the subrecipient for the proper audit. The prime recipient is ultimately responsible for Federal awards passed through to a subrecipient.

The determining factor for A-133 audit requirements is the dollar amount of Federal awards received (See question numbers 5 and 7), not whether the audit is requested.⁶² All not-for-profit subrecipients whose total Federal awards received meet the dollar thresholds are required to have an A-133 audit. However, it is essential that the prime recipient identify Federal awards to the subrecipient.⁶³

If the prime recipient fails to advise the subrecipient that the award is Federal, this should be considered a weakness in the prime recipient's internal control system for monitoring subrecipients.

⁶¹ A-133 Attachment, Paragraph 1g; Government Auditing Standards, Pages 3-8 through 3-10, Paragraphs 18 through 25.

⁶² A-133 Attachment, Paragraph 2a.

⁶³ A-133 Attachment, Paragraph 1e(4); OMB A-128 Q&A, Question 28.

55. Federal Part of Award to Subrecipient Unknown

What does a not-for-profit subrecipient do when the prime recipient is unable or unwilling to indicate how much of an award is Federal?

Prime recipients are responsible to identify Federal awards to subrecipients.⁶⁴ However, when the not-for-profit subrecipient is unable to determine the amount of the award which is Federal, the full amount should be audited as a Federal award. The full amount should also be reported on the Schedule of Federal Awards with a footnote that the Federal amount is undeterminable.⁶⁵

56. Individual Student Receiving Over \$25,000

If a student receives more than \$25,000 in Federal financial assistance, is the student a subrecipient subject to audit under A-133?

An individual who is a beneficiary of a program is not a subrecipient and therefore not subject to A-133 audit.⁶⁶

57. Not-for-profit Compliance Responsibility for Vendors

What are a not-for-profit organization's responsibilities when the vendor is responsible for compliance or the vendor's records must be reviewed to determine compliance by the not-for-profit?

In most cases, the not-for-profit's compliance responsibility for vendors is only to ensure that the procurement, receipt, and payment for goods and services comply with laws and regulations. Compliance requirements normally do not pass through to vendors.

However, some transactions may be structured such that the vendor should also be responsible for compliance or the vendor's records must be reviewed to determine compliance. In these cases, the not-for-profit is responsible to ensure compliance for applicable transactions by vendors. Methods to ensure this compliance are pre-award audits, monitoring during the contract, and post-award audits. Audits may be done or procured by the not-for-profit or the terms and conditions of the contract may require the vendor to procure the audit.

When necessary, contracts with vendors should include compliance requirements, audit and monitoring requirements, or the right to audit. Including the compliance

⁶⁴ A-133 Attachment, Paragraphs 1e(4) & 13c(2).

⁶⁵ OMB A-128 Q&A, Questions 28 & 38.

⁶⁶ A-133 Attachment, Paragraph 1p.

requirements will establish a benchmark to measure compliance. Including audit and monitoring requirements and the right to audit provides the authority to access a vendor's records for monitoring or to obtain audit assurances.

58. Auditor's Compliance Responsibility for Vendors

What are the not-for-profit auditor's responsibilities when the vendor is responsible for compliance or the vendor's records must be reviewed to determine compliance by the not-for-profit?

As discussed in question number 57, compliance requirements normally do not pass through to vendors.

However, some transactions may be structured such that the vendor should also be responsible for compliance or the vendor's records must be reviewed to determine compliance. In these cases, the auditor is still responsible to determine compliance for applicable vendor transactions.

When the auditor cannot obtain compliance assurances from reviewing the not-for-profit's records and monitoring procedures, the auditor will need to perform additional procedures to determine compliance. These procedures may include testing the vendor's records or relying on work performed by the vendor's independent auditor.

Internal Control

59. Auditor's Internal Control Responsibility

What is the auditor's responsibility for obtaining an understanding of the internal control structure, assessing control risk, and testing internal control structure policies and procedures for Federal awards in an A-133 single audit?

The auditor is responsible for obtaining an understanding of the internal control structure (including whether relevant controls have been placed in operation) and assessing control risk for Federal awards. Additionally, the auditor must perform tests to evaluate the effectiveness of the design and operation of significant policies and procedures in preventing or detecting material noncompliance.⁶⁷ These tests should include both accounting controls and administrative controls (controls designed to ensure compliance with laws and regulations). The auditor's internal control responsibility under A-133 also includes testing a not-for-profit's system for monitoring subrecipients and the controls in effect to ensure direct and indirect costs were properly computed and billed.⁶⁸

The auditor is not required to perform tests of controls for areas where the internal control structure policies and procedures are not likely to be effective in preventing or detecting material noncompliance. When internal controls are not tested for this reason, the auditor's report is required to:

- Include the internal control deficiency as either a reportable condition or material weakness;
- Identify the programs and requirements for which the relevant internal control policies and procedures were not tested; and
- Describe the absence of relevant policies and procedures or other circumstances that cause the auditors to conclude that policies and procedures are likely to be ineffective.⁶⁹

As an example, a small not-for-profit organization may have too few employees for effective separation of duties. The auditor would report the lack of separation of duties as a reportable condition or a material weakness. Alternatively, the auditor may determine that there are compensating controls which can be tested. In this case there may not be a reportable condition.

The auditor's reporting on internal control is described in question number 30.

⁶⁷ A-133 Attachment, Paragraph 13b(2)(a).

⁶⁸ A-133 Attachment, Paragraph 13b(2)(b) & 13b(2)(c).

⁶⁹ Uniform Quality Control Review Guide for A-128 Single Audits (1991 Edition), Question 45.

60. 50% Rule

Does the 50% rule apply to A-133 single audits?

The 50% rule, developed for A-128 single audits, states that it is sufficient to perform tests of controls for only major programs, when major program expenditures are at least 50% of total Federal expenditures. However, when major program expenditures are less than 50% of total Federal expenditures, the auditor should test controls over all major programs and the next largest nonmajor programs until controls over at least 50% of total Federal expenditures are subjected to testing. The auditor is required to obtain an understanding of the internal control structure and assess control risk for the remaining nonmajor programs.

A preferred alternative to selecting the "next largest" nonmajor programs (to reach the 50% of Federal expenditures) is to select nonmajor programs on a rotating basis so that all but clearly insignificant programs are covered at least once every three years.

Use of the 50% rule consistent with existing A-128 single audit guidance is acceptable for A-133 single audits until further guidance is issued.⁷⁰

61. Cyclical Approach for Other Nonmajor Programs

Does the cyclical approach apply to A-133 single audits?

Use of the cyclical approach for other nonmajor programs (not tested under the 50% rule) consistent with PCIE Position Statement No. 3 is acceptable for A-133 single audits.

The cyclical approach provides that in some circumstances, it may not be practical to obtain an understanding of the internal control structure and assess risk for nonmajor programs annually. This may occur when a not-for-profit organization has a large number of nonmajor programs administered by multiple operating components. Under the cyclical approach, in the first year the auditor should gain an understanding of internal controls and assess risk for each nonmajor program. Thereafter, the auditor would obtain an understanding of internal controls and assess control risk for each nonmajor program once every three years. Any new nonmajor programs should be reviewed the first year the program is active.

⁷⁰ AICPA Audit and Accounting Guide, Audits of State and Local Governmental Units (1989); Statement of Position 90-9, The Auditor's Consideration of the Internal Control Structure Used in Administering Federal Financial Assistance Programs Under the Single Audit Act; and PCIE Position Statement No. 2.

For an annual audit, each nonmajor program should be covered at least once every three years. If two year (biennial) audits are performed, all programs should be covered by every second audit.

Compliance

62. Auditor's Compliance Responsibility

What is the auditor's responsibility for auditing compliance under the A-133 single audit?

The auditor's objective is to determine whether the not-for-profit organization has complied with laws and regulations that may have a direct and material effect on the financial statement amounts and on each major Federal program.⁷¹ Financial statement compliance is the normal responsibility under generally accepted auditing standards.

Federal program compliance is the additional A-133 single audit responsibility. Question number 63 discusses how the auditor should determine applicable laws, regulations, and compliance tests. The extent of the tests is up to the auditor's judgment.

While the A-133 audit objective is to determine compliance relative to major Federal programs, the auditor must also test any nonmajor program transactions that are otherwise selected during the audit.⁷² These nonmajor program transactions selected as part of the financial statement audit or internal control work should be tested for compliance with Federal laws and regulations that may apply to the transaction. The transaction tests are normally for allowable costs/cost principles, administrative requirements, types of services allowed or unallowed, eligibility, and other relevant compliance requirements applicable to the transaction.

63. Guidance for Compliance Tests

What guidance should the auditor follow for compliance tests?

General Compliance

For testing general compliance requirements, the Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions (October 1991) ("A-133 Compliance Supplement") sets forth the compliance requirements and suggested audit procedures.

Specific Compliance

For testing specific compliance requirements of programs listed, the A-133 Compliance Supplement or the A-128 Compliance Supplement titled Compliance Supplement for Single Audits of State and Local Governments (Revised 1990) set forth the specific

⁷¹ A-133 Attachment, Paragraphs 12b(3) & 13c(1).

⁷² A-133 Attachment, Paragraphs 13c(1) & 13c(7).

compliance requirements and suggested audit procedure. For programs contained in a compliance supplement which have not had subsequent changes, an audit of the requirements contained in the compliance supplement will meet the A-133 single audit requirements.⁷³ If there have been changes, then the auditor should follow the provisions of the compliance supplement as modified by the changes.

For testing specific requirements of programs not listed in the compliance supplements, the auditor should determine the availability of agency prepared supplements or audit guides. This can be done by reviewing the Program Audit Guide Survey (October 1991) prepared by the PCIE Standards Subcommittee (See question number 22 for how to order the Survey). The auditor may also contact the appropriate Inspector General's Office to determine whether subsequent audit guides have been issued or to obtain a copy of an audit guide.

Guidance on specific compliance requirements is also available from grant agreements, laws, regulations, or the Catalog of Federal Domestic Assistance ("CFDA").⁷⁴ Even when programs are not listed, the compliance supplements can provide overall guidance on suggested audit procedures and the types of compliance requirements (i.e., types of services allowed or unallowed; eligibility; matching, level of effort, and/or earmarking requirements; special reporting requirements; and special tests and provisions).

Auditors should be alert to changes in Federal laws and regulations and modify their audit procedures as appropriate. For major programs, auditors should review grant agreements to determine whether specific requirements reflected in the compliance supplement have changed.

64. Financial Reports & Allowable Costs/Cost Principles

Does A-133 require two general requirements, Federal financial reports and allowable costs/cost principles, to be tested as specific compliance requirements?

The auditor's opinion on major programs must also include two compliance categories which are listed in the compliance supplements as general requirements (See discussion in question number 30, item 6b). Therefore the auditor's testing to support the compliance opinion on major programs must include the general requirements of **Federal financial reports and allowable costs/cost principles** (including claims for advances, reimbursements, and matching).⁷⁵ Following is a list of categories of compliance requirements which, if applicable, must be included in the compliance opinion on major programs:

⁷³ OMB A-128 Q&A, Question 10.

⁷⁴ OMB A-128 Q&A, Question 11.

⁷⁵ OMB A-133 Attachment, Paragraphs 13c(5) & 15c(3).

- Types of services allowed or unallowed;
- Eligibility;
- Matching, level of effort, and/or earmarking requirements;
- Reporting:
 - Financial reporting;
 - Special reporting;
- Special tests and provisions (describe any specific tests and provisions); and
- Allowable costs/cost principles (including claims for advances, reimbursements, and matching).

65. Compliance Responsibility - Related Party Transactions

What is the auditor's compliance responsibility under A-133 for related party transactions when these transactions involve Federal awards?

Transactions may occur between a not-for-profit and another party which the auditor must consider as related party transactions in accordance with generally accepted auditing standards. Because the requisite conditions of competitive, free market dealings may not exist, transactions involving related parties cannot be presumed to be carried out on an arm's-length basis.⁷⁶ When related party transactions involve Federal awards, the not-for-profit's auditor is responsible for determining whether these transactions would be in compliance with Federal laws and regulations and allowable if originated by the not-for-profit charging the Federal award. Depending on the Federal award involved and the type of cost, related party charges paid from Federal awards should not result in a profit. Also, the organizational structure should not result in claiming of costs that would otherwise be unallowable under Federal regulations.

Question number 13 discusses audit requirements for organizations associated with a not-for-profit organization ("Associated Organizations").

66. Responsibility for Testing Indirect Costs

What is the auditor's responsibility for testing indirect costs?

Indirect costs testing is part of the testing for total costs (indirect costs plus direct costs). A-133 requires total costs to be tested for internal controls and compliance as part of allowable costs/cost principles and amounts claimed for advances, reimbursements, and matching.⁷⁷

If indirect costs were claimed as expenditures on Federal programs during the audit period, the auditor should determine whether the amounts claimed were determined in

⁷⁶ FASB Statement No. 57.

⁷⁷ A-133 Attachment, Paragraphs 13b(2)(c) & 13c(5).

accordance with appropriate cost principles. Federal departments and agencies should rely on the work done by independent auditors on cost allocation procedures and practices to avoid duplicate audits.⁷⁸

The A-133 Compliance Supplement provides suggested audit procedures for both direct and indirect costs. The extent of testing of total costs should be sufficient to support the opinion on compliance for each major program.

67. Responsibility for Program Income

What is the auditor's responsibility for Federal program income?

Program income compliance requirements and suggested audit procedures are included in the A-133 Compliance Supplement under the "Administrative Requirements," part of "General Requirements." Also, since program income will normally be included in Federal financial reports, the auditor should consider program income in determining whether Federal financial reports contain information that is supported by books and records from which the basic financial statements are prepared.

The auditor's responsibility for Federal program income is the same as the responsibility for Federal expenditures. The auditor is responsible for internal controls over program income consistent with the auditor's internal controls responsibility discussed in question number 59 and for compliance over program income consistent with the auditor's compliance responsibility discussed in question number 62.

68. Drug-Free Workplace Act

Does the Drug-Free Workplace Act apply to subrecipients?

The Drug-Free Workplace Act applies to recipients who receive grants directly from Federal agencies.⁷⁹ The Drug-Free Workplace Act does not apply to subrecipients. However, if a subrecipient is also a prime recipient, then the auditor must test for compliance with the Drug-Free Workplace Act. Also, in some cases the prime recipient may by contract pass the Drug-Free Workplace requirements on to a subrecipient.

⁷⁸ A-133 as published in Federal Register March 16, 1990, Supplementary Information, Paragraph B - Comments and Responses, Other Comments.

⁷⁹ Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions (October 1991), Page 2-8.

Sampling; Sample Sizes

69. Program-Specific Audit vs. Sample Sizes

The U.S. Department of Education ("Education"), Audits of Student Financial Assistance Programs ("Audit Guide") specifies testing procedures and minimum sample sizes. Under A-133, is the auditor required to follow these procedures and minimum sample sizes?

For an A-133 single audit, the Education Audit Guide procedures and minimum sample sizes are not required, but the auditor may use them as guidance. However, if the entity elects to have a program-specific audit because it has only one program or it received less than \$100,000 in Federal awards, the auditor must use the Education Audit Guide.

70. Compliance Sample from All Major Programs

Is the auditor required to select a sample from each major program for compliance testing?

The selection and testing must include a sufficient number of transactions from each major program to support the opinion on each major program.

Under certain circumstances, such as when programs have similar compliance requirements, it may be efficient to select a single sample from multiple programs. However, the auditor should be careful to ensure that sufficient testing is made of the compliance requirements of each major program.⁸⁰

⁸⁰ A-133 Attachment, Paragraph 13c(3); OMB A-128 Q&A, Question 18.

Two Year (Biennial) Audits

71. Annual A-133 Single Audit if Annual Financial Audit

May a not-for-profit organization perform the financial statement audit annually but perform the A-133 single audit of Federal awards every two years?

A-133 states that audits shall usually be performed annually but not less frequently than every two years.⁸¹ The intent was for not-for-profit organizations usually having annual financial audits to also have annual A-133 single audits. The reason for permitting two year audits was to not increase the audit frequency on not-for-profit organizations that were only having audits every two years.

Therefore, the A-133 single audit must be annual when the not-for-profit has annual financial audits.

Since some not-for-profit organizations and their auditors had interpreted A-133 to allow an A-133 single audit every two years in all cases, the Inspectors General may use judgment in accepting two year audits in the first cycle of audits under A-133.

72. Implementation Year for Two Year Audits

A not-for-profit organization has audited Federal programs under A-110 on a two year cycle ending June 30, 1989. The not-for-profit wishes to continue the two year cycle. How should A-133 audits be implemented since A-110 is effective for the first year (year ended June 30, 1990) and A-133 is effective for the second year (year ended June 30, 1991)?

The not-for-profit has two choices to implement a two year audit approach under A-133 which is effective for fiscal years that begin on or after January 1, 1990.⁸²

The first choice is to implement A-133 early with an A-133 audit for the two year period ending June 30, 1991. Early implementation is encouraged by A-133.⁸³

The second choice is to do a one year A-110 audit for the year ended June 30, 1990. The not-for-profit could then start A-133 audits with a new two year cycle ending June 30, 1992, or do a one year A-133 audit for the year ended June 30, 1991, and keep the original two year cycle ending June 30, 1993.

⁸¹ A-133 Attachment, Paragraph 7.

⁸² A-133 Paragraph 6; A-133 Attachment, Paragraph 7.

⁸³ A-133 Paragraph 6.

The not-for-profit should consult with the cognizant or oversight agency when implementing a two year audit.

73. Two Year Audit Cover Both Years

Must the two year audit cover both years or can the audit skip every other year?

A two year audit must cover both years.⁴⁴

74. Major Program Determination for Two Year Audits

In two year audits, is the test for major programs based on expenditures in each individual year or the combined expenditures for the two year period?

The determination for major programs should be based on expenditures for the two year period.

75. Two Year Audits Not Always Permitted

Are two year audits permitted even if the program laws or regulations require an annual audit?

A-133 Attachment, paragraph 7 states, "Audits shall usually be performed annually but not less frequently than every two years." However, if the laws or regulations for the program require an annual audit, then an annual audit must be performed.

For example, Head Start regulations and Section 330 of the Public Health Act (covering community health centers) both require an annual audit. A-133 guidance should be followed in performing the annual audit.

⁴⁴ A-133 Attachment, Paragraph 7.

Audit Costs; Audit Fees

76. Audit Cost Recovery - Overhead or Direct

A not-for-profit organization currently has a multi-year overhead rate which does not include audit costs under A-133. What can the not-for-profit do to recover the cost of the audit?

A-133 allows audit costs to be recovered as either direct or indirect costs in accordance with applicable cost principles. However, there is no special appropriation for audit costs. To recover audit costs, the not-for-profit must build them into the specific grant documents (if direct) or into the overhead proposal (if indirect).⁸⁵

77. Audit Costs Exceeding Allowable Administrative Costs

If expenses and A-133 audit costs exceed the maximum allowable for administrative costs, how may the additional audit costs be reimbursed? An example would be student financial aid administrative expenses exceeding the maximum allowed by the programs.

Audit costs may be considered as allowable administrative expenses. However, if administrative costs exceed the program maximum, then only the program maximum may be recovered. While A-133 provides that audit costs are allowable, A-133 does not authorize additional funds for audits.

78. When Audit Costs Charged

Can the costs of an A-133 single audit be recovered even if part or all of the year being audited has passed?

The audit is usually performed and paid for after the audit period. Therefore, it is proper to charge audit costs in the fiscal year immediately following the end of the audit period.

79. Charging Audit Costs in Advance

May audit costs be charged in advance of their being incurred?

Audit costs, like other expenses, should be reimbursed currently, rather than in advance. However, in some cases there will not be Federal awards in the next year to pay the

⁸⁵ A-133 Attachment, Paragraph 9.

audit cost. In this case, it would be acceptable to charge the Federal award in the current year and set up a reserve to pay the audit costs in the following year. The charge should be based on a valid contract with the auditor.

80. Charges for Quality Control Reviews

How may independent auditors charge for time spent with Federal agencies during quality control reviews ("QCR")?

When audits are properly performed and documented, the independent auditor's time with Federal agencies during a QCR is expected to be minimum. QCR time is similar to other time for quality control such as training, auditor policies and procedures, and peer review. Also, the process of having a Federal agency perform a QCR on the auditor's working papers should enhance the quality of the auditor's work. Therefore, Federal agencies do not expect Federal awards to be charged for the independent auditor's time spent on QCRs.

Hospitals

81. Hospital Definition

What is the definition of a hospital for purposes of A-133?

A hospital is a facility that meets the following criteria:⁸⁶

- Is primarily engaged in providing by or under the supervision of doctors of medicine or osteopathy, inpatient services for the diagnosis, treatment, and care or rehabilitation of persons who are sick, injured, or disabled;
- Is not primarily engaged in providing skilled nursing care and related services for inpatients who require medical or nursing care;
- Provides 24-hour nursing service; and
- Is licensed or approved as meeting the standards for licensing by the State or local licensing agency as a hospital.

82. When Under A-128, A-133, or Excluded as Not-Affiliated

When are hospitals included under A-128 or A-133, or excluded because they are not-affiliated?

Under A-128

State and local governments have an option to include their hospitals as part of the State or local government's A-128 audit. Hospitals included as part of a State or local A-128 audit are under A-128.⁸⁷

Under A-133

A-133 applies to hospitals affiliated with an institution of higher education but not audited as part of a State or local government under A-128. Since A-133 does not define affiliated, the Department of Health and Human Services ("HHS") has developed a definition to include hospitals with significant research and training funds. The HHS definition of affiliated, which is consistent with the intent of Office of Management and Budget, includes all situations in which:

⁸⁶ 42 CFR Ch. IV (10-1-91 Edition), Part 409 - Hospital Insurance Benefits, Section 409.3 Definitions.

⁸⁷ A-133 Attachment, Paragraph 1k; A-128 Paragraph 6c; OMB A-128 Q&A, Question 24.

- Either a hospital or an institution of higher education has an ownership interest in the other entity or some other party (other than a State or local unit of government) has an ownership interest in each of them;
- An affiliation agreement exists; or
- Federal research or training awards to a hospital or institution of higher education are performed in whole or in part in the facilities of, or involve the staff of, the other entity.⁸⁸

Excluded as Not-Affiliated

A-133 does not apply to not-affiliated hospitals. The basis for excluding not-affiliated hospitals is that they receive most of their Federal reimbursements from Medicare or Medicaid programs which have their own audit mechanisms.⁸⁹

Not-affiliated hospitals are subject to program-specific audit requirements imposed by any Federal awards they may receive.

⁸⁸ HHS Interim final rule published Federal Register Friday, March 1, 1991, starting at page 8712.

⁸⁹ HHS Interim final rule published Federal Register Friday, March 1, 1991, starting at page 8712.

Other Questions

83. Coordinated Audit Approach

What is the coordinated audit approach?

When the independent auditor and other Federal and non-federal auditors each have audit responsibility for a not-for-profit organization, they should coordinate to minimize duplication of audit work. This coordination normally occurs when the Federal and non-federal auditors arrange to do the work at the same time or the non-federal auditors perform the single audit and later the Federal auditors build upon this work. When the work is performed by various auditors and pulled together to meet the A-133 audit requirements, it is referred to as the coordinated audit.⁹⁰

A coordinated audit should not limit the scope of work necessary to meet audit objectives or issue timely reports. A coordinated audit must comply with the due professional care requirements of Government Auditing Standards in relying on the work of other auditors.⁹¹

Cognizant and other Federal audit agencies are required to coordinate, to the extent practical, audits made for Federal agencies which are in addition to A-133. The purpose is for these additional audits to rely and build upon the work of the A-133 audit.⁹²

The coordinated audit approach does not limit the authority of Federal agencies or auditors nor does it authorize a not-for-profit to constrain Federal agencies or auditors in performing audits.⁹³

To facilitate the audit cooperation, all contracts for not-for-profit audits should provide for appropriate access to working papers by other auditors.⁹⁴

84. Close-Out Audit

What is a close-out audit?

⁹⁰ A-133 Attachment, Paragraphs 1c, 3h, 3i, & 13a.

⁹¹ Government Auditing Standards, Pages 3-14 through 3-16 , Paragraphs 35 through 40.

⁹² A-133 Attachment, Paragraphs 3f, 6a, 6b, & 12a.

⁹³ A-133 Attachment, Paragraphs 6c & 6d.

⁹⁴ Government Auditing Standards, Page 3-16, Paragraph 39.

Federal award terms and conditions sometimes specify that residual funds may not be remitted to the not-for-profit organization until a contract specific audit is performed. This will often occur in cost-type contracts. The specific audit is called a close-out audit.

To the extent practical, Federal agencies should rely on A-133 audits for purposes of closing out a contract.⁹⁵ If the Federal agency needs to perform or arrange for additional audit work, the additional work should build upon the A-133 audit. See question number 35 for discussion of audits by Federal agencies in addition to A-133.

85. Assignment of Cognizant & Oversight Agencies

What is the process for arranging for an assignment of a cognizant agency or oversight agency?

The Office of Management and Budget ("OMB") will assign a cognizant agency to larger not-for-profit organizations.⁹⁶

Smaller not-for-profit organizations that are not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them with the most direct funds. Where there is no direct funding, the Federal agency with the most indirect funding will be the oversight agency.⁹⁷ The oversight agency may assume all or some of the responsibilities performed by the cognizant agency.⁹⁸

86. Working Papers and Report Retention

How long must audit working papers and reports be kept?

A-133 requires auditors to keep audit reports and working papers for a minimum of three years after the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the period.⁹⁹ A-133 requires prime recipients and subrecipients to keep their audit reports, and the reports of any of their subrecipients, for this same three year period.¹⁰⁰

⁹⁵ A-133 Attachment, Paragraph 6a.

⁹⁶ A-133 Attachment, Paragraphs 2b & 3.

⁹⁷ A-133 Attachment, Paragraph 1l (one, lowercase L).

⁹⁸ A-133 Attachment, Paragraphs 2b & 4.

⁹⁹ A-133 Attachment, Paragraph 17.

¹⁰⁰ A-133 Attachment, Paragraph 15k.

When auditors are aware that findings and questioned costs are still unresolved, the applicable Federal agency should be contacted prior to destruction of working papers and reports.

87. Quality Checklists

Are the quality control checklists used by the Inspectors General available for practitioners to use in evaluating the quality of their own working papers and reports?

Checklists prepared by the President's Council on Integrity & Efficiency (PCIE) are currently available for A-128 audits. They may be obtained by written request to the Treasury Office of Inspector General, Room 7210, ICC Building, 1201 Constitution Ave., N.W., Washington, D.C. 20220 or FAX 202-927-5418. Titles of the 1991 editions of these checklists are Uniform Desk Review Guide for A-128 Single Audits (Order number PCIE-06-056) and the Uniform Quality Control Review Guide for A-128 Single Audits (Order number PCIE-06-057).

The PCIE plans to develop separate checklists for A-133 audits. The A-128 checklists may be helpful until the A-133 checklists are developed; however, auditors should consider the differences between the circulars.

88. Auditors Suspended or Debarred from Federal Programs

How can a not-for-profit organization determine whether an auditor or audit firm has been excluded from audits of Federal programs, i.e., suspended or debarred?

The U.S. General Services Administration issues a monthly publication titled Lists of Parties Excluded From Federal Procurement or Nonprocurement Programs. The Lists of Parties is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402. Since either the firm or an individual CPA may be excluded, the not-for-profit should check both the firm name and the name of the key auditors who will be assigned to the audit. The not-for-profit may seek the advice of its cognizant or oversight agency to determine whether a particular firm or auditor has been suspended or debarred.

As part of the auditor procurement process, the not-for-profit may wish to obtain a written statement from the audit firm that neither the firm nor anyone assigned to the engagement has been excluded from Federal programs.

89. Foreign Auditors

Should reports be accepted from foreign auditors when the auditor did not fully meet Government Auditing Standards?

Auditors performing A-133 audits are required to meet Government Auditing Standards. No specific exception is provided for foreign auditors.

However, in some cases because of the language capabilities or specialized local knowledge, it is necessary to use independent auditors in developing countries. These auditors may not fully meet Government Auditing Standards such as the requirements for continuing education or external quality control reviews. Under these circumstances, the auditor should disclose the auditing standards which were not met. The Inspectors General, or prime recipients in the case of a subrecipient, should use their judgment on whether to accept the reports.

90. Reference Correction in A-133

In the A-133 Attachment, is the reference to paragraph 13c(3) in paragraph 15 - Audit Reports, sub-paragraph 15c(3) correct?

This reference is not correct. The correct reference should be to paragraphs 13c(4) and 13c(5) which describe the specific objectives for the compliance tests and opinion.

Federal Agency Contact Points for A-128 & A-133 Audits

This appendix lists Federal agency contact points for A-128 and A-133 questions and materials. These points may differ from where recipients are required to submit their audit reports. Therefore, distribution points for audit reports under A-128 or A-133 should be verified with the Federal agency providing the funds.

A separate table is provided for each Federal agency. The left side of the table lists the addresses and phone numbers and the right side lists the applicable audit locations.

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Federal Agency Contact Points for A-128 & A-133 Audits

| ACTION | |
|--|-------------------|
| <p>Deputy Inspector General Office of Inspector General ACTION Agency 1100 Vermont Ave. NW Washington, DC 20525 Phone: Voice (202) 606-4804 FAX (202) 606-5290</p> | <p>All audits</p> |

| AGENCY FOR INTERNATIONAL DEVELOPMENT (A-133 Audits Only) | |
|--|---|
| <p>Director of Financial Audits Office of Inspector General Agency for International Development Room 514, SA-16 Washington, DC 20523 Phone: Voice (703) 875-4171 FAX (703) 875-6584</p> | <p>For audits of all U. S. based not-for-profit organizations</p> |

| APPALACHIAN REGIONAL COMMISSION | |
|---|-------------------|
| <p>Appalachian Regional Commission Grants Office of Inspector General Appalachian Regional Commission 1666 Connecticut Ave. NW, Suite 600 Washington, DC 20235 Phone: Voice (202) 673-7822 FAX (202) 673-7930</p> | <p>All audits</p> |

Federal Agency Contact Points for A-128 & A-133 Audits

| DEPARTMENT OF AGRICULTURE | |
|--|--|
| <p>Regional Inspector General U.S. Department of Agriculture 6506 Belcrest Rd., Room 422 Hyattsville, MD 20782 Phone: Voice (301) 436-8763 FAX (301) 436-7610</p> | <p>For audits in Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia, Puerto Rico, and the Virgin Islands</p> |
| <p>Regional Inspector General U.S. Department of Agriculture 401 W. Peachtree St. NW Atlanta, GA 30365-3520 Phone: Voice (404) 730-3210 FAX (404) 730-3221</p> | <p>For audits in Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, and Tennessee</p> |
| <p>Regional Inspector General U.S. Department of Agriculture 111 N. Canal St., Suite 1130 Chicago, IL 60606 Phone: Voice (312) 353-1352 FAX (312) 353-8963</p> | <p>For audits in Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin</p> |
| <p>Regional Inspector General U.S. Department of Agriculture 101 South Main, Room 324 Temple, TX 76501 Phone: Voice (817) 774-1430 FAX (817) 774-1358</p> | <p>For audits in Arkansas, Louisiana, New Mexico, Oklahoma, and Texas</p> |
| <p>Regional Inspector General U.S. Department of Agriculture P.O. Box 293 Kansas City, MO 64141 Phone: Voice (816) 926-7667 FAX (816) 926-3861</p> | <p>For audits in Colorado, Iowa, Kansas, Missouri, Montana, Nebraska, North Dakota, South Dakota, Utah, and Wyoming</p> |
| <p>Regional Inspector General U.S. Department of Agriculture 555 Battery St., Room 511 San Francisco, CA 94111 Phone: Voice (415) 705-2244 FAX (415) 705-2251</p> | <p>For audits in Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Washington, Trust Territories of the Pacific, and Territory of Guam</p> |
| <p>National Single Auditor Coordinator U.S. Department of Agriculture Office of Inspector General Administration Building - Room 434-E 14th and Independence Ave. SW Washington, DC 20250 Phone: Voice (202) 720-6279 FAX (202) 720-0319</p> | <p>NATIONAL OFFICE CONTACT</p> |

Federal Agency Contact Points for A-128 & A-133 Audits

| DEPARTMENT OF COMMERCE | |
|--|-------------------|
| Office of Inspector General U.S. Department of Commerce Atlanta Regional Office of Audits Suite 2342 401 W. Peachtree St. NW Atlanta, GA 30308 Phone: Voice (404) 730-2780 FAX (404) 730-2788 | All audits |

| DEPARTMENT OF DEFENSE | |
|---|-------------------|
| Office of the Assistant Inspector General for Audit Policy and Oversight Office of Inspector General U.S. Department of Defense 400 Army Navy Drive, Room 1076 Arlington, VA 22202-2884 Phone: Voice (703) 693-0006 FAX (703) 697-1563 | All audits |

Federal Agency Contact Points for A-128 & A-133 Audits

| DEPARTMENT OF EDUCATION | |
|--|--|
| Regional Inspector General for Audit Office of Inspector General U.S. Department of Education 3535 Market St., Room 16280 Philadelphia, PA 19104 Phone: Voice (215) 596-0262 FAX (215) 596-0124 | For audits in Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia, Puerto Rico, and the Virgin Islands |
| Regional Inspector General for Audit Office of Inspector General U.S. Department of Education 1200 Main Tower, Room 2130 Dallas, TX 75202 Phone: Voice (214) 767-3826 FAX (214) 767-2024 | For audits in Alabama, Arizona, Arkansas, California, Florida, Georgia, Hawaii, Kentucky, Louisiana, Mississippi, Nevada, New Mexico, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, and Guam |
| Regional Inspector General for Audit Office of Inspector General U.S. Department of Education 10220 N. Executive Hills Blvd., 2nd Floor Kansas City, MO 64153 Phone: Voice (816) 891-7981 FAX (816) 374-6703 | For audits in Alaska, Colorado, Idaho, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Montana, Nebraska, North Dakota, Ohio, Oregon, South Dakota, Utah, Washington, Wisconsin, and Wyoming |
| National Single Audit Coordinator Office of Inspector General U.S. Department of Education 400 Maryland Ave. SW, Room 4200 MES Washington, DC 20202-1510 Phone: Voice (202) 205-8200* FAX (202) 205-8238* *Effective July 1, 1992 | NATIONAL OFFICE CONTACT |

| DEPARTMENT OF ENERGY | |
|---|-------------------|
| Director, Financial Audit Division Office of Inspector General U.S. Department of Energy 1000 Independence Ave. SW Washington, DC 20585 Phone: Voice (202) 586-1946 FAX (202) 586-0099 | All audits |

Federal Agency Contact Points for A-128 & A-133 Audits

| DEPARTMENT OF HEALTH AND HUMAN SERVICES | |
|---|------------|
| National Audit Managers - Non-Federal Audits HHS OIG National External Audit Resources Lucas Place 323 West 8th Street Room 514 Kansas City, MO 64105 Phone: Voice (816) 374-6714 (800) 732-0679 FAX (816) 374-6727 | All audits |

| DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT | |
|--|------------|
| Director, HUD-OIG National Review Center for Non-Federal Audits 950 N. King's Highway Cherry Hill, NJ 08034-1518 Phone: Voice (609) 968-4850 (800) 659-5692 FAX (609) 968-4864 | All audits |

| DEPARTMENT OF INTERIOR | |
|--|--|
| Director of External Audits Office of Inspector General U.S. Department of Interior 1550 Wilson Blvd., Suite 725 Arlington, VA 22209 Phone: Voice (703) 235-3061 FAX (703) 235-3237 | For audits in all 50 states and the District of Columbia |
| Regional Audit Manager Office of Inspector General U.S. Department of Interior Federal Building & U.S. Courthouse St. Thomas, Virgin Islands 00802 Phone: Voice (809) 774-8300 FAX (809) 774-7847 | For audits in U.S. Virgin Islands and Puerto Rico |
| Regional Audit Manager Office of Inspector General U.S. Department of Interior 238 Archbishop F.C. Flores Street PDN Building, Suite 807 Agana, Guam 96910 Phone: Voice 011-671-472-7279 FAX (671) 234-9061 | For audits in American Samoa, Commonwealth of the Northern Mariana Islands, Guam, and Trust Territories of the Pacific Islands |

Federal Agency Contact Points for A-128 & A-133 Audits

| DEPARTMENT OF JUSTICE | |
|--|---|
| <p>U.S. Department of Justice Northeast Regional Audit Office 5113 Leesburg Pike Four Skyline Place Suite 701 Falls Church, VA 22041 Phone: Voice (703) 756-6294 FAX (703) 756-7494</p> | <p>For audits in Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, Virginia, and West Virginia</p> |
| <p>U.S. Department of Justice Atlanta Regional Audit Office 101 Marietta Street Suite 2322 Atlanta, GA 30323-2401 Phone: Voice (404) 331-5037 FAX (404) 331-5046</p> | <p>For audits in Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee, Puerto Rico, and the Virgin Islands</p> |
| <p>U.S. Department of Justice Chicago Regional Audit Office 175 W. Jackson Boulevard Suite A-1335 Chicago, IL 60604 Phone: Voice (312) 353-1203 FAX (312) 886-0513</p> | <p>For audits in Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, Ohio, and Wisconsin</p> |
| <p>U.S. Department of Justice Dallas Regional Audit Office 207 South Houston Street Box 4 (Room 334) Dallas, TX 75202 Phone: Voice (214) 939-6625 FAX (214) 939-6635</p> | <p>For audits in Arkansas, Colorado, Louisiana, Montana, New Mexico, North Dakota, South Dakota, Texas, Utah, Wyoming, and Oklahoma</p> |
| <p>U.S. Department of Justice San Francisco Regional Audit Office 525 Market Street Room 3522 San Francisco, CA 94105-2705 Phone: Voice (415) 744-6567 FAX (415) 744-6566</p> | <p>For audits in Alaska, American Samoa, Arizona, California, Guam, Hawaii, Idaho, Nevada, Oregon, Washington, Trust Territories of the Pacific Islands, and the Commonwealth of Northern Mariana Islands</p> |
| <p>U.S. Department of Justice Office of Operations 5113 Leesburg Pike Four Skyline Place Suite 701 Falls Church, VA 22041 Phone: Voice (703) 756-6475 FAX (703) 756-6299</p> | <p>NATIONAL OFFICE CONTACT</p> |

Federal Agency Contact Points for A-128 & A-133 Audits

| DEPARTMENT OF LABOR | |
|---|---|
| <p>Regional Inspector General U.S. Department of Labor 201 Varick St., Room 871 New York, NY 10014-4811 Phone: Voice (212) 337-2566 FAX (212) 337-2268</p> | <p>For audits in Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont, Puerto Rico, and Virgin Islands</p> |
| <p>Regional Inspector General U.S. Department of Labor 3535 Market St., Room 12100 Philadelphia, PA 19104 Phone: Voice (215) 596-4024 FAX (215) 596-0166</p> | <p>For audits in Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, and West Virginia</p> |
| <p>Regional Inspector General U.S. Department of Labor 1371 Peachtree St. NE, Room 240 Atlanta, GA 30367 Phone: Voice (404) 347-3256 FAX (404) 347-0178</p> | <p>For audits in Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, and Tennessee</p> |
| <p>Regional Inspector General U.S. Department of Labor 230 South Dearborn St., Suite 744 Chicago, IL 60604 Phone: Voice (312) 353-2416 FAX (312)353-2880</p> | <p>For audits in Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, Ohio, and Wisconsin</p> |
| <p>Regional Inspector General U.S. Department of Labor Federal Office Bldg., Room 415 525 Griffin Street Dallas, TX 75202 Phone: Voice (214) 767-6980 FAX (214) 767-2559</p> | <p>For audits in Arkansas, Colorado, Louisiana, Montana, New Mexico, North Dakota, Oklahoma, South Dakota, Texas, Utah, and Wyoming</p> |
| <p>Regional Inspector General U.S. Department of Labor 71 Stevenson St., Room 720 San Francisco, CA 94105 Phone: Voice (415) 744-6664 FAX (415) 744-7020</p> | <p>For audits in Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Washington, and Guam.</p> |
| <p>National Single Audit Coordinator Office of Financial Management Audits U.S. Department of Labor 200 Constitution Ave. NW, Room S-5022 Washington, DC 20010 Phone: Voice (202) 523-5906 FAX (202) 523-1453</p> | <p>NATIONAL OFFICE CONTACT</p> |

Federal Agency Contact Points for A-128 & A-133 Audits

| DEPARTMENT OF STATE | |
|---|-------------------|
| U.S. Department of State Office of Inspector General OIG/AUD/PP Room 6817 Washington, DC 20520-6817 Phone: Voice (202) 663-1940 FAX (202) 663-1991 | All audits |

Federal Agency Contact Points for A-128 & A-133 Audits

| DEPARTMENT OF TRANSPORTATION | |
|---|--|
| Regional Manager U.S. Department of Transportation 1633 Broadway, Room 200 New York, NY 10019 Phone: Voice (212) 399-5200 FAX (212) 399-5218 | For audits in Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont |
| Regional Manager U.S. Department of Transportation 31 Hopkins Plaza, Room 1628 Baltimore, MD 21201 Phone: Voice (301) 962-3612 FAX (301) 962-7469 | For audits in Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, and West Virginia |
| Regional Manager U.S. Department of Transportation Suite 376 1718 Peachtree St. NW Atlanta, GA 30309 Phone: Voice (404) 347-7825 FAX (404) 347-5274 | For audits in Alabama, Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Minnesota, Mississippi, North Carolina, North Dakota, Ohio, South Carolina, South Dakota, Tennessee, and Wisconsin |
| Regional Manager U.S. Department of Transportation Federal Office Building 819 Taylor St., Room 9A27 Fort Worth, TX 76102 Phone: Voice (817) 334-3545 FAX (817) 885-7008 | For audits in Arkansas, Louisiana, New Mexico, Oklahoma, and Texas |
| Regional Manager U.S. Department of Transportation 601 E 12th St., Room 113 Kansas City, MO 64106 Phone: Voice (816) 426-2761 FAX (816) 426-2727 | For audits in Iowa, Kansas, Missouri, and Nebraska |
| Regional Manager U.S. Department of Transportation 211 Main St., Suite 1022 San Francisco, CA 94105 Phone: Voice (415) 744-2517 FAX (415) 227-8209 | For audits in Arizona, California, Hawaii, and Nevada |
| Regional Manager U.S. Department of Transportation Federal Office Building 915 Second Ave., Room 644 Seattle, WA 98174 Phone: Voice (206) 442-5720 FAX (206) 442-6703 | For audits in Alaska, Colorado, Idaho, Montana, Oregon, Utah, Washington, and Wyoming |

Federal Agency Contact Points for A-128 & A-133 Audits

| DEPARTMENT OF TRANSPORTATION (Continued) | |
|---|--------------------------------|
| National Single Audit Coordinator U.S. Department of Transportation JA-30 400 7th St. SW Washington, DC 20590 Phone: Voice (202) 366-1974 FAX (202) 366-3912 | NATIONAL OFFICE CONTACT |

| DEPARTMENT OF VETERANS AFFAIRS | |
|---|-------------------|
| Director Contract Review and Evaluations Division (53C) Department of Veterans Affairs 810 Vermont Ave. NW Washington, DC 20420 Phone: Voice (202) 233-5621 FAX (202) 275-0675 | All audits |

Federal Agency Contact Points for A-128 & A-133 Audits

| ENVIRONMENTAL PROTECTION AGENCY | |
|---|---|
| Audit Manager Eastern Audit Division (OIG 521) Office of Inspector General U.S. Environmental Protection Agency Boston, MA 02203 Phone: Voice (617) 565-3160 FAX (617) 565-3660 | For audits in Connecticut, Maine, Massachusetts New Hampshire, Rhode Island, and Vermont. |
| Branch Manager Suboffice Eastern Audit Division Office of Inspector General U.S. Environmental Protection Agency 90 Church St., Room 802 New York, NY 10007 Phone: Voice (212) 264-5730 FAX (212) 264-9310 | For audits in New Jersey, New York, Puerto Rico, and Virgin Islands. |
| Divisional Inspector General for Audit Mid-Atlantic Division Office of Inspector General U.S. Environmental Protection Agency 841 Chestnut St., 13th Floor Philadelphia, PA 19107 Phone: Voice (215) 597-0497 FAX (215) 597-9802 | For audits in Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, and West Virginia |
| Divisional Inspector General for Audit Southern Division Office of Inspector General U.S. Environmental Protection Agency 1375 Peachtree St. NE, Suite 276 Atlanta, GA 30309 Phone: Voice (404) 347-3623 FAX (404) 347-1578 | For audits in Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, and Tennessee |
| Branch Manager Suboffice Southern Audit Division Office of Inspector General U.S. Environmental Protection Agency 1445 Ross Ave., Suite 1200 Dallas, TX 75202-2733 Phone: Voice (214) 655-6621 FAX (214) 655-6589 | For audits in Arkansas, Louisiana, New Mexico, Oklahoma, and Texas |
| Divisional Inspector General for Audit Northern Division Office of Inspector General (IA-13J) U.S. Environmental Protection Agency 77 West Jackson Blvd., 13th Floor Chicago, IL 60604 Phone: Voice (312) 353-2486 FAX (312) 353-4225 | For audits in Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin |

Federal Agency Contact Points for A-128 & A-133 Audits

| ENVIRONMENTAL PROTECTION AGENCY (Continued) | |
|---|---|
| Divisional Inspector General for Audit Central Division Office of Inspector General U.S. Environmental Protection Agency 726 Minnesota Ave. Kansas City, KS 66101 Phone: Voice (913) 551-7878 FAX (913) 551-7837 | For audits in Iowa, Kansas, Missouri, Nebraska, Colorado, Montana, North Dakota, South Dakota, Utah, and Wyoming |
| Audit Manager Western Audit Division (I-4) Office of Inspector General U.S. Environmental Protection Agency 75 Hawthorne St., 19th Floor San Francisco, CA 94105 Phone: Voice (415) 744-2445 FAX (415) 744-2438 | For audits in Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Washington, American Samoa, and Guam |
| Chief Financial and Compliance Audit Unit (A-109) Office of Inspector General U.S. Environmental Protection Agency 401 M Street, SW Washington, DC 20460 Phone: Voice (202) 260-4175 FAX (202) 260-1896 | NATIONAL OFFICE CONTACT |

Federal Agency Contact Points for A-128 & A-133 Audits

| FEDERAL EMERGENCY MANAGEMENT AGENCY | |
|---|---|
| District Audit Manager Office of Inspector General Federal Emergency Management Agency Suite 632 1371 Peachtree St. NE Atlanta, GA 30309 Phone: Voice (404) 853-4242 FAX (404) 853-4259 | All audits in Alabama, Connecticut, Delaware, District of Columbia, Florida, Georgia, Illinois, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, West Virginia, Wisconsin, Puerto Rico, and the Virgin Islands |
| District Audit Manager Office of Inspector General Federal Emergency Management Agency Building 105 Presidio of San Francisco San Francisco, CA 94129 Phone: Voice (415) 923-7010 FAX (415) 923-7017 | All audits in Alaska, Arizona, Arkansas, California, Colorado, Hawaii, Idaho, Iowa, Kansas, Louisiana, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Texas, Utah, Washington, Wyoming, and Guam. |
| Office of Inspector General Federal Emergency Management Agency 500 C Street SW - Suite 825 Washington, DC 20472 Phone: Voice (202) 646-3911 FAX (202) 646-3901 | NATIONAL OFFICE CONTACT |

| GENERAL SERVICES ADMINISTRATION (A-133 Audits Only) | |
|---|------------|
| Regional Inspector General for Auditing (JA-R) Real Property Audit Office 7 & D Street SW, Room 1064 Washington, DC 20407 Phone: Voice (202) 708-5340 FAX (202) 708-7494 | All audits |

| NATIONAL AERONAUTICS AND SPACE ADMINISTRATION | |
|---|------------|
| Assistant Inspector General for Auditing Office of Inspector General National Aeronautics and Space Administration Code W Washington, DC 20546 Phone: Voice (202) 453-1232 FAX (202) 472-4086 | All audits |

Federal Agency Contact Points for A-128 & A-133 Audits

| NATIONAL ARCHIVES AND RECORDS ADMINISTRATION | |
|---|-------------------|
| Office of Inspector General National Archives and Records Administration 7th Street & Pennsylvania Ave. NW Washington, DC 20408 Phone: Voice (202) 724-0067 FAX (202) 724-0554 | All audits |

| NATIONAL ENDOWMENT FOR THE ARTS | |
|--|-------------------|
| Office of Inspector General National Endowment for the Arts 1100 Pennsylvania Ave. NW, Room 207 Washington, DC 20506 Phone: Voice (202) 682-5402 FAX (202) 682-5610 | All audits |

| NATIONAL ENDOWMENT FOR THE HUMANITIES | |
|--|-------------------|
| Office of Inspector General National Endowment for the Humanities 1100 Pennsylvania Ave. NW, Room 801 Washington, DC 20506 Phone: Voice (202) 786-0350 FAX (202) 786-0243 | All audits |

| NATIONAL SCIENCE FOUNDATION | |
|---|-------------------|
| Office of Inspector General National Science Foundation Assistant Inspector General for External Audit 1800 G Street NW, Room 1241 Washington, DC 20550 Phone: Voice (202) 357-7813 FAX (202) 357-7401 | All audits |

Federal Agency Contact Points for A-128 & A-133 Audits

| NUCLEAR REGULATORY COMMISSION | |
|--|------------|
| U.S. Nuclear Regulatory Commission Office of Inspector General Washington, DC 20555 Phone: Voice (301) 492-4470 FAX (301) 492-4474 | All audits |

| SMALL BUSINESS ADMINISTRATION | |
|---|------------|
| Deputy Assistant Inspector General for Financial Audits and Operational Support Small Business Administration National Press Building, Suite 300 Washington, DC 20416-4112 Phone: Voice (202) 376-6620 FAX (202) 376-6674 | All audits |

| TENNESSEE VALLEY AUTHORITY | |
|---|------------|
| Assistant Inspector General, Audit Operations Tennessee Valley Authority Office of Inspector General 400 West Summit Hill Drive Knoxville, TN 37902-1499 Phone: Voice (615) 632-3437 FAX (615) 632-4130 | All audits |

| U.S. INFORMATION AGENCY | |
|--|------------|
| Office of Inspector General U.S. Information Agency 400 Sixth St. SW, Room 1100 Washington, DC 20547 Phone: Voice (202) 401-7933 FAX (202) 401-7666 | All audits |

PCIE DRAFT STUDY

Improving the Single Audit Process



PRESIDENT'S COUNCIL on INTEGRITY & EFFICIENCY
STANDARDS SUBCOMMITTEE

February 16, 1993

Dear Colleague:

Enclosed is a draft study titled *Improving the Single Audit Process*. It was prepared by a Task Force appointed by this Committee to study audits under the Single Audit Act. The Task Force identified perceived problems, studied their validity, and has made recommendations to improve the single audit process. To carry out the recommendations will require action by Congress, the Office of Management and Budget, Federal agencies, state and local program managers, and the audit community.

Please pay particular attention to the first recommendation titled *Dollar Thresholds for Audit*. We did not include this issue in our original questionnaires and were only able to send a second questionnaire to Inspectors General Staff. Therefore, we need the opinions of program managers and auditors.

We ask for your comments both in support of or opposition to any part of the draft. It will be helpful if your comments reference specific recommendations or page and line numbers in the draft. We would also welcome any additional issues or recommendations you may have, even if the issues are not in the draft.

Address all responses to ATTN: Terry Ramsey, U.S. Department of Education, Office of Inspector General, Room 4200 MES, 400 Maryland Ave. SW, Washington, D.C. 20202-1510 or FAX 202-205-8238. Please send your responses in time for us to receive them by March 31, 1993.

Sincerely,

A handwritten signature in black ink that reads "James B. Thomas, Jr." in a cursive style.

James B. Thomas, Jr.
Chair

Enclosure

DRAFT - February 16, 1993

Improving the Single Audit Process



Report of the
President's Council on Integrity & Efficiency
Standards Subcommittee

Prepared by the
Single Audit Study Task Force

PRESIDENT'S COUNCIL ON INTEGRITY & EFFICIENCY

Standards Subcommittee

(1993)

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Hubie Sparks, Appalachian Regional Commission

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EXECUTIVE SUMMARY

Basis for this Study

The Single Audit Act of 1984¹ ("the Act") was an outgrowth of several earlier efforts to improve audits of Federal programs provided to state and local governments. OMB Circular A-128 ("A-128") was issued in April of 1985 to implement the Act.

Federal agencies, independent public accountants, state auditors, and state and local program managers have expressed concerns that while the Act is working, the process needs to be improved. Also, a GAO report titled *Single Audit Act: Single Audit Quality Has Improved but Some Implementation Problems Remain* (July 1989) recommended single audit changes. OMB decided that before making these changes, a study was needed to determine what other changes were needed. Also, A-128 required the Office of Management and Budget ("OMB") to conduct a sunset review on the single audit. As a result, OMB requested the President's Council on Integrity and Efficiency ("PCIE") to perform a study on how to improve the single audit process.

The objectives set forth for the study were to:

1. Identify perceived problems relating to the single audit;
2. Determine the validity, extent, and adverse effects of perceived problems, and;
3. Make cost effective recommendations concerning changes to the Single Audit Act of 1984, OMB Circular A-128, and other single audit guidance.

Another study consideration was to not significantly increase single audit costs. For example, a concern that audit coverage was not sufficient would not be answered with a simple recommendation to increase single audit scope. Increases to the single audit would need to be mitigated by efficiencies and reductions such as simplifying audit reporting and reducing or eliminating ineffective requirements.

The Standards Subcommittee of the PCIE accepted this project to study the single audit. Individuals from various Offices of Inspector General ("OIG") were appointed to a single audit study task force ("Task Force"). Task Force members were selected based on their broad experience with single audits and to be representative of the Federal agencies involved in single audits.

¹ Public Law 98-502 amended Section 2(a) Subtitle V of Title 31, of the United States Code.

Study Methodology

The basic study methodology was to start with perceived problems, use a questionnaire and other inquiries to gather data on these perceived problems, analyze the results of the questionnaires, combine the results of the questionnaires with the single audit experience of the task force, develop a draft report describing the single audit problems and recommended solutions, expose the draft report for public comment, analyze the comments to the draft report, and develop a final report. See the Study Methodology section of this report on page 3 for more details.

Study Results

Overall the single audit is a significant improvement over the prior approach of auditing Federal programs on a grant by grant basis. As discussed in section 10 on page 81, all groups of respondents generally agreed that the objectives of the Act had been achieved and the single audit was an effective approach to auditing Federal programs. Small local government managers volunteered in narrative responses that the single audit reduced the overlap and duplication from the prior approach to auditing Federal programs.

Specific recommendations from this study are presented both in a Summary of Recommendations starting on page 6 and a Details of Recommendations starting on page 10.

Report Audience and Expected Change Process.

The recommendations in this report are those of the PCIE Standards Subcommittee based upon the results of this study. Implementation of these recommendations will require action by Congress, the OMB, the PCIE, the GAO, Federal agencies (Both OIG and program managers), state and local program managers, state auditors, the American Institute of Certified Public Accountants, and the audit community.

This report on its own is not authoritative guidance for current single audits and does not modify current single audit guidance. For the changes recommended in this report to be effective, there will need to be changes to the Single Audit Act, OMB Circular A-128, and the AICPA single audit guidance.

Readers of this report will need a basic knowledge of the single audit. Individuals without this background may need to consult with their auditor, OIG staff, or other single audit resource person for guidance in understanding the single audit concepts.

STUDY METHODOLOGY

Identification of Perceived Problems

The Task Force identified perceived problems relating to the single audit from:

- Issues previously raised to the OMB and the PCIE,
- Concerns observed during desk reviews and quality control reviews,
- Issues identified in various published studies on the single audit, and
- Concerns identified from the experience of the Task Force members.

Questionnaires

The Task Force identified five groups involved with the single audit and developed questionnaires to obtain data. The first four groups were asked the same basic questions. As explained below, a separate questionnaire was developed for the fifth group (Small Government Managers). The five groups were:

1. Office of Inspectors General Staff ("OIG Staff").
2. Auditors (State Auditors and Independent Public Accountants ("IPAs")).
3. Federal Program Managers.
4. State and large local government managers ("State/Local Managers").
5. Small local government managers ("Small Government Managers")

The Task Force asked the first four groups the same basic questions. However sometimes a particular group, because of their perspective on the single audit, would not have direct knowledge about an area of the single audit. In these cases, additions or deletions were made to the questionnaires to ensure that the respondents could answer the questions. For example, we only asked Auditors questions about sample size and estimated changes to single audit costs because only Auditors have direct knowledge about these areas. Similarly, we did not ask Auditors about their use of single audit products to manage Federal programs because Auditors do not manage Federal programs.

The questionnaires were designed to be answered by persons who were knowledgeable of single audits and solicited responses to specific issues previously raised about single audits. These issues included the effectiveness of the single audit in meeting the original objectives, validity of perceived problems, possible improvements in auditing internal controls and compliance with laws and regulations, and audit reporting. In addition, the

questionnaires encouraged respondents to provide narrative comments and any additional information they believed to be helpful.

During questionnaire pretesting the Task Force learned that Small Government Managers did not work with the detailed specifics of the single audit. A simpler questionnaire was needed for their responses to be valid. Therefore a separate questionnaire was developed which asked Small Government Managers about their use and satisfaction with the single audit and whether smaller organizations had unique concerns. This simpler questionnaire did not include the detailed specifics asked the other four groups of respondents. Therefore, in most cases the Responses Sections of this report does not include responses from Small Government Managers.

Response Rate

The following table identifies the number of questionnaires sent out, the number of responses received, and the percentage of responses for each group of questionnaires:

| <u>Target Group</u> | <u>Sent Out Number</u> | <u>Received</u> | |
|---------------------------|----------------------------|-----------------|----------------|
| | | <u>Number</u> | <u>Percent</u> |
| OIG Staff | 35 | 35 | 100% |
| State Auditors | 53 | 49 | 92% |
| IPAs | 150 | 106 | 71% |
| Federal Program Managers | 98 | 79 | 81% |
| State/Local Managers | 170 | 143 | 84% |
| Small Government Managers | 147 | 111 | 76% |

See Attachment 1 on page 84 for details of the sampling approach.

The Task Force analysis included looking at how strongly a particular group responded in relation to how other groups responded. In the Responses Sections of the report, references to a particular group are the average of responses by that particular group.

Other Data Collection

In addition to the basic questionnaires described above, a supplemental questionnaire concerning dollar thresholds for audit was sent to the OIG Staff. Besides questionnaires, data was collected by various offices of Inspectors General during quality control reviews ("QCRs") of single audits.

Coordination with the GAO

The General Accounting Office ("GAO") is also conducting a study of the single audit. This study was coordinated with the GAO study. Information was shared to allow each study to build upon the research and ideas of the other and minimize any duplication of effort.

STUDY RESULTS

Summary of Recommendations

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| | (b) Raise the threshold for requiring a single audit, and no longer accepting program-specific audits, from \$100,000 to \$250,000 | 11 |
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| | (b) Provide a procedure for Federal agencies to pay to have selected nonmajor programs audited as major | 15 |
| | (c) Remove requirements for internal control coverage unique to nonmajor programs except when they are tested as major programs under the 50% rule | 15 |
| | (d) Remove the current requirement for compliance testing of nonmajor program transactions otherwise selected during the course of the audit | 15 |
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| | (a) Revise the Compliance Supplement on a regular basis, at least once every two years | 22 |
| | (b) Establish a project team to update the Compliance Supplement as a continuous process | 22 |
| | (c) When laws and regulations change, require Federal agencies to promptly submit Compliance Supplement changes | 22 |
| | (d) Develop criteria for what should be included in the Compliance Supplement | 22 |
| 3.2 | <u>Revise Definition of General and Specific Compliance</u> | 24 |
| | (a) Revise definition of specific compliance to include all compliance items on which an auditor can provide a compliance opinion | 26 |
| | (b) Clarify that if indirect costs are charged to major programs, the auditor must consider the indirect cost system | 27 |
| | (c) Reclassify Civil Rights, Drug-Free Workplace Act from general requirements to requirements to be tested as part of internal controls | 27 |

- (d) Include compliance requirements and suggested audit procedures which are the same for many Federal programs once in an appendix rather than multiple times with each program 27
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STUDY RESULTS

Details of Recommendations

1 DOLLAR THRESHOLDS FOR AUDIT

1.1 Raise Dollar Thresholds for Single Audits and Program-Specific audits

Concern

The current dollar thresholds under the Act requires audits of entities with relatively small amounts of Federal funding. These audits of small dollars may not be cost effective.

Current Requirements

An audit is required when Federal assistance totaling \$25,000 or more a year is received. A program or single audit may be performed when assistance is at least \$25,000 but less than \$100,000, and the single audit is required when assistance is \$100,000 or more a year.

Responses

The Task Force sent out a supplemental questionnaire to the 35 OIG Staff and received at least one response from each Inspector General ("IG") organization. Some IG organizations chose to only send one response for the organization.

The questionnaire asked for opinions on the appropriate dollar thresholds to require any Federal audit and to require the single audit. OIG Staff were also asked whether entities with only one program should be permitted to have a program-specific audit, regardless of the amount of Federal assistance.

Twenty-one of the twenty-five OIG Staff (84%) who responded to this question indicated they could accept raising the threshold for requiring an audit of Federal funds (program-specific audit or single audit) from \$25,000 to \$100,000.

Eighteen of the twenty-four OIG Staff (75%) who responded to this question indicated they could accept raising the threshold for requiring a single audit (and no longer accepting a program-specific audit) from \$100,000 to \$250,000.

Twenty-four of the twenty-eight OIG Staff (86%) who responded to this question agreed that the Single Audit Act should be changed

to permit entities receiving Federal assistance under only one program to have the option of having a single audit or an audit of the one program, regardless of the amount of assistance. Four respondents disagreed with this issue. One respondent indicated the reason for disagreement was that they needed financial information about the entity contained in single audits and this information would not be provided in a program-specific audit.

Task Force Analysis

The Task Force is concerned that when the amount of Federal assistance received is small, requiring an audit, or particularly a single audit, may not be cost effective. Also, the current dollar limits have not been changed since the Act was passed in 1984 and at a minimum, should be raised because of inflation.

Recommendations

(a) Raise the threshold for requiring an audit from \$25,000 to \$100,000.

(b) Raise the threshold for requiring a single audit, and no longer accepting program-specific audits, from \$100,000 to \$250,000.

(c) With approval, permit a program-specific audit anytime an entity has only one Federal program, regardless of the amount of funding received. The Federal funding agency and its Inspector General should approve for prime recipients and the prime recipient should approve for subrecipients.

2 MAJOR/NONMAJOR PROGRAM AUDITING

2.1 Improve Audit Coverage of Nonmajor Programs

Concern

Limited internal control and compliance testing is performed for nonmajor programs and the testing that is performed is not very effective.

Current Requirements

The auditor is required to gain an understanding and assess risk for internal controls over all nonmajor programs. Testing of internal controls and compliance is only performed under the following circumstances:²

- Nonmajor program internal controls are tested when the entity is under the 50% rule. (The 50% rule requires that when major program expenditures are less than 50% of total Federal expenditures, the auditor must test controls over all major programs and selected nonmajor programs until controls over at least 50% of total Federal expenditures are subjected to testing.³)
- Nonmajor program transactions otherwise selected during the course of the audit are tested for compliance applicable to the specific transaction.
- Federal agencies that require audit coverage in addition to single audits are required to make or arrange for the additional audits and the funding for these audits.

Responses

Federal agency respondents (Federal Program Managers and OIG Staff) agreed more with the following statements about the single audit than did non-Federal respondents (State Auditors, IPAs, and State/Local Government Managers):

- Nonmajor program testing is insufficient.
- Improvement could be expected from increased testing of nonmajor programs for internal controls and compliance.

² Under certain circumstances, testing is required for general requirements of nonmajor programs. However, this is not significant to the points discussed here.

³ *Audits of State and Local Governmental Entities Receiving Federal Financial Assistance*, AICPA SOP 92-7, Paragraph 4.9.

Also, in narrative responses, some Auditors questioned the effectiveness of only gaining an understanding and assessing risk for internal controls without testing internal controls.

Task Force Analysis

Federal Program Managers whose programs are smaller in dollar size and classified as nonmajor in single audits have expressed concerns that their programs are never audited. The Task Force agrees the single audit provides little direct audit coverage of nonmajor programs unless they are selected under the 50% rule.

The Task Force was also sensitive to the need to minimize any cost increases for single audits. Therefore we looked for cost effective ways to modify and enhance current audit coverage of nonmajor programs as well as ways to eliminate requirements we believe are not effective.

Enhance Current Nonmajor Program Coverage

The 50% rule's requirement to test controls over selected nonmajor programs totaling at least 50% of Federal expenditures sets a base line for testing internal controls. While testing internal controls for selected nonmajor programs usually provides some level of compliance testing⁴, there is no 50% base line for testing compliance. Also, the amount of internal control testing required is not clear (See discussion in section 4.1 on page 41) and the selected nonmajor programs are not included in the auditor's opinion on compliance.

The Task Force believes that the base line for testing under the 50% rule should include testing of compliance in addition to the currently required testing of internal controls. The extent of compliance testing should be sufficient to support an auditor's opinion on compliance. This would provide meaningful audit coverage of selected nonmajor programs at a minimum cost increase.⁵

Although a Federal program does not meet the dollar threshold to be tested as a major program, there may be particular reasons it should be audited. These reasons include being significant to a particular Federal agency's mission or having a higher risk for fraud, waste or abuse. Currently, under the Single Audit Act, Federal agencies can only receive meaningful audit assurances for

⁴ Compliance testing is usually included with internal control testing because the auditor will usually test compliance to determine whether the control is working. Also, nonmajor program transactions selected for internal control testing must also be tested for compliance as transactions otherwise selected during the course of the audit.

⁵ It should be noted that the 50% rule normally affects smaller entities so enhancements to also require compliance testing under the 50% rule would normally only affect smaller entities.

nonmajor programs if they require and pay for additional audits. While any additional audits should build upon the single audit, this requires additional coordination by auditors and added audit reporting. It also imposes additional administrative burdens and costs to obtain the desired level of nonmajor program coverage. A more efficient approach would be to expand the scope of the single audit to include selected nonmajor programs.

Remove Ineffective Requirements

The Task Forces believes the current requirement to only gain an understanding of internal controls unique to nonmajor programs (those not tested under the 50% rule) is ineffective. To gain the understanding of internal controls, some auditors send clients questionnaires to complete which the auditor uses as the basis for gaining an understanding of internal controls. The auditor may perform limited follow-up procedures (telephone calls) when the client responds with control problems. However, a site visit and actual walk through of transactions may not be performed. Although this approach may be very efficient, we believe this type of correspondence and telephone auditing is not effective. While many auditors use more effective approaches, we agree with the narrative comments from Auditors that it is not effective to only gain an understanding of internal controls without testing controls.

Also, the Task Force believes the current approach to compliance testing nonmajor program transactions otherwise selected during the course of the audit is not effective. Normally only a few transactions are selected from any one program. Learning about compliance for only a few transactions does not provide useful information about a Federal program's compliance. For example, to test two transactions and determine that one was not in compliance provides no assurances about the balance of a program's transactions. In a single audit, when exceptions are found in nonmajor program testing, the auditor is only required to report the exception. The auditor is not required to expand the sample or otherwise determine the level of noncompliance for a nonmajor program.⁶ Also, it is difficult for the auditor to determine the cause of exceptions when only a few transactions are tested.

Recommendations

(a) Treat nonmajor programs selected for internal control testing under the 50% rule as major programs for purposes of compliance testing and reporting. This will increase audit coverage of nonmajor programs at entities where major programs are less than 50% of Federal financial assistance. Also, for entities which previously had no major programs, this will require at least one or more programs to be tested and reported on as a major program. The

⁶ The only exception to this is the rare case when noncompliance for a nonmajor program could materially affect the entity's financial statements.

cost increase should be small, since under current practice, testing of internal controls must cover at least 50% of expenditures and nonmajor program transactions selected for internal control testing are required to be compliance tested (as transactions otherwise selected during the course of the audit).

(b) Provide a procedure for Federal agencies to pay to have selected nonmajor programs audited as major. The single audit provides little specific coverage for individual nonmajor programs. Implementing recommendations 2.1(c) and 2.1(d) will eliminate all specific audit coverage of nonmajor programs unless they are tested as major. This recommendation will provide a Federal Program Manager (or prime recipient in the case of a subrecipient) a procedure to provide full major program audit coverage to a nonmajor program. As is currently required, when additional audits are needed the nonmajor program must pay the full additional costs of expanding the single audit. Benefits of this recommended approach are less audit procurement costs, less audit costs, and no need for separate audit coordination and reporting.

The Federal agency (or prime recipient in the case of a subrecipient) must clearly pay the full amount of the additional audit costs. Otherwise, this recommendation will not be consistent with the single audit being in lieu of other audit requirements under individual Federal programs. It is anticipated that Federal agencies could use such methods as increasing the current budget for administrative expenses or providing additional funding to pay the additional costs. It is recognized that sometimes program laws may need to be changed to allow Federal agencies to pay the full amount of the additional cost.

(c) Remove requirements for internal control coverage unique to nonmajor programs except when they are tested as major programs under the 50% rule. This reduces single audit costs by removing an ineffective requirement and simplifies internal control reporting. However internal controls that process nonmajor program transactions may be covered with the financial statement or major program segments of the single audit. This occurs because major and nonmajor program transactions are often processed by the same systems.

(d) Remove the current requirement for compliance testing of nonmajor program transactions otherwise selected during the course of the audit. This reduces single audit costs by removing an ineffective audit requirement and simplifies compliance reporting by eliminating the compliance report on nonmajor programs (See recommendation 5.1(a) on page 48 to reduce the number of single audit compliance reports).

2.2 Use a Risk-Based Approach to Allocate Audit Resources between Major/Nonmajor Programs

Concern

Often the same programs are tested each year as major programs even though they have good systems of internal control and no previous findings. By contrast, other programs may have significant internal control weaknesses or compliance problems but are not tested because they are classified as nonmajor programs.

Current Requirements

Major Programs

Major programs are tested both for internal control and compliance. For internal controls over major programs, the auditor is required to gain an understanding, assess risk, and test controls. For the specific compliance requirements (See OMB Compliance Supplements) the auditor is required to perform sufficient audit procedures to support an opinion on specific compliance for each major program.

For the general compliance requirements the auditor is required to perform audit procedures as listed in the OMB Compliance Supplement for Single Audit of State and Local Governments. These procedures lead to an audit report of positive assurance on items tested and negative assurance on items not tested.

Nonmajor Programs

The explanation of current requirements for nonmajor programs is found in section 2.1 on page 12.

Major/Nonmajor Program Criteria

The definition of major programs is based solely on dollar thresholds as defined in the Single Audit Act. For entities receiving less than \$100 million, a major program is any program having Federal expenditures during the year which exceed the larger of \$300,000 or 3% of total Federal expenditures. When expenditures exceed \$100 million, the Single Audit Act provides a table specifying dollar thresholds. Any Federal program not meeting the criteria of a major program is a nonmajor program.

Responses

Auditor respondents expressed a higher level of support for reducing the required level of testing for low risk major programs

than did other respondents. Narrative responses from Auditors supported the combination of increased coverage of high risk nonmajor programs and decreased coverage of low risk major programs.

Some State Auditors expressed concern that many Federal programs are audited as major programs year after year without identifying any significant findings. They stated these programs have been thoroughly audited, that program staff have improved internal controls and corrected significant problems, and that there has been a decline in reportable conditions, noncompliance, and questioned costs.⁷ Some State Auditors agreed with concerns expressed by Federal Program Managers that many nonmajor programs receive little or no audit testing under the single audit.

All groups of respondents indicated that if nonmajor programs were to be tested, a risk based approach for selecting which programs to test would be preferable to a random selection.

Task Force Analysis

Auditors are required to audit all Federal programs meeting the dollar threshold for major programs. There is no provision to exclude low risk major programs which have been audited many years without exceptions. Similarly, the auditor has no responsibility to perform additional audit procedures on nonmajor programs, even if the auditor believes they have a high risk of noncompliance. The only exception to this is the rare case when noncompliance for nonmajor programs could materially affect the financial statements of the entity.

The Task Force agrees with arguments for a risk-based approach to select Federal programs to be tested as major. When the same program is audited for the same compliance requirements, year after year, without any significant internal control or compliance findings; and the conditions have not changed for the current year; it is not likely the auditor will find significant problems in the current year.

The Task Force also agrees that in entities where major programs comprise over 50% of Federal assistance, there may be nonmajor programs which will never be effectively tested under a single audit. Although these nonmajor programs may have a high risk of noncompliance or be significant to the funding of a Federal agency, they may not be audited. The single audit only provides significant testing for major programs and major program determination is based solely on dollar threshold.

The coverage of nonmajor programs was reduced further when states switched from a department by department single audit to a state-wide single audit. For example, in a department by

⁷ National State Auditors Association Position Paper on the Single Audit dated February 1993.

department single audit the dollar threshold for determining major programs was lower and more Federal programs were classified as major. Changing to a state-wide single audit increased the base of Federal programs which also increased the dollar threshold for major programs. Therefore, fewer Federal programs were classified as major and programs which had previously met the dollar threshold for major were classified as nonmajor.

In contrast, the Task Force is concerned that in some cases Federal agencies know their programs will be classified as major and are relying on the major program coverage under the single audit. The Federal Program Managers may be uncomfortable with a reduction of audit coverage without approval from the Federal agency.

A key consideration before recommending increased single audit coverage of nonmajor programs is audit costs. Therefore, the Task Force believes the costs of any increases in audit coverage of nonmajor programs should be mitigated by other single audit reductions or efficiencies.

Recommendation

(a) Institute a pilot project for audits at the state level that, with the approval of the funding agency, the state may use a risk-based approach to select Federal programs to test. Approval from the funding agency should include the approval from the Office of the Inspector General. States were chosen for the pilot because State Auditors have expressed the most concern over this issue. Following is our recommendation on how the pilot should be implemented.

Methodology to implement pilot:

The auditor (State Auditor or IPA engaged to audit a state) would first identify major and nonmajor programs using the current dollar thresholds. The auditor would then identify low risk major programs to be considered for exclusion and high risk nonmajor programs to be tested as major programs during the current audit. In making these determinations the auditor should use the guidance in the "*Criteria to identify risk in major and nonmajor programs*" section on page 19.

For a major program to qualify as low risk (and be eligible for exclusion), it should have been audited as a major program during the prior audit period without any significant:

- Internal control weakness,
- Noncompliance, or
- Questioned costs.

Either individually or cumulatively.

A major program should only be excluded from testing when there have been no significant changes since the prior audit. Significant changes would include changes in the program's operations, internal controls (accounting and administrative), or laws and regulations since the prior audit. This will require the auditor to gain an understanding of current year internal controls over low risk major programs.

The auditor would also need to obtain written approval from the funding agency's Office of Inspector General ("OIG") for any major programs identified as low risk which would be excluded and not audited as major during the current year. Under some circumstances the OIG may need to consult with program officials within their agency before giving approval.

For each low risk major program not audited during the current year, the auditor should select one or more high risk nonmajor programs to be audited as a major program. To avoid concerns during desk reviews and quality control reviews, the auditor should provide written notice of the change to the cognizant agency OIG.

The percentage of Federal assistance covered as major programs should not drop by more than ten percentage points. For example, if the percentage of Federal assistance covered by major programs was 80% of total Federal assistance, then the amount of expenditures covered under this risk-based approach should be at least 70% of total Federal assistance. Also, at least 50% of all Federal assistance must be covered as major programs to be consistent with the 50% rule. (See recommendation 2.1(a) on page 14 which would expand the 50% rule to cover both internal controls and compliance testing.)

Criteria to identify risk in major and nonmajor programs:

The auditor, after consulting with management of the audited entity ("Entity Management"), should use criteria such as the following to identify low risk major programs and high risk nonmajor programs:

- Larger dollar value of expenditures would indicate higher risk while smaller dollar value would indicate lower risk. Federal programs that are close to the major program threshold would

be more likely to be audited as major. The single audit would not be expected to test clearly insignificant programs.

- Weaknesses in internal accounting or administrative controls would indicate higher risk.
- Risk could be higher for programs identified as high risk by Federal agencies. For example, programs on the OMB high risk list.
- Any monitoring or other review by a Federal agency during the prior or current audit period should be considered in determining risk. For example, a monitoring review which reported significant exceptions would indicate higher risk.
- The nature of a program may indicate risk. For example, programs which disburse funds through procurement and contracting, or have eligibility criteria may be of higher risk. Programs involving primarily staff payroll costs may have a high risk for time and effort reporting, but otherwise be at low risk.
- Significant prior audit findings would indicate higher risk, particularly when findings have not been properly corrected.
- Programs not previously audited as major would be considered to have a higher risk than programs recently audited as major without significant exceptions.
- A program administered by multiple operating units with different systems of internal control would indicate higher risk.
- The system for monitoring subrecipients (including reviewing subrecipient audit reports) should be part of the risk analysis. For example, when significant parts of a program are passed through to subrecipients, a weak system for monitoring subrecipients would indicate higher risk.
- The phase of program in its life cycle at the entity may indicate risk. For example, the first and last years of the life cycle of a Federal program might be considered higher risk.

As part of the risk evaluation the auditor may also wish to discuss a particular program with the funding Federal agency.

Evaluation of pilot

After two audit cycles, OMB and the PCIE should evaluate the results of this pilot project. The evaluation should determine whether this risk-based approach has resulted in more effective single audits.

3 COMPLIANCE SUPPLEMENT AND COMPLIANCE REQUIREMENTS

3.1 Update the Compliance Supplement on a Regular Schedule

Concern

The Compliance Supplement needs to be updated on a regular basis to provide auditors with current requirements.

Current Requirements

The principal compliance requirements of the largest Federal programs are listed in the *Compliance Supplement for Single Audits of State and Local Governments* issued by the Office of Management and Budget. The first Compliance Supplement under the Single Audit Act was issued in April 1985. It was updated 5 years later with the current Compliance Supplement issued in September 1990.

Responses

In narrative responses all four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers) cited the need for more frequent updates to the Compliance Supplement.

Task Force Analysis

Currently there is no regular schedule for updating the Compliance Supplement. It took 5 years for the first update (1985 to 1990). Although OMB has just started the process for a current update, we expect it will be at least late 1993 before the next update is issued. The Task Force believes there should be a process in place to ensure that the Compliance Supplement is updated at least once every two years.

Federal agencies rely upon non-Federal auditors for compliance tests of Federal grants. The Compliance Supplement conveys the Federal agencies' expectations for these tests. Current audit procedures require the auditor to research and determine whether the laws and regulations in the Compliance Supplement are current, and if not, to make appropriate changes to audit procedures. It is cumbersome to require many non-Federal auditors to each research for changes in laws and regulations. It would be more efficient for Federal agencies to make timely changes to the supplement. Also, providing more current guidance mitigates the risk that non-Federal auditors may interpret changes differently from Federal agency expectations. The Compliance Supplement must be kept current to ensure non-Federal auditors are applying the appropriate criteria when auditing Federal programs.

The Task Force believes that one of the reasons that the 1990 update took three years to complete was that criteria was not stated for what should be included in the supplement. The lack of clear criteria resulted in a lengthy negotiation process between the Federal agencies (who wanted the supplement to include as many requirements as possible) and OMB (who wanted to keep the Compliance Supplement requirements to a manageable size).

Recommendations

(a) **Revise the Compliance Supplement on a regular basis, at least once every two years.** The revision process should systematically address new Federal programs and their requirements as well as requirements no longer applicable or significant. Changes should only be made when the laws or regulations have changed or when the Federal agencies have demonstrated significant problems with current requirements or suggested audit procedures.

(b) **Establish a project team to update the Compliance Supplement as a continuous process.** Since changes to Federal laws and regulations are ongoing, updating the Compliance Supplement should also be ongoing. One method would be for OMB to delegate the staff work of updating single audit guidance to the PCIE. The PCIE has personnel who work on a regular basis with single audits. Even though OMB may wish to retain final approval authority for the updates, a staff dedicated to keeping single audit information current would help ensure that other priorities did not supersede regular updates.

This project team could also be responsible for other Compliance Supplement enhancements recommended in this section. Any changes to the Compliance Supplements will need to involve Federal program managers who more thoroughly understand program objectives, laws, and regulations.

(c) **When laws and regulations change, require Federal agencies to promptly submit Compliance Supplement changes.** Updating the Compliance Supplement should be a continuous process. The best time to provide recommended changes is as part of the implementation process for new laws and regulations. To ensure timely updates, Federal agencies should submit recommendations to revise the Compliance Supplement requirements within 180 days after changes in laws or regulations which are significant to program compliance.

(d) **Develop criteria for what should be included in the Compliance Supplement.** For example, under each of the types of compliance requirements (e.g., eligibility and matching), OMB should establish criteria which can be used to determine what kinds of noncompliance could have a material effect on programs. Examples of possible criteria are how important a particular compliance requirement is to meeting a particular program's objectives, potential disallowance because of noncompliance, risk of noncompliance, complexity of requirements and prior instances of noncompliance.

DRAFT - February 16, 1993

Specific criteria should help make the Compliance Supplement requirements more consistent between programs as well as make updates easier.

3.2 Revise Definition of General and Specific Compliance

Concern

In practice because of the structure and types of requirements included in the Compliance Supplement, auditors have interpreted the single audit as requiring two levels of compliance reporting for Federal assistance. The levels are an opinion on specific compliance and a report on general compliance. This has resulted in complex and confusing audit reporting.

Also, the current reporting may not meet the single audit requirements since noncompliance with some general compliance requirements could have a material effect on a major program.

Current Requirements

The Single Audit Act requires the auditor to determine and report whether the entity has complied with laws and regulations that may have a material effect upon each major program. The OMB published the Compliance Supplement which describes the general and specific program requirements for the larger Federal programs. This helps the auditor by identifying the laws and regulations which could be material to the program. General requirements are national policies which apply to the assistance programs of one or more Federal agencies. Specific requirements apply to individual programs.

The auditor provides different levels of audit assurance on compliance depending upon the classification of general or specific. The higher level, an opinion, is provided on specific compliance for major programs.⁸ The lower level, a report (based upon performing audit procedures listed in the Compliance Supplement) is provided on general requirements as applicable for both major and nonmajor programs.

Responses

All four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers), either in specific questions or narrative responses, agreed with the need for simpler and fewer audit reports. Auditor respondents indicated they would

⁸ Single Audit Act, Paragraph 7502(d)(2)(C).

⁹ Please note that OMB Circular A-128, Paragraph 8.b.(2)(b) requires two general requirements, *Federal Financial Reports* and *Amounts Claimed or Used for Matching (Allowable Costs/Cost Principles)*, to be included in the opinion on specific compliance.

expect some cost decrease in single audits from simpler and fewer audit reports.¹⁰

For *Civil Rights* and *Drug-Free Workplace*, all four groups of respondents indicated there was a low risk of noncompliance and the audit procedures listed in the Compliance Supplement were not effective. There was also a high support from all groups of respondents to eliminate these two requirements from single audit testing.

Task Force Analysis

The current practice to provide two different levels of audit assurance makes the compliance reporting complex by having an auditor's report on general compliance and an opinion on specific compliance.

One reason for the Compliance Supplement grouping between general and specific requirements was to reduce repetition in writing the Compliance Supplement. For example, the compliance requirements and suggested audit procedures for *Federal Financial Reports* are listed once under general requirements rather than listed repeatedly with each program's specific requirements. The Task Force does not believe the original grouping of requirements as either general or specific was intended to affect the level of auditor's work or audit assurances.

The reason often given by auditors for not being able to give an opinion on all general compliance requirements is because they cannot give an opinion on two, *Civil Rights* and *Drug-Free Workplace*. Specific reasons are that noncompliance with these two is not quantifiable¹¹ and the Compliance Supplement procedures are not adequate to support an opinion on whether the entity complied with civil rights laws or maintained a drug-free workplace. The Task Force believes these two requirements could be more effectively tested as part of the internal control coverage than as general or specific compliance.

The Task Force believes the auditor can test the other seven general requirements to the opinion level for affected major programs. Specifically, six requirements (*Davis Bacon*, *Relocation Assistance and Real Property Acquisition*, *Cash Management*, *Federal Financial Reports*, *Allowable Costs/Cost Principles*, and *Administrative Requirements*) are transaction oriented to specific programs and if applicable to a major program can be tested to the opinion level. The seventh requirement, *Political Activity*, could also be tested as specific compliance if it were included with cost principles and tested with *Allowable Costs/Cost Principles*.

¹⁰ Questions on cost were only asked to auditors because the Task Force believes that only auditors would be able to accurately estimate cost changes.

¹¹ AICPA SOP 92-7, Paragraph 4.70.

Additional support for redefining the way general requirements are handled is when general compliance requirements only apply to nonmajor programs. An example is when only nonmajor program transactions are subject to *Relocation Assistance and Real Property Acquisition* and the auditor must test nonmajor program transactions to test this general requirement. The Task Force believes it is inconsistent to test *Relocation Assistance and Real Property Acquisition*, a general requirement that only applies to an individual nonmajor program, just because there are no major programs with this requirement.

Recommendations

The following recommendations should eliminate the need for a report on general compliance (See section 5.1 on page 46) and improve compliance testing. They will also enhance compliance auditing by requiring the auditor to provide a compliance opinion for all requirements for which an opinion can be rendered.

(a) **Revise definition of specific compliance to include all compliance items on which an auditor can provide a compliance opinion.** The recommended definition of specific compliance should include current specific requirements plus items previously grouped as general compliance for which the auditor can provide an opinion. Also included, will be subrecipient monitoring as discussed in section 3.7 on page 39.

The recommended definition of specific compliance should include the following:

- **Types of Services Allowed or Unallowed** (This refers to whether the amounts reported as expenditures for a particular program were for allowable services for that program.)
- **Allowable Costs/Cost Principles** (This refers to whether the amounts reported as Federal expenditures were in accordance with the applicable cost principles. This testing should also include *Political Activity*.)
- **Administrative Requirements**
- **Eligibility**
- **Matching, Level of Effort, and/or Earmarking** (This includes determining whether any costs used for matching are in accordance with *Allowable Costs/Cost Principles*)
- **Special Reporting**
- **Federal Financial Reports**
- **Cash Management**

- Subrecipient Monitoring (See section 3.7 on page 39)
- Special Tests and Provisions (including *Davis Bacon*, and *Relocation Assistance and Real Property Acquisition*).

(Please note there is not a substantive change for *Allowable Costs/Cost Principles* and *Federal Financial Reports* because these requirements are currently required to be included in the auditor's opinion on specific compliance. The above items listed in *italics* are currently grouped in the Compliance Supplement as general requirements.)

(b) Clarify that if indirect costs are charged to major programs, the auditor must consider the indirect cost system. This recommendation clarifies that the auditor should include the indirect cost system as part of the single audit. This recommendation is necessary because moving the allowable costs/cost principles from a general requirement to a specific requirement (See recommendation 3.2(a)) removes the requirement to always test indirect costs. Indirect costs should be tested when there is a negotiated indirect cost plan or when indirect costs are material to either total financial assistance, all major programs, or a single major program.

(c) Reclassify Civil Rights, Drug-Free Workplace Act from general requirements to requirements to be tested as part of internal controls. By implementing recommendation 3.2(a) to reclassify most general requirements as specific compliance, there are only two general requirements left. The appropriate tests for these fit more appropriately with internal control tests as discussed in section 3.4 on page 31.

(d) Include compliance requirements and suggested audit procedures which are the same for many Federal programs once in an appendix rather than multiple times with each program. Recommendation 3.2(a) would require the Compliance Supplement to include with each program, requirements which are now only listed once as general requirements. An approach is needed to prevent relisting the same information repeatedly in the Compliance Supplement. It would be more efficient to list these requirements once in an appendix which can then be referenced by the appropriate specific programs. This would allow the supplement to present information unique to a program with the program as well as reference the appendix for requirements which are the same for multiple programs.

3.3 Clarify Civil Rights and Drug-Free Workplace Requirements

Concern

Suggested audit procedures listed in the Compliance Supplement for *Civil Rights* and *Drug-Free Workplace* are not meaningful tests of controls or compliance. The purpose of requiring the auditor to test these two requirements is not clear.

Current Requirements

Explained with Task Force Analysis below.

Responses

For *Civil Rights* and *Drug-Free Workplace* tests, all four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers) indicated a low level of effectiveness for the current tests and many respondents recommended eliminating them from testing as part of the single audit.

The Task Force reviewed the current Compliance Supplement steps with a Federal agency's field office for civil rights compliance. They agreed that the current steps would provide only minimum benefit for ensuring compliance with civil rights laws.

Task Force Analysis

The purpose of the auditor testing these two requirements and the level of assurance required is not clear. It is not practical for the auditor to determine whether an entity complied with civil rights laws or has a drug-free workplace. Also, one or more Federal organizations could have responsibilities to enforce these requirements. However, the non-Federal auditor could provide support to Federal enforcement by performing specified audit procedures such as reviewing entity documents and controls or determining whether certain policies and procedures controls have been established. As a result of these steps the auditor could report any exceptions found.

Following are examples of suggested audit procedures in the Compliance Supplement which the Task Force does not believe are meaningful audit tests and our analysis of these procedures:

Civil Rights

Current Requirements

- Ascertain the number of complaints filed with Federal, State, and/or local agencies responsible for ensuring nondiscrimination in government programs during the fiscal year, the status of unresolved complaints or investigations, and the actions taken on resolved complaints or completed investigations.
- Obtain representation and/or attorney letters to determine if any civil rights suits have been adjudicated or are pending.

(Above are Compliance Supplement Suggested Audit Procedures)

Task Force Analysis

The Task Force does not see practical benefit for the auditor to obtain documents and information already filed with the appropriate agency responsible for enforcement of civil rights laws. The auditor is not required to audit this information or appear to have need for it. There is also no clear guidance on the auditor's responsibility to report this information.

Drug-Free Workplace

Current Requirements

- Determine whether the report made to Federal grantor agencies on convictions of employees is filed and complete.

(Above are Compliance Supplement Suggested Audit Procedures)

Task Force Analysis

If the auditor's test is whether the report was filed, this can only be done by sending a confirmation to the Federal grantor agency who should already know whether they got the report.

If the auditor's test for completeness is whether all the blocks on the form are filled out, the Federal agency receiving the report should already know this. If the auditor's test for completeness is whether the recipient reported all convictions, the recipient's accounts, books, and records would not necessarily disclose this.

Based upon a review of the suggested audit procedures in the Compliance Supplement for *Civil Rights and Drug-Free Workplace*, the Task Force believes audit coverage for these could more appropriately be handled as part of internal control testing. For example, consider the requirements of determining whether there is:

(Under *Civil Rights Requirements*)

- An announced policy of nondiscrimination.
- A person designated to oversee civil rights compliance.

(Under *Drug-Free Workplace Requirements*)

- A communication of policy concerning a drug-free workplace.
- An established drug-free awareness program.

The Task Force believes testing the above requirements are more related to internal controls than detail testing of transactions for compliance.

Recommendations

(a) Determine the purpose for using the single audit to test Civil Rights and Drug-Free Workplace.

(b) Review the suggested audit procedures for Civil Rights and Drug-Free workplace to ensure that they meet their intended purpose. This review should identify changes needed to the Compliance Supplement or, alternatively, whether these requirements should continue to be included as part of the single audit. This review should be done with recommendation 3.4(a) on page 32.

3.4 Add to Compliance Supplement a Section on Internal Controls

Concern

Currently, there is limited guidance in the single audit literature on typical internal controls over compliance with laws and regulations ("Controls Over Compliance"). Also, the guidance in the Compliance Supplement for these controls needs to be clarified.

The main purpose of the Compliance Supplement is to provide guidance on substantive testing of compliance with laws and regulations. However, it does include steps related to Controls Over Compliance for some requirements or some programs. For other requirements and programs it does not include this guidance. Because of the inconsistency of when Controls Over Compliance are included, auditors may be confused on their responsibility. For example, an auditor may conclude in error that unless requirements to test Controls Over Compliance are listed in the Compliance Supplement, it is not necessary to test them.

Current Requirements

The auditor is required to test Controls Over Compliance for all major programs and, when required by the 50% rule, for selected nonmajor programs.

Responses

Federal agency respondents (Federal Program Managers and OIG Staff) indicated that there was a problem with insufficient internal control review and testing. All four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers) indicated expected improvements from better Compliance Supplement guidance on acceptable internal controls.

Task Force Analysis

The Single Audit Act places an emphasis on internal controls and requires the auditor to "Determine and report whether the government, department, agency, or establishment has internal controls systems to provide reasonable assurance that it is managing its Federal financial assistance programs in compliance with applicable laws and regulations." To meet this requirement, both program managers and auditors need guidance on typical or suggested internal Controls Over Compliance.

The current Compliance Supplement only provides very limited guidance on Controls Over Compliance. The suggested audit procedures for some programs in the Compliance Supplement require

the auditor to review and evaluate internal controls¹² while others do not specifically mention controls. This raises the question as to whether the auditor's internal control responsibility changes when Controls Over Compliance are specifically listed in the Compliance Supplement's suggested audit procedures.

The Task Force believes that the Compliance Supplement is a logical place for Federal agencies to provide guidance on internal Controls Over Compliance. This guidance should include guidance on appropriate internal controls and typical audit procedures to test internal controls as well as guidance on when the auditor is expected to test Controls Over Compliance.

Recommendation

(a) Add a new Compliance Supplement section to provide specific guidance on typical or suggested internal Controls Over Compliance.

This section should include the required internal control considerations for Civil Rights and Drug Free Workplace as discussed in recommendation 3.2(c) on page 27 and section 3.3 on page 28.

This internal control section should also provide examples of typical Controls Over Compliance and audit procedures for each type of specific compliance requirement. Since internal controls may vary widely between entities, these examples should be considered informational only and not required steps. Guidance should be provided for situations unique to both large and small entities. Providing typical Controls Over Compliance and audit procedures should serve as a basis to improve the auditor's review and testing of Controls Over Compliance.

(b) Modify the Compliance Supplement to identify which compliance requirements it is expected that Control Over Compliance be tested. For some compliance requirements there would normally be specific Controls Over Compliance which the auditor should test. The Compliance Supplements should be modified to identify and specifically require the auditor to test these Controls Over Compliance.

In other cases, the compliance requirements may be of a nature that it is not practical to expect Controls Over Compliance to be tested. For example, a compliance requirement to hold a public hearing annually would normally not have internal controls to be tested. In such cases, the Compliance Supplement would not include steps to test Controls Over Compliance and the auditor would not be required to test these controls.

¹² For example, A-128 Compliance Supplement, CFDA number 13.600, suggested audit procedure "Review and evaluate internal controls designed to ensure expenditures are made only for allowable services."

If this recommendation is not implemented, additional guidance should be given. Specifically, guidance as to whether performing the identified work satisfies the auditor's responsibilities for testing Controls Over Compliance for the program. It should also be made clear that even though testing of Controls Over Compliance is not specified in the Compliance Supplement, tests of these controls may still be necessary.

3.5 Inform Auditors of High Risk Programs and Audit Areas

Concern

Currently there is no formal process to inform auditors of Federal programs or compliance requirements which Federal agencies believe to have the highest risk of noncompliance. Auditors need this information to properly plan and execute the audit and to ensure appropriate audit coverage of the areas of greatest risk.

Current Requirements

The Compliance Supplement provides the auditor with information on the compliance requirements and suggested audit procedures for the larger Federal programs. The auditor is responsible to determine the compliance requirements for Federal programs not listed in the Compliance Supplement.

Responses

All four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers) indicated they would expect a significant improvement in single audits from increased Compliance Supplement guidance to identify high risk Federal programs and audit areas as well as from issuance of interim risk alerts of potential problems.

Task Force Analysis

While the Compliance Supplement does identify the compliance requirements which may be material to a program, it does not identify whether a particular program or compliance requirement has a greater risk. The Task Force believes that there are specific Federal programs and compliance requirements which have a higher risk and should receive a greater emphasis during audits. Informing the auditor of potential high risk areas allows the auditor to more effectively plan the audit and perform internal controls and compliance tests.

An example of a higher risk program is Medicaid. Reasons Medicaid is higher risk include: (a) it is a large, growing program which significantly impacts recipient's budgets, (b) the regulations are complex, and (c) the methods of administering the program and determining reimbursement vary.

Examples of high risk areas within Medicaid are:

- Nursing home reimbursement rates. Even a small error in a daily rate can be significant since the total error would be a combination of (the daily rate error) X (365 days per year) X (number of patients in nursing homes in an entity).

- Eligibility of the provider. If the provider is not eligible then all reimbursement requests for that provider are unallowable costs.
- Edits in Medicaid management information systems. Since the volume of claims is high, there is pressure to reduce backlogs of claims by removing system edits.

By contrast, some programs such as Social Services Block Grant have a low risk of noncompliance because they have simple requirements for eligibility and allowable costs.

Also, periodically Federal agencies learn of potential problem areas which may be pervasive throughout a program or where an audit should place particular emphasis. These areas may be discovered by Inspector General audits, program reviews, or single audits. Also, changes in laws and regulations may change the importance of a particular compliance requirement.

While audit procedures currently suggested in the Compliance Supplement may address the particular compliance area, a particular emphasis may be needed for the auditor to fully understand what to look for and the significance of certain types of compliance exceptions.

Recommendations

(a) Identify Federal programs that are high risk to recipients and subrecipients. A method should be developed for Federal agencies to indicate in the Compliance Supplement those programs which are higher risk at the recipient and subrecipient level. The determination of risk would be based on past problems identified by auditors and program officials or inherent weaknesses in the design of the program.

The auditor should consider these indicators of risk when planning the audit and use professional judgment to determine an appropriate audit approach. No special audit reporting would be required because a program is listed as high risk. Indicating risk in the Compliance Supplement will not change the auditor's responsibility to test all major programs, whether or not they are labeled as high risk.

(b) Identify high risk audit areas in Federal programs. A method should be developed for Federal agencies to indicate when a particular requirement in the Compliance Supplement is high risk and why. This should include relevant information to assist in auditing the area. Past problems identified by auditors and program officials or inherent weaknesses in the design of the program could be used to determine high risk.

The auditor would be expected to consider whether a compliance area is high risk when planning the audit and use professional

judgment to determine an appropriate audit approach. No special audit reporting would be required because a compliance area is listed as high risk. Also, the auditor would still be required to test compliance areas that were not identified as high risk.

(c) **Issue interim risk alerts of potential problems.** This recommendation would provide Federal agencies with a method to promptly communicate potential problem areas to auditors along with any relevant information to help in auditing the area.

Methods for issuing these risk alerts include using the annual AICPA industry risk alerts, issuing annual or semiannual Federal agency risk alerts, and using the Federal Register and professional organizations to publicize the availability of these documents. Federal agencies could provide more current information by setting up an electronic bulletin board for auditors to call into anytime and request or download current risk alerts.

3.6 Improve the Compliance Supplement Program Guidance

Concern

While the Compliance Supplement lists the larger Federal programs which provide over 90% of the Federal aid to state and local governments, there are still many programs not listed in the supplement. Also, sometimes the auditor needs more specific guidance on audit procedures.

Current Requirements

For programs listed in the Compliance Supplements (Either A-128 or A-133 supplement) which have not had subsequent changes in laws or regulations, an audit of the requirements in the Compliance Supplement will meet the single audit requirements. If there have been changes, then the auditor should follow the provisions of the Compliance Supplement as modified by the changes. For programs not listed in the Compliance Supplement, the auditor is responsible to determine the compliance requirements.

Responses

Federal Program Managers identified insufficient guidance in the Compliance Supplement as a significant problem. Federal agency respondents (Federal Program Managers and OIG Staff) indicated they would expect improvement in single audits if the Compliance Supplement included more programs.

IPAs and Federal agency respondents indicated they would expect improvement from more detailed audit procedures and guidance on extent of audit tests in the Compliance Supplement. In narrative responses, Auditors expressed concern that detailed audit procedures should not result in increased audit requirements.

Task Force Analysis

Including a program in the Compliance Supplement provides specific guidance on which compliance requirements to test and the suggested audit procedures. This benefits the auditor because it is more efficient to have the requirements listed in one place than to search program laws, regulations, etc. to determine the requirements. This benefits the Federal agencies by knowing what requirements auditors should have tested. It should also help ensure more consistent audits.

Auditors frequently ask guidance from Offices of Inspectors General on what to test when Federal programs are not listed in the Compliance Supplement. It would be more efficient if the Compliance Supplement described what to do in these cases.

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Recommendations

(a) Add more programs to the Compliance Supplement. The additional programs should be ones that are commonly classified as major. One approach would be to review the Schedule of Federal Financial Assistance from states and larger cities and counties and add to the Compliance Supplement programs that are classified as major by multiple entities. An additional approach would be to sample medium and smaller cities and add programs which are often classified as major.

(b) Provide a generic compliance supplement. Include in the Compliance Supplement procedures to perform when a specific program is not included in the Compliance Supplement. This should include how to determine the material compliance requirements and audit steps. Even with recommendation 3.6(a) above to add more programs, there will still be many programs which cannot be listed in the Compliance Supplement. A generic compliance supplement will provide a consistent structure and methodology for auditor's to use in determining and testing the compliance requirements for programs not listed. (See Attachment 2, Example of Generic Compliance Supplement, on page 86)

(c) Provide more specific guidance on suggested audit procedures. This guidance should include specifics on expected audit tests (both internal control and compliance), descriptions of likely noncompliance, and examples of typical exceptions. This is not a recommendation to include more requirements but to provide better guidance on how to audit the current requirements.

3.7 Subrecipient Monitoring

Concern

The single audit requirements for the prime recipient's monitoring of subrecipients needs to be enhanced.

Current Requirements

The auditor is required to examine the recipient's system for monitoring subrecipients and obtaining and acting on subrecipient audit reports. Paragraph 9 of OMB Circular A-128 provides specific requirements for prime recipients that pass funds through to subrecipients.

When awards to subrecipients are part of major programs (or a nonmajor program used to meet the 50% rule), the auditor is required to test the controls the government uses to monitor subrecipients.¹³

Responses

This issue was not specifically addressed in the questionnaires.

Task Force Analysis

The auditor's responsibility for subrecipient monitoring is not clear. Subrecipient monitoring is not included in the Compliance Supplement as a general or specific requirement. The auditor does not refer to subrecipient monitoring in either the internal control or compliance reports. Although the auditor is required to test the controls over monitoring subrecipients, the extent of the auditor's tests is not clear.

Task Force believes subrecipient monitoring should be added to the Compliance Supplement as a specific requirement. The requirements for subrecipient monitoring are sufficiently specific and important that the auditor should be required to include this with the compliance opinion for major programs.

Recommendations

(a) Include subrecipient monitoring as a specific requirement in the Compliance Supplement. This will clarify that the auditor

¹³ SOP 92-7, *Audits of State and Local Governmental Entities Receiving Federal Financial Assistance*, Paragraph 4.22.

needs to test internal controls and compliance for subrecipient monitoring for major programs.

Some recipients pass a large part of a major program through to subrecipients. When this happens the major program compliance testing at the recipient will only cover a small part of the major program's funding. Including subrecipient monitoring as a specific requirement will improve the audit coverage of funds passed through to subrecipients, particularly when large amounts are passed through.

4 INTERNAL CONTROL AND COMPLIANCE TESTING

4.1 Clarify the Amount of Internal Control Testing Required

Concern

For major programs and nonmajor programs tested under the 50% rule, the amount of testing required for internal controls is not clear.

Current Requirements

The Single Audit Act¹⁴ and A-128¹⁵ require the independent auditor to determine and report on whether the organization has internal control systems to provide reasonable assurance that it is managing Federal assistance programs in compliance with applicable laws and regulations.

Responses

Federal agency respondents (Federal Program Managers and OIG Staff) indicated a significant problem with insufficient testing (internal control and compliance). By contrast, non-Federal respondents (IPAs, State Auditors, and State/Local Program Managers) did not believe testing was insufficient.

Responses by Auditors to questions on minimum sample size for testing internal controls over compliance and for testing compliance indicated a common minimum sample size of 25 items.¹⁶ Almost 60% of the Auditors providing information on minimum sample sizes indicated a range of 25 to 30 items. Also, information collected during quality control reviews indicated a sample size of 25 items was often used.

Federal respondents (OIG Staff and Federal Program Managers) expected significant improvement for expanding testing for exceptions to provide information to project the questioned costs or know what additional action they should take. Auditors did not support expanding testing for exceptions and indicated the expected cost increase for this to be in the range of 10% to 25%.

There was generally strong support from all four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers) to use the Compliance Supplement to provide guidance on the extent of audit tests. Similarly, Federal agency respondents expected significant improvement from specifying a minimum sample size. However, non-Federal respondents, and in

¹⁴ Single Audit Act, Paragraph 7502.

¹⁵ A-128, Paragraph 8.

¹⁶ Only auditors were asked questions on sample sizes.

particular State Auditors, were not supportive of specifying minimum sample sizes.

Task Force Analysis

Since the testing requirements for internal controls are not specified, it is not clear to the auditor how much internal control testing is required. It is not clear to the Federal program manager how much internal control testing was performed. For example, the required testing of internal controls over compliance is more than the minimum walk through of transactions done as part of gaining an understanding of the internal control structure as required by SAS 55. However, it is less than would be required to provide an opinion on internal controls under SAS 30.¹⁷ Both auditors and Federal agencies need more guidance on the expected internal control testing.

From the Federal agency's perspective, the purpose of the auditor performing tests of internal controls is to provide the Federal government with some level of assurance that the organization has reasonable internal controls systems to: (a) have managed; and (b) have the ability to continue to manage Federal programs in compliance with laws and regulations.

The Federal agencies need assurance that the auditor's tests will have a reasonable opportunity to detect significant deficiencies in the design or operation of the internal control structure that could adversely affect the organization's ability to administer Federal financial assistance according to laws and regulations (reportable conditions) as well as to identify material noncompliance.

A frequent source of guidance used by auditors for sample sizes in single audits is the *Guide to Audits of Local Governments* published by Practitioners Publishing Company. For attribute sampling of internal controls over compliance, this publication recommends a sample size of either 25, 40, or 60, depending upon the planned (or supported) level of control risk.

The U.S. Department of Education has issued an audit guide which requires minimum sample sizes in program-specific audits of Student Financial Assistance ("SFA") programs. The minimum for certain compliance areas is 50 transactions or 25% for populations less than 200. Although not specifically applicable to single audits, this does provide guidance on the sampling expected by one Federal agency in a program-specific audit.

¹⁷ It is recognized that the AICPA issued an April 20, 1992 exposure draft of an attestation standard titled "Reporting on an Entity's Internal Control Structure Over Financial Reporting", which could supersede SAS 30.

¹⁸ This includes both accounting and administrative controls.

Recommendations

(a) Require the auditor to plan the internal control testing to perform sufficient tests to support an assessed level of control risk of low for each major program. This would set a minimum level of testing for each compliance area as listed in the Compliance Supplement or that otherwise could be material to a major program. Generally this will mean a tolerable error rate of between 5% and 7% and require auditors to sample between 40 and 60 transactions¹⁹ for populations of 200 and over. For populations of less than 200, auditors would normally select sample sizes of 10% to 25% of the transactions.

This recommendation contemplates that transactions which are tested for internal controls will usually be tested for compliance. Therefore, the internal control tests will also provide support for the opinion on compliance. For example, when the auditor performs tests of internal controls over compliance areas, and in particular when these tests are made on accounting transactions, the auditor also tests the specific transaction for compliance and proper accounting. Therefore, the sample size to support a low assessed level of control risk may provide sufficient evidence to support the opinion of compliance required for each major program.

Also, the sample sizes of 40 to 60 will provide program managers with more information to project the questioned costs or know what additional action they should take for exceptions.

(b) Allow the auditor to not perform internal control testing when internal controls are not effective and assess the risk at the maximum. It would not be appropriate under recommendation 4.1(a) to require testing of internal controls which are not be effective (e.g., not properly designed) or not working (e.g., the first several transactions tested are exceptions and it is not effective to continue testing). In these cases the auditor should have a reportable condition or a material weakness. Also, the auditor would need to perform alternative procedures to support the opinion on compliance.

¹⁹ *Guide to Audits of Local Governments*, published by Practitioners Publishing Company, Volume 1, Fourth Edition (July 1989), Page 520.17, Illustration 5-7.

4.2 Programs Under a Common System of Internal Controls

Concern

The current requirement to test a representative number of transactions from each major program can result in inefficient auditing of transactions flowing through a common system.

Current Requirements

The Single Audit Act, OMB Circular A-128, and the November 1987 Questions and Answers on the Single Audit Process of OMB Circular A-128 ("OMB's Circular A-128 Q&A Guidance") require the auditor to select and test a representative number of transactions from each major program when testing compliance.²⁰

Responses

This issue was not specifically addressed in the questionnaires.

Task Force Analysis

The Task Force believes the interpretation to require testing of each major program needs to be clarified to recognize that when like transactions are processed under a common system of internal controls which the auditor determines is working, then it is not necessary to make sure that the sample selection includes transactions from each major program. What is more important is to ensure that all the significant internal control systems, including any subsystems, are appropriately tested.

Recommendation

(a) Recognize benefits provided by a common system of internal controls. One method would be when major programs share a common system of internal controls over like compliance requirements and sufficient transactions are tested for conformity with the like compliance requirements, then the tests need not include transactions from each major program. This method anticipates the auditor would use procedures such as walking through transactions from each major program to ensure that each major program's internal controls are appropriately included in the common system. Also, the common system should not have significant deficiencies, or alternatively, the auditor would need to expand testing to determine the impact of deficiencies on each major program.

²⁰ Single Audit Act, Paragraph 7502.(d)(2)(C), OMB Circular A-128, Paragraph 8.b.2, and OMB A-128 Q&A, Question 18.

The auditor should only rely upon the common system for the applicable controls and compliance areas tested in that system. Payroll is an example of a common system which may be used to process transactions for more than one Federal program. The common system may be used to ensure that payroll is correctly computed, based on proper documentation such as time sheets, and is in conformance with the cost principles. An auditor could rely upon such a system for testing these compliance elements. However, for compliance areas that were not part of the common system such as a program limitation on the type and amount of salary payments, the auditor would need to perform separate tests beyond the common system.

Another example would be a test of a common disbursement system. Tests could be designed to determine whether there was proper procurement, receipt, and payment for goods and services; proper support was maintained; and mathematical accuracy. However, additional compliance tests such as eligibility for the service or client, use of the expenditure for matching, or an individual program cost limitation would not be part of the common system and would need to be tested separately.

This option is consistent with testing the indirect cost system instead of testing individual expenditures charged to every grant by the system. This recommendation should mitigate the additional costs of recommendation 4.1(a) on page 43 concerning requirements for internal control testing.

5 REPORTING

5.1 Reduce and Simplify Auditor's Reports

Concern

Current reporting practices for single audits result in a complex single audit reporting package. It is cumbersome for preparers and confusing to users.

Current Requirements

Auditing literature currently requires the auditor to report on the following:

1. General purpose or basic financial statements ("Financial Statements").
2. Supplementary Schedule of Federal Financial Assistance (with the auditor's opinion in relation to Financial Statements).
3. Entity-wide internal control matters based on the auditor's understanding of the internal control structure and the assessment of control risk, made as part of the financial statement audit. [Yellow Book requirement]
4. Internal controls (accounting and administrative) designed to provide reasonable assurance of compliance with laws and regulations applicable to Federal awards. [A-128 requirement]
5. Compliance which may be material to the financial statements. [Yellow Book requirement]
6. Compliance with laws and regulations applicable to each major Federal program (opinion) and a statement of positive assurance on those items that were tested under A-128 for compliance and negative assurance on those items not tested. [A-128 requirements]

In single audit practice, auditors have interpreted these requirements to be met with the following three reports:

- a. Report on compliance with general requirements (opinion disclaimer with positive/negative assurance). {Applicable for all A-128 single audits}
- b. Opinion on compliance with specific requirements applicable to each major program. The opinion should include whether Federal financial reports

and claims for advances and reimbursements contain information supported by books and records; and whether amounts claimed or amounts used for matching are in accordance with allowable costs/cost principles {Applicable only when there are major programs}

- c. Report on compliance with requirements tested for nonmajor programs (opinion disclaimer with positive/negative assurance). {Applicable only when nonmajor programs are tested}
7. Schedule of Reportable Conditions (including material weaknesses) for internal control findings and a Schedule of Findings and Questioned Costs for compliance findings (if not included in the internal control or compliance reports).
8. Management letter.
9. Separate communication of nonmaterial findings relative to Federal programs.
10. Report of illegal acts.

Although combining of like reports is permissible, it is discouraged because the resulting combined reports are long, complex, and confusing.

Responses

The IPA respondents indicated a significant problem that the internal control and compliance reports were confusing. They expected significant improvement and lower costs by simplifying and reducing the number of auditor's reports.

Task Force Analysis

The reason for multiple compliance reports is to allow the auditor to provide different levels of audit assurance. Different levels are provided based on the class of compliance requirements (general or specific) and whether the programs are major or nonmajor. The results are lengthy and confusing reports needed to precisely describe each level of responsibility.

The Task Force believes the most appropriate way to reduce and simplify the reporting is to eliminate the need for providing different levels of assurance. The recommendations in section 3.2 on page 24 will redefine general and specific requirements to eliminate general compliance. This will eliminate the need for a report on general compliance.

Recommendation 2.1(c) on page 15 and recommendation 2.1(d) on page 15 will remove the current requirements to audit internal controls and compliance for nonmajor programs. This will eliminate the need for a report on compliance for nonmajor programs since they would either be audited as major programs or not tested.

Based upon the changes discussed in this section, one compliance report could be issued to meet the additional requirements of the single audit. This report would provide an opinion on Federal programs tested as major programs.

The Task Force also believes having two internal control reports is confusing to users. Both of the current internal control reports are unnecessarily long due to technical boilerplate, which is included in both reports.

Recommendations

(a) Reduce number of single audit compliance reports from three to one. As discussed in the Task Force analysis, this requires implementing recommendation 2.1(d) on page 15 to remove the requirement to test nonmajor program transactions otherwise selected during the course of the audit and the recommendations in section 3.2 on page 24 to revise the definition of general and specific compliance. These recommendations will reduce the number of reports by eliminating or putting into different categories the underlying work on which the reports on general requirements and nonmajor programs are based. Other alternatives should be developed for reducing the number of compliance reports if these recommendations are not implemented.

(b) Simplify and explore further reduction in the number of the remaining reports. Implementation of recommendation 2.1(c) on page 15 will simplify the internal control reporting by dropping the requirement to perform audit procedures with respect to internal controls not tested as major programs. This will eliminate the need to describe such work in the report. Further simplification could be made by eliminating unneeded boilerplate language.

Further reduction in the number of reports should also be explored. This can be accomplished by consolidating the remaining reports. For example, the compliance reports required by OMB Circular A-128 and Government Auditing Standards ("GAS") could be combined into a single understandable report. The two internal control reports could also be combined. Alternatively, the GAS compliance and internal control reports could be combined into a single report as could the OMB Circular A-128 compliance and internal control reports.

5.2 Report National Issues

Concern

There is no established method for non-Federal auditors to report to Federal agencies design problems in Federal programs. Poor program design can cause inefficiencies in program delivery or difficulty in achieving program objectives. Also program laws and regulations may be written in a way that is difficult or impractical for recipients to comply. These problems can be at the national, prime recipient, or subrecipient level.

Current Requirements

Auditors are required to report internal control and compliance findings applicable to the entity audited. There is no requirement to report problems with the design of the Federal program.

Responses

The Task Force did not specifically address this issue in the questionnaires.

Task Force Analysis

A significant part of the auditing of Federal programs is performed by non-Federal auditors. These auditors see first hand how Federal programs are administered. Also, non-Federal auditors are independent of both the Federal program and the state and local governments being audited. They can objectively assess problems in program design and provide recommendations for improvement. A system is needed to encourage non-Federal auditors to provide direct feedback to Federal agencies on program design. This will provide Federal agencies with objective information from the service delivery level on how to improve their programs.

Recommendation

(a) Set up a system for non-Federal auditors to report directly to Federal agencies when they see problems in program design. This system should track recommendations made by non-Federal auditors and provide recognition to the auditors who make meaningful recommendations. This system would provide Federal Program Managers and Offices of Inspector General direct information on how to improve program delivery.

5.3 Shorten Due Dates for Audit Reports

Concern

Audit reports would be more useful to program managers if they were received sooner.

Current Requirements

The audit is required to be completed within 12 months of the end of the entity's fiscal year and the report is required to be submitted within one month after the audit is completed. Therefore, the audit report is not due until 13 months after year end.

Responses

Responses on this issue were inconclusive. In response to one question Federal Program Manager respondents indicated a significant problem with audits completed or submitted too late. Other respondents did not consider this a problem. In a separate question none of the respondents supported shorter due dates for audit reports.

By contrast, in narrative responses some Federal Program Managers and State/Local Managers cited specific concerns that reports reached the program office too late and they would prefer a shorter due date for audit reports.

Task Force Analysis

The Task Force believes that single audit reports will be more useful to program managers if they are received sooner. Many state and local governments are already completing the audit of the comprehensive annual financial report within six months to participate in the Government Finance Officer's Association ("GFOA") Certificate of Excellence Program. An earlier due date for the single audit report is consistent with this requirement.

Recommendations

(a) Shorten the due date for single audit reports to seven months. Provide an exception of ten months for states and large local governments. This would require smaller entities to complete their audits within six months and states and large local governments within nine months. All entities would still have one month after completion of the audit to submit the single audit report.

This would improve the timeliness of audit information to program managers and spread out the processing of reports by

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Federal agencies with staggered due dates. Providing more time for larger entities recognizes that their audits are more complex and may need more time to complete. Also, since smaller entities are more often subrecipients, there would be a greater chance that the subrecipient's single audit is completed before the prime recipient's audit report is due.

5.4 Require the Auditor to Disclose Materiality Levels

Concern

Current reporting does not inform the user of single audit reports what amounts the auditor considered material.

Current Requirements

There is no current requirement for the auditor to disclose materiality levels in the audit report.

The auditor is required by SAS 47 to consider materiality in planning the audit and by SAS 68 to determine whether the effect of noncompliance, either individually or in the aggregate, is material to a major program.

Responses

Federal agency respondents (Federal Program Managers and OIG Staff) expected improvement if the single audit reports identified materiality levels. However, non-Federal respondents (IPAs, State Auditors, and State/Local Program Managers), and in particular Auditors were not supportive of reporting information on materiality levels.

Task Force Analysis

Both in planning the audit and evaluating noncompliance, the auditor is required to consider the amount of noncompliance that is material to each major program. Therefore, it should not be difficult for the auditor to disclose the materiality level for each major program in the single audit report.

Since materiality is determined by auditor judgment, different auditors may have a different opinion on what is material to an individual major program. This information would be useful to both the entity and the Federal agency.

Recommendation

(a) Require disclosure in the single audit report of the amount the auditor considered material for each major program. Knowing what the auditor considered as material would help both the entities audited and the Federal agencies relying on the report understand the characteristics of the audit services provided. This information could be reported by major program on the Schedule of Federal Financial Assistance or with the compliance matrix suggested in section 5.5 on page 53.

5.5 Identify the Types of Compliance Requirements Tested

Concern

The auditor tests compliance requirements which could have a material effect on each major program. However, the auditor does not report which compliance requirements were tested for which major programs.

Current Requirements

The auditor's internal control and compliance reports disclose the types of compliance requirements tested for all major programs. The disclosure is for the group of major programs as a whole and not for individual major programs. For example, if any major programs were tested for eligibility, then the report would identify that eligibility was tested. However the report would not identify whether an individual major program was tested for eligibility.

Responses

Federal agency respondents (Federal Program Managers and OIG Staff) indicated a significant problem with audit reports not describing the work performed. By contrast, non-Federal respondents (Auditors and State/Local Program Managers) did not see this as a problem.

Similarly, Federal agency respondents indicated expected improvement from a clearer description of the internal controls and compliance tested for major programs. Auditors did not support this change.

The questionnaire asked all groups to evaluate a sample compliance matrix which would identify by major program which types of requirements were tested. All four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers) indicated support for this additional reporting. OIG Staff, Federal Program Managers, and State/Local Program Managers indicated greater support than Auditors.

Auditors were asked to estimate the additional costs of completing the matrix to identify types of compliance tested for each major program. Most of the Auditors responding (64%) estimated the additional cost for the matrix would be 5% or less.

Task Force Analysis

The types of compliance requirements tested for individual major programs vary with the program and the entity audited. Some compliance requirements may not be the entity's responsibility,

e.g., eligibility may be determined by the Federal agency or a recipient in the case of a subrecipient. The Task Force believes program managers need more detailed information on the types of compliance tested for each major program and this disclosure would allow auditors to more clearly indicate the level of responsibility taken.

For major programs listed in a Compliance Supplement, the auditor is expected to test (or be able to justify why not tested) the Compliance Supplement requirements. Therefore, for these major programs a program manager can review the Compliance Supplement and determine which types of compliance requirements should have been tested. However, sometimes a compliance requirement may not apply to a particular recipient or subrecipient. In this case it will not be clear whether the auditor tested a specific type of compliance requirement.

For major programs not listed in the Compliance Supplement, a program manager can only hope the auditor clearly read the grant agreement, program laws and regulations, made appropriate inquires, and tested the same material compliance requirements the program manager expected to be tested. Here the program manager cannot be sure which types of compliance requirements were tested for a particular major program without looking at the auditor's working papers.

Recommendation

(a) Require the auditor's reports on internal controls and compliance to reference a matrix which identifies the types of compliance requirements tested for each major program. Preparing this compliance matrix will provide program managers a better understanding of the audit coverage for their major programs. Since the auditor must identify the material compliance requirements to test them, listing the types of requirements in a matrix should be little additional effort. See Attachment 3 on page 92 for an example of this matrix.

Another benefit of this recommendation is that with a brief reference to the compliance matrix, the auditor's report will clearly show by major program which types of compliance requirements were tested. Also, eliminating the listing of the types of compliance requirements in the body of the report will simplify the report. Federal agency quality control reviews can easily verify that the auditor has working papers to support all tests reported in the compliance matrix.

A concern considered by the Task Force was whether this compliance matrix would create an expectation that when a Federal agency accepted a report, the Federal agency had verified that the type of compliance indicated as tested were correct. Since the applicable types of compliance requirements may vary between different entities, the Task Force concluded that a Federal agency's desk review and report acceptance process cannot be

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expected to verify the auditor's compliance matrix. Any verification of the compliance matrix by a Federal agency would need to be done as part of a quality control review or other monitoring process.

5.6 Improve Presentation of Audit Findings

Concern

Findings presented in single audit reports often do not provide sufficient information for program officials to resolve findings or determine the significance of noncompliance. In addition, single audits often include many insignificant findings. Therefore, program managers must spend considerable time separating the significant from the insignificant findings and seeking the additional information needed to resolve findings.

Current Requirements

OMB Circular A-128 requires the auditor's report on compliance to include a summary of all instances of noncompliance, and an identification of total amounts questioned, if any, for each Federal assistance award, because of noncompliance. However, the GAS standards for financial audits specify that all material instances of noncompliance related to the entity's financial statements or the program, award, claim, fund or group of accounts being audited should be reported. Further, several instances of noncompliance that separately may not be material, but that cumulatively could have a material effect on the financial statements or results of the financial related audit, should be reported. All instances of illegal acts that could result in the audited entity being subject to criminal prosecution should be reported. Other nonmaterial instances of noncompliance need not be disclosed in the compliance report but should be reported in a separate communication to the audited entity, preferably in writing. Such instances of noncompliance when communicated in a management letter should be referred to in the report on compliance. OMB Circular A-133 follows the GAS standards but requires the separate reporting of nonmaterial compliance to be in writing.

OMB Circular A-128 has no specific guidance on the content of findings other than to say the questioned costs should be identified for each award. OMB Circular A-133 requires that material findings include size of universe and sample in number of items and dollars as well as the number and dollar value of noncompliance. The GAS standards require auditors to place their findings in proper perspective. The extent of noncompliance should be related to the number of cases examined to give the reader a basis for judging the prevalence of noncompliance. In presenting the findings, the GAS standards specify that auditors are to follow the report presentation standards required for performance audits. A footnote to these standards, clarifies that findings have often been regarded as containing the elements of criteria, condition, and effect, plus cause when problems are found.

Responses

Federal agency respondents (Federal Program Managers and OIG Staff) responded that there was a problem with audit findings not being informative. This was also supported in narrative responses from Federal Program Managers who commented findings were sketchy, not related to program regulations, the significance of findings was not clear, and it was a waste of their time to resolve insignificant findings.

Federal agency respondents indicated they would expect improvement in single audits from the audit report providing detailed information on sampling. By contrast, non-Federal respondents (IPAs, State Auditors, and State/Local Managers) indicated less expected benefit from providing detailed information on sampling.

Task Force Analysis

The requirement as set forth in OMB Circular A-128 to report all instances of noncompliance in the auditor's report on compliance is inconsistent with the GAS requirement for reporting noncompliance in financial audits. The reporting of all instances of noncompliance in the single audit report may serve to dilute the presentation of the more significant findings identified during single audits.

In addition, most guidance for developing findings in OMB Circular A-128 is based on the GAS requirements contained in both the financial and performance auditing standards. Some auditors may not recognize the need to seek guidance in the performance auditing standards for a single audit. Also GAS is currently being revised and the findings disclosure requirements may change. The Task Force believes OMB Circular A-128 should clearly describe the expectation for single audit findings.

Recommendation

(a) Make OMB Circular A-128 consistent with A-133 by permitting insignificant instances of noncompliance to be reported separately in writing. This will focus the user's attention on the more significant findings. Also, auditors may be more likely to include the reporting elements as specified in GAS when reporting more material findings of noncompliance. The separate communication of insignificant findings should be submitted with the single audit report.

(b) Revise OMB Circular A-128 to give more guidance on the content of findings. In implementing this recommendation consideration should be given to the GAS and the OMB Circular A-133 requirements. Also, Federal Program Managers should be consulted for the information they need to resolve findings.

5.7 Require the Auditor to Highlight Significant Findings

Concern

Users have difficulty identifying which findings are significant when single audit reports have many findings.

Current Requirements

OMB Circular A-128 requires the auditor to report all questioned costs by award. Reporting practices allow auditors to either identify findings of noncompliance and reportable conditions in the auditor's reports or refer to a schedule of findings.

Responses

Federal Program Manager respondents indicated significant expected improvement by providing a report summary for program managers on audit scope and results. There was some support for this from OIG Staff and State/Local Manager respondents, however there was little support from Auditors. In narrative responses Federal Program Managers indicated that it was often difficult to identify the significant audit findings.

Federal agency respondents (OIG Staff and Federal Program Managers) and State/Local Managers indicated expected improvement from prioritizing the significance of audit findings and identifying high risk areas for Federal follow-up. There was less support for these from Auditors.

Task Force Analysis

Recommendation 5.6(a) on page 57 to separately report insignificant findings will help mitigate this concern. Additional methods are needed to highlight the more significant findings for program managers.

Recommendations

(a) Require the auditor to specifically identify significant findings and recommendations in the body of the internal control and compliance reports. This would help program managers focus on the significant findings which need prompt corrective action. Also the reports should indicate when there were no significant findings.

(b) When there are many findings and recommendations, require the auditor to include an executive summary. This executive summary will help the program managers focus on the big picture changes needed to improve internal control systems and correct

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noncompliance with laws and regulations. It is anticipated that an executive summary should be provided for state-wide and other large entity-wide audits with many findings.

5.8 Improve Audit Resolution

Concern

Auditors have expressed concerns that audit resolution process is not timely and the lack of feedback from Federal agencies on audit resolution. This is especially bothersome to auditors when they are performing subsequent audits which identify the same findings for which audit resolution has not been made or communicated.

Audit resolution officials have expressed concerns that during resolution entities may submit additional documentation which refutes a finding. However, this documentation was not provided to the auditor either during or after the single audit. This puts the resolution official in the role of either being the auditor and verifying this documentation or accepting unaudited documentation to refute an audit finding.

Current Requirements

Federal agencies are required to resolve audit findings affecting their programs within six months after receiving the audit report. Resolution of audit findings affecting the programs of more than one Federal agency are the responsibility of the cognizant agency. The Federal agency should notify the entity audited of their decision on the findings in an audit resolution document.

Responses

Our questionnaires did not specifically address the audit resolution process. However, Auditor respondents in narrative comments indicated that the resolution of findings was arbitrary, not documented, not communicated, slow, and were based upon representations by management which were not audited or otherwise supported.

Task Force Analysis

The Task Force believes that the comments received concerning audit resolution are not unique to single audits. However, the apparent lack of good documentation of why a finding was not supported and the reasoning behind the nonconurrence is a valid concern. When an auditor reports a finding, the auditor often uses the audit resolution document as guidance in performing subsequent audits. Therefore, audit resolution official should be specific when findings are not supported so the auditor can learn from the audit resolution process.

The Task Force believes that any additional documentation submitted during resolution should be audited by the entity's independent auditor before it is submitted.

Recommendations

(a) Provide feedback to auditors when resolution officials do not sustain findings. This will help educate auditors by pointing out where they may have misunderstood compliance requirements or the type of information needed to resolve findings.

(b) When additional documentation is presented during resolution that was not provided to the auditor during the single audit, require this documentation to be audited. It should be made clear that requiring the auditor to examine the additional documentation does not constitute additional audit work requiring the Federal agency to arrange for its funding. Auditing this documentation is consistent with the single audit, since sufficient documentation should have been available during the original audit.

5.9 Improve Audit Follow-up

Concern

Program managers rely on subsequent audits to ensure that corrective action has occurred. However, subsequent audit reports only state when corrective action has not occurred. The program manager must assume that if the finding is not listed in a subsequent report, then correction action must have occurred.

Current Requirements

As part of due professional care, *Government Auditing Standards* require the auditor to follow-up on known findings and recommendations from previous audits that could have an effect on the current audit objectives to determine whether prompt and appropriate corrective actions have been taken by entity officials or other appropriate organizations. Also the auditor's report is required to disclose the status of known but uncorrected significant or material findings and recommendations from prior audits that effect the current audit objectives.

Responses

This issue was not specifically addressed in the questionnaires.

Task Force Analysis

Program managers review the auditor's reports and management's corrective action plan and render a management decision describing the corrective action the entity needs to take. Under current procedure, in the subsequent audit, the auditor reviews prior findings and determines whether corrective action has occurred. The auditor reports when corrective action has not occurred, but is not required to report that the entity has taken positive corrective action.

Recommendation

(a) Require auditors to positively report that prior recommendations have either been corrected or management has demonstrated that corrective action is no longer needed. Since auditors are already required to follow-up on prior period recommendations, to positively report that their follow-up was complete should not require additional field work. This will provide program managers positive assurance that appropriate corrective action has occurred.

6 LARGE ENTITY-WIDE AUDITS

6.1 Major Program Administered by Multiple Operating Units

Concern

A major program can be administered by more than one agency, department, or establishment ("Multiple Operating Units") within a large entity-wide audit. Examples of large entities are state-wide audits, state university systems, or large city audits. Concerns have been expressed about how many of the Multiple Operating Units must be audited for internal control and compliance to provide adequate coverage for an individual major program.

For example in current practice it is not clear whether the auditor should examine the internal control system and test compliance with laws and regulations at each operating unit or whether the auditor may omit testing at some operating units based on materiality. Sometimes the part of a program a single operating unit could be large enough to be a major program if separate.

Current Requirements

The auditor is required to consider the internal control structure, policies and procedures of each separate component of a multiple operating unit.²¹

Responses

Federal agency respondents (Federal Program Managers and OIG Staff) expressed concern that entity-wide audits were too large. However, non-Federal respondents (Auditors and State/Local Managers), and in particular State Auditors, did not share this concern.

In narrative responses, Federal Program Managers and State/Local Managers expressed some dissatisfaction with the single audits of larger governmental units.

Task Force Analysis

Large entity-wide audits often include a major program that is administered by Multiple Operating Units. Examples are student financial aid ("SFA") programs such as Perkins Loans, Guaranteed Student Loans, College Work Study, and Pell grants which are often major programs for the audit of the state but are administered by

²¹ *Audits of State and Local Government Entities Receiving Federal Financial Assistance*, AICPA SOP 92-7, Paragraph 4.12.

individual colleges. In this example, each college may have a completely separate internal control system from any other college. The auditor's gaining an understanding and testing one college's system provides no information about another college's system.

In practice, on a case by case basis, Offices of Inspectors General have permitted entities to not visit each operating unit each year. Consistent guidance is needed on how to audit a major program which is administered by Multiple Operating Units.

The Task Force evaluation of the responses was that the concerns of Federal officials could be addressed by better guidance on required audit coverage when a major program is administered by more than one operating unit.

Recommendation

(a) Provide guidance on how much of the major program must be tested each year. At least once every three years, the auditor should test internal controls and compliance for each operating unit within Multiple Operating Units. An exception would be when a particular operating unit administered clearly insignificant parts of a major program.

In any one year, the internal control and compliance review in accordance with OMB Circular A-128 paragraphs 8.a and 8.b ("Full Review") should be performed at operating units that administer at least 70% of expenditures for a particular major program. For the remaining operating units, the auditor should perform a limited internal control review. The purpose of the limited review is to determine whether there have been major changes in the internal controls structure policies and procedures since the last audit. Also, the auditor should follow-up on known audit findings.

When either of the following conditions occur, the limited review would not be acceptable and the operating unit must be included in the Full Review:

- Significant changes have occurred in the operating unit's internal control systems or other procedures relative to the major program.
- Proper corrective action has not been taken on prior period findings (either internal controls or compliance) which were significant to the individual operating unit's share of the major program.

(b) Provide guidance on the materiality base for planning the audit and reporting. When planning the audit and reporting internal control and compliance findings the auditor should base materiality relative to each individual operating unit. However, when providing the opinion on compliance, the auditor should base materiality on the total major program.

For example, a student financial aid program ("SFA"), was a major program in a state-wide audit and was split as follows between six colleges:

| | |
|-----------|-----------|
| College A | 35% |
| College B | 30% |
| College C | 15% |
| College D | 10% |
| College E | 5% |
| College F | <u>5%</u> |
| Total | 100% |

In a given year the auditor chose Colleges A, B, and F to meet the 70% requirement for testing as discussed in recommendation 6.1(a) above. Internal control findings at College F would be considered reportable conditions (or material weakness) based on the effect on College F although they may not be material to the whole SFA program state-wide. The reporting of findings should provide information to put them in perspective for both the particular college SFA program as well as the whole SFA program state-wide.

Similarly, questioned costs and noncompliance would be reported based on materiality to College F, with information to put them in perspective for both College F as well as the major program as a whole. The single audit opinion on compliance for the major program SFA would not be modified unless the exceptions from all operating units were material to the whole SFA program state-wide.

7 SUBRECIPIENT AUDITS

7.1 Quality of Subrecipient Audits

Concern

There is a need to ensure that subrecipient audits meet the required standards.

Current Requirements

OMB Circular A-128 paragraph 9.a requires recipients to determine whether state or local subrecipients have met the audit requirements of this Circular.

Responses²²

OIG Staff indicated significant support for quality control reviews ("QCRs") of subrecipient audits. Other respondents (Auditors and State Local Managers) indicated lessor support.

Auditors were asked to estimate the increase to single audit costs for this enhancement. They responded with an expected 10% to 25% cost increase by requiring recipients to perform QCRs on subrecipients.

Task Force Analysis

Circular A-128 does not specifically require recipients to perform QCRs of subrecipient audits. However, prime recipients are expected to establish a system to assure that audits of the subrecipients meet the requirements of Circular A-128. Such a system should include a desk review of each subrecipient report to ensure it conforms to the Circular.

Recipients are charged with the responsibility to ensure that subrecipients expend Federal funds in accordance with laws and regulations. As such, recipients are to monitor subrecipients to ensure compliance. One form of monitoring is to place reliance on subrecipient audits.

Besides the requirement for recipients to perform a desk review of subrecipient audits to assure that subrecipient audits meet A-128 reporting requirements,²³ recipients may need to determine whether underlying audit work conducted for subrecipient

²² These questions were not asked to Federal program managers because they do not deal directly with subrecipients.

²³ OMB A-128 Q&A, Question 23.

audits meets *Government Auditing Standards* and OMB Circular A-128 or A-133 requirements, as applicable. This is essential in instances where subrecipient audits are material to a major Federal program of the recipient.

The GAO and Inspectors General have identified problems with the quality of single audits. The deficiencies cited have related to both single audit field work and reporting. Where recipient monitoring identifies inconsistencies with subrecipient audit results, the recipient should consider conducting a quality control review ("QCR") of the subrecipient audit. Recipients having internal auditors or other qualified personnel on staff probably could carry out this quality review function themselves. Other recipients may need to obtain assistance to perform a QCR from such sources as the recipient's IPA, another IPA, or the State Auditor.

The recipient should advise the subrecipient's auditor when an audit does not meet applicable audit requirements. In this instance, the subrecipient auditor should be expected to take corrective action. If corrective action is not taken, the recipient should inform the subrecipient of the auditor's failure to correct the audit deficiencies. The recipient should ensure that any major inadequacies or repetitive substandard performance of an independent auditor is referred to appropriate professional bodies for possible disciplinary action.

Recommendation

(a) Clarify the recipient's responsibility to review subrecipient audit reports to determine whether they meet applicable audit requirements. At a minimum the recipient should perform a sufficient desk review to determine whether the audit report submitted by the subrecipient appears on its face to be a valid single audit report. However, when subrecipient audits are material to a major Federal program of the recipient, the recipient should consider using procedures such as conducting a QCR to confirm the quality of the subrecipient audit.

The need to consider performing a QCR is especially important when subrecipient audit reports show departures from applicable audit requirements or the recipient finds inconsistencies between the results of their own monitoring and the results of the audit on the subrecipient. For example, a monitoring visit by the recipient may show that the subrecipient does not have a system or records to support determining eligibility. If a subrecipient audit for this period did not show any problems with eligibility, then the recipient may have a good reason to perform a QCR on the subrecipient's audit.

8 AUDIT COGNIZANCE

8.1 Regularly Reassign Cognizance

Concern

Cognizance is not reassigned regularly and sometimes not assigned to the Federal agency with the greatest interest in the entity.

Current Requirements

The cognizant agency is the Federal Agency assigned by OMB to serve as the primary single audit contact to an entity.²⁴ The last complete assignment of cognizant agencies was made in January 1986. In this assignment, the same agency was assigned cognizance for both the indirect cost plan and the single audit.

Responses

OIG Staff respondents indicated a problem with cognizance being improperly assigned because funding level changed or because there was large indirect funding but no direct funding.²⁵

Task Force Analysis

The cognizance assignments were made considering the amount of direct funding to the entity and to divide work loads between Offices of Inspectors General. Also, since the cognizance assignment was for both indirect cost plans and single audits, some entities were assigned to the Federal agencies because of indirect cost experience rather than the amount of direct funding provided.

There has only been limited reassignment of cognizance since 1986, usually because of a state changing from a department by department audit to a state-wide audit. Since the amount and source of Federal funding to an entity can change, the assignment of single audit cognizance needs to be reviewed periodically to ensure that the Federal agency assigned cognizance provides a significant amount of direct funding.

²⁴ OMB Circular A-128, Paragraph 5a and 11.

²⁵ Cognizance questions were only asked to OIG Staff.

Recommendations

(a) Update assignment of cognizance on a 3-year cycle. Consideration should be given to OMB delegating staff work related to the reassignment to the PCIE similar to the update of the Compliance Supplement as discussed in recommendation 3.1(b) on page 22.

(b) Set up a process for the cognizant agency and another funding agency to have cognizance changed for good reason. An example of a good reason would be when the current cognizant agency's funding to an entity falls significantly below another Federal agency's funding. The process could be for the current cognizant agency and the Federal agency with the most (or significant) funding to present a joint request to OMB requesting that cognizance be reassigned. This would help ensure that cognizance is assigned to a Federal agency with an interest in performing the cognizant agency responsibilities.

(c) Base cognizant assignments primarily on the extent of direct funding. Making assignments based on direct funding will increase the level of cognizant agency interest in effectively carrying out the cognizant agency responsibilities. The Single Audit Clearinghouse can be used as a resource for obtaining information about levels of funding to specific entities.

(d) Assign cognizance for single audit and indirect cost rates separately. This would help ensure the Federal agency assigned single audit cognizance had interest in the organization's single audit.

9 TECHNICAL CHANGES

9.1 Identification of Federal Funds

Concern

Federal funds are not properly identified to recipients and subrecipients.

Current Requirements

There are no specific requirements in OMB Circular A-128 relating to identifying Federal funds. By contrast, the Attachment to OMB Circular A-133 provides the following guidance:

Paragraph 1.e.(4)

"The granting agency is responsible for identifying the source of funds awarded to recipients; the recipient is responsible for identifying the source of funds awarded to subrecipients."

Paragraph 13.c.(2)

"To assist recipients in identifying Federal awards, Federal agencies and primary recipients shall provide the Catalog of Federal Domestic Assistance (CFDA) numbers to the recipients when making the awards."

Responses

OIG Staff, Auditors, and State/Local Managers expected improvement from requiring Federal agencies to identify amount, CFDA number, and program name for Federal financial assistance provided to prime recipients. They also expected improvement from prime recipients to identify this same information to subrecipients.

In narrative responses, Small Government Managers indicated a significant problem when the CFDA number was not provided for Federal funds passed through to them.

Task Force Analysis

CFDA numbers are sometimes not provided by Federal agencies to the recipients or by prime recipients to subrecipients. Prime recipients often commingle Federal and non-Federal funding passed through to subrecipients. Also, Federal funds are often renamed or given slang titles when passed through to subrecipients. All of these cause confusion to the auditor performing single audits.

As Federal agencies provide funding to recipients or as prime recipients pass through Federal funds to subrecipients, each step of the process should clearly provide for identification of the

original source of all Federal funding. If state or local funds are subgranted with Federal assistance, prime recipients should clearly identify the Federal part. This is necessary for the entity to ensure Federal compliance as well as to complete the Schedule of Federal Financial Assistance.

Recommendations

(a) Require identification of Federal funds awarded to recipients and when passed through to subrecipients. Federal agencies awarding funds to recipients and prime recipients passing Federal funds through to subrecipients should identify the funding as Federal and include CFDA number, title of program, and the amount of Federal funds awarded.

9.2 Changes to be Consistent with OMB Circular A-133

Concern

The differences between OMB Circular A-128 and A-133 should be minimized and only reflect those differences required because of the differences between governmental and not-for-profit organizations.

Current Requirements

As necessary, requirements will be discussed with each recommendation.

Responses

The Task Force did not specifically address these issues in the questionnaires. However, all four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers) in narrative responses generally indicated satisfaction with the single audit enhancements made in OMB Circular A-133 and supported consistency between the two circulars.

Task Force Analysis

The guidance given in OMB Circular A-133 was developed based on the experience gained from single audits of state and local governments under the Single Audit Act and OMB Circular A-128. The recommended changes will make single audits easier to understand and administer by only having differences which are necessary because of the differences between governmental and not-for-profit entities.

Recommendations

(a) Use the term *Awards* and include Federal cost-type contracts with single audits. Currently the Single Audit Act and OMB Circular A-128 do not include cost-type contracts. Cost-type contracts need to be audited and the most efficient approach is to include them as part of the single audit. OMB Circular A-133 includes cost type contracts by using the term *Award* and defining awards as including both Federal financial assistance and cost-type contracts.

A governmental institution of higher education can be audited under either OMB Circular A-128 or OMB Circular A-133. Therefore, for consistency, OMB Circular A-128 needs to use the term *Awards* and include cost-type contracts to provide the same audit coverage under either circular. This will also change the name of the

Schedule of Federal Financial Assistance in A-128 audits to the same name used in A-133 audits, Schedule of Federal Awards.

(b) Define R&D and SFA as separate programs. Under OMB Circular A-133 the sum of expenditures from research and development ("R&D") awards received is considered a program and the sum of expenditures from student financial assistance ("SFA") is considered a program. Under an A-133 single audit, expenditures for all R&D awards are tested as one program which may have different compliance requirements within the program. SFA is treated the same way.

A governmental institution of higher education can be audited under either OMB Circular A-128 or OMB Circular A-133. Therefore, for consistency OMB Circular A-128 should define R&D and SFA the same way as OMB Circular A-133.

Defining SFA and R&D categories as separate programs requires that guidance be given on how they will be presented in the Schedule of Federal Awards. The Task Force recommends reporting similarly to that recommended in the *Questions and Answers on OMB Circular A-133, Audits of Institutions of Higher Education and Other Nonprofit Institutions* (PCIE's Q&A on OMB Circular A-133), question number 29, with reporting of each individual award as a separate line on the schedule whenever practical.

(c) Determine oversight agency based on the predominant amount of direct funding rather than total funding. Under OMB Circular A-133 oversight is determined based on direct funding. The Federal agency that awards the predominant amount of direct funding is the Federal agency that is most affected by the entity's management of Federal programs. Where there is no direct funding, it would be appropriate for the Federal agency with the predominant indirect funding to assume general oversight.

(d) Enhance the concept of oversight agency to allow them to assume the responsibilities normally performed by a cognizant agency. Under OMB Circular A-133 the concept of oversight was more clearly defined and the oversight agency was permitted to assume all or some of the responsibilities normally performed by the cognizant agency. Although OMB's Circular A-128 Q&A Guidance, question number 48, provides guidance in this area, the circular should be changed to enhance the concept of oversight agency.

(e) Update single audit guidance for current terminology. The Single Audit Act, OMB Circular A-128, and A-133 use different terms to describe the same concepts. Unless there are specific differences between governmental and not-for-profit entities, the same terms should be used. Also, some terms in A-128 are not the current terms used in auditing standards.

Examples of changes needed are the terms for the audit resolution process and updating the terminology relating to internal controls.

(f) Clarify that procurement contracts are not included as Federal awards. OMB Circular A-133 provided clarification that procurement contracts to vendors under grants or contracts, used to buy goods or services are not awards. Although OMB's Circular A-128 Q&A Guidance, question number 26, provides guidance in this area, the circular should be changed to clearly indicate that procurement contracts should not be considered awards.

9.3 Changes to Clarify and Provide Support for Existing Guidance

Concern

Besides the formal Federal single audit guidance, e.g., the Single Audit Act and OMB Circular A-128, additional guidance is provided by the OMB's Circular A-128 Q&A Guidance, PCIE Position Statements, the AICPA in statements on auditing standards, audit guides, and statements of position; and single audit practice. Often the additional guidance provides clarification for issues not specifically addressed in the original guidance. The more significant issues should be included in the Act or OMB Circular A-128.

Current Requirements

As necessary, requirements will be discussed with each recommendation.

Responses

The Task Force did not specifically address these issues in the questionnaires.

Task Force Analysis

This section does not change the way single audits are being performed but clarifies and supports current guidance and practice.

Recommendations

(a) Provide specific guidance on program-specific audits. The Single Audit Act and OMB Circular A-128 permit program-specific audits but do not define them or provide guidance on program-specific audit performance or reporting. It is recognized that for a few programs, Offices of Inspector General have prepared program-specific audit guides. However, for most programs a current program-specific audit guide is not available.

Guidance is needed that program-specific audits should be performed in accordance with *Government Auditing Standards*. The reporting should include an opinion on the financial statements of the program, a report on the program's internal controls, and a report on program compliance with laws and regulations. When there is no audit guide and a program is listed in a Compliance Supplement, the auditor should consider the Compliance Supplement steps in the program-specific audit. A schedule of findings and questioned costs, management letter, and report on illegal acts may also be required when applicable.

(b) Clarify that the auditor's responsibility for auditing Federal program income is the same as the responsibility for auditing Federal awards. The Single Audit Act and Circular A-128 do not clearly define the auditor's responsibility for Federal program income. It should be made clear that the auditor has the same responsibility for program income as Federal awards. For example the auditor is responsible for internal controls and compliance over program income the same as for program expenditures.

(c) Clarify the basis for determining awards received. Generally the definition of receipt of Federal awards should be based on how an organization recognizes and reports its revenue. However for unique circumstances such as loan programs, loan guarantee programs for both lending institutions and other non-lending program participants, one time loans or loan guarantees without continuing compliance requirements other than repayment, non-cash awards such as food stamps and surplus property, and endowment funds need specific guidance. Some guidance has been provided in OMB's Circular A-128 Q&A Guidance²⁶, PCIE's Q&A on OMB Circular A-133²⁷, and responses by Inspectors General to specific inquiries.

The Task Force believes there is now sufficient experience with single audits to include in OMB Circular A-128 the basis for determining awards receive. For example the circular should define the basis for awards received in determining when an audit is required, determining major programs, and for reporting in the Schedule of Federal Financial Assistance.

(d) Require the single audit reports to identify major programs. AICPA Statement of Position 92-7, paragraph 3.13 requires auditors to identify which Federal programs are major programs. However, OMB Circular A-128 does not require the identification of major programs. Since users of single audit reports need to know which programs are major, the circular should include this requirement.

(e) Clarify that, unless otherwise instructed, single audit reports from subrecipients should only be sent to organizations directly awarding Federal funds to the entity. For example, a subrecipient should send the audit report to the prime recipient providing funds but not to the Federal agency indirectly providing the award. An exception would be if the Federal agency specifically requested the report. Entities that are both recipients and subrecipients should submit reports to the Federal agencies providing direct funding and to each prime recipients passing through Federal funds.

(f) Clarify that the auditor is required to issue an opinion on compliance for each major program. Paragraph 15.c.(3) of OMB Circular A-133 makes it clear that an opinion is required on each

²⁶ Question 8 and 33.

²⁷ Questions number 7, 26, 27, and 29.

major program. Although the language in OMB Circular A-128 has been interpreted to require an opinion on major program compliance, specific language requiring the compliance opinion should be included in the circular.²⁸

(g) Clearly define what entities are covered by the single audit. Since the passage of the Single Audit Act certain Federally funded entities have taken the position that they are not bound by the requirements of the Single Audit Act. Agencies taking this position include Legal Services Corporation, Public Broadcasting Corporation, and the Department of Defense for National Guard funds. It should be clarified whether Federal agencies such as these should be included under the single audit.

(h) Clarify that entities audited under OMB Circular A-128 must follow the administrative requirements and cost principles applicable to the type of entity being audited. For example, OMB Circular A-128 only mentions the state and local government guidance (OMB Circulars A-102 and A-87). A governmental institution of higher education is under OMB Circulars A-110 and A-21 for administrative requirements and cost principles, but can be audited under OMB Circular A-128 as part of a state or local government. Since OMB Circular A-128 fails to list the guidance for institutions of higher education, some auditors have tried to apply guidance applicable to state and local governments to institutions of higher education.

(i) Clarify that the definition of the entity should be the same for the financial statements and the single audit. The Single Audit Act requires an audit of the entire operations of a state or local government, or at the option of the government it may cover departments, agencies, or establishments. The Act requires the auditor to issue an opinion on the financial statements of the entity being audited. PCIE Statement No. 1 was issued to clarify that if the audited entity was a department, agency, or establishment the financial statements to be audited were of the same department, agency, or establishment and not the government as a whole.

(j) Clarify that the Compliance Supplements set forth the major compliance requirements that should be considered in a single audit. Federal agencies have identified the requirements in the Compliance Supplements as being significant to the programs and auditors should be encouraged to use the supplements. However, the auditor is responsible for ensuring that significant requirements which are modified because of changes in laws or regulations are included. The auditor should be prepared to justify any departures from a Compliance Supplement.

Separate Compliance Supplements have been developed for circulars A-128 and A-133 which set forth the major compliance

²⁸ This should be modified to each program tested as major if recommendation 2.1(b) on page 15 or recommendation 2.2(a) on page 18 are implemented.

requirements that should be considered in performing an audit in accordance with the circulars. The Single Audit Act and its implementing regulations do not define the purpose or authority of the Compliance Supplements.

(k) Update reference to Common Rule. Paragraph 8.b.(2)(b) of OMB Circular A-128 references Attachment F of Circular A-102 and the correct reference is now the Common Rule.

9.4 Training

Concern

Current training for both auditors and program managers on single audits needs to be enhanced.

Current Requirements

Auditors are required to have training to meet the continuing education requirements of *Government Auditing Standards*. There are no specific training requirements for program managers.

Responses

OIG Staff, Auditors, and State/Local Program Mangers responses indicated that adequate single audit training was available. Federal Program Managers indicated some concern about available training. As a whole, all four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers) indicated more concern about program official's understanding of the single audit than auditor's understanding of it.

By contrast, all four groups of respondents (OIG Staff, Auditors, Federal Program Managers, and State/Local Managers) provided narrative responses that indicated single audit training could be improved. Respondents said that auditors did not properly understand the Federal programs being audited. Auditors responded that program managers did not understand what was required by the Single Audit Act and the limitations on projecting audit test results. Some Auditors felt that they were being required to provide more than required by the Act.

Task Force Analysis

The Task Force believes that the differences between the objective and narrative questions may be related to the need for more specific program training. Currently generalized training is available for single audit concepts, auditing, and reporting requirements. However, limited training is available to focus on individual Federal programs, groups of programs, or types of entities. For example, training should be available on the Federal programs normally found in a school district and how to audit a school district.

The delivery of the training should include case studies, sample working papers, examples of typical internal controls, sample methods of testing and documenting tests, and how to identify, document, and report typical noncompliance. The training should orient the non-Federal auditor to view areas where noncompliance is likely to occur with increased professional

skepticism. This does not imply that non-Federal auditor should look at additional requirements (as may be done by the OIG Staff or Federal Program Managers), but rather to look very closely at the key requirements for major programs.

Recommendations

(a) Develop training programs to help program managers understand what the single audit is and is not designed to provide. The training should include examples of Federal programs and explain specifics on how the auditor would test the program and what should and should not be included in the audit.

(b) Provide training to help auditors understand the internal control and compliance requirements of specific Federal programs or types of entities. Program Managers should be involved in the development and presentation of this training. This training should include areas of program vulnerability, the design of audit tests, and examples of working papers. Examples should also be provided on how to review and evaluate administrative control systems.

(c) Develop case studies on auditing internal controls and compliance areas that are common to several Federal programs. Eligibility is an example of an area that is common to many Federal programs for which a generalized audit approach could be taught.

10 SINGLE AUDIT OBJECTIVES

Concern

Whether the objectives of the Single Audit Act of 1984 ("Act") had been achieved and whether there are objectives that should be added to the Act?

Current Requirements

The stated objectives of the Act were to:

- Improve the financial management of state and local governments with respect to Federal financial assistance programs,
- Establish uniform requirements for audits of Federal financial assistance provided to state and local governments,
- Promote the efficient and effective use of audit resources, and
- Ensure that Federal departments and agencies, to the maximum extent practicable, rely upon and use audits done pursuant to the Single Audit Act.

Responses and Task Force Analysis

The Task Force asked each respondent whether they believed each of the four objectives of the Single Audit Act been achieved. Overall, all groups of respondents (OIG Staff, Auditors, Federal Program Managers, State/Local Managers, and Small Government Managers) indicated the Act's objectives had been achieved. State Auditors, State/Local Managers, and Small Government Managers responded more strongly than other groups that financial management had been improved and audit resources were used more efficiently and effectively. The Task Force believes these groups would have a more direct knowledge of these benefits from single audits to their entities.

All groups of respondents gave the strongest response that the Act established uniform audit requirements for audit of Federal financial assistance.

All groups of respondents indicated that Federal departments and agencies generally relied upon and used the single audit work. However the Task Force was concerned that Federal Program Managers, the group that should have the best knowledge of how well Federal agencies rely upon single audits, gave the lowest support that this objective had been achieved.

The Task Force also provided a list of possible additional objectives for the Act and asked whether these would improve single audits. The additional objectives were:

- Provide program managers with information needed to carry out their responsibilities for Federal financial assistance.
- Conduct program results audits for Federal financial assistance.
- Conduct economy and efficiency audits for Federal financial assistance.
- Recipient management report on performance data for Federal financial assistance.
- Auditors provide assurances on recipient management's reporting of performance data for Federal financial assistance.

Except for the objective of providing program managers with the information they need to carry out their responsibilities, none of the additional objectives were supported by any of the groups of respondents.²⁹ The strongest support for this objective was from Federal Program Managers, OIG Staff, and State/Local Managers.

Recommendations

Overall, the Task Force does not believe the survey results support a need to add additional objectives to the Act. However, we do believe there is support to ensure that single audits provide program managers with the information they need to carry out their responsibilities for Federal programs. Providing this information to program managers will also help single audits to better achieve the fourth objective of the Act. The following recommendations in this report will help ensure single audits provide program managers with the information they need:

| <u>Ref.</u> | <u>Page</u> | <u>Summary of Recommendation</u> |
|-------------|-------------|---|
| 2.1 | 12 | Improve audit coverage of nonmajor programs. |
| 4.1 | 41 | Clarify the amount of internal controls testing required. |
| 5.1 | 46 | Reduce and simplify auditor's reports. |
| 5.2 | 49 | Report national issues. |
| 5.3 | 50 | Shorten due dates for audit reports. |

²⁹ Small Government Managers were not asked questions about additional objectives.

- 5.4 52 Require the auditor to disclose materiality levels.
- 5.5 53 Identify the types of compliance tested.
- 5.6 56 Improve presentation of audit findings.
- 5.7 58 Require the auditor to highlight significant findings.
- 5.8 60 Improve audit resolution.
- 5.9 62 Improve audit follow-up.
- 9.4(a) 80 Develop training to help program managers understand the single audit.

SAMPLING APPROACH

Attachment 1

Offices Of Inspectors General

Questionnaires were sent to staff members ("OIG Staff") in each of the Offices of Inspectors General which are involved with single audits. Questionnaires were sent to both field and headquarter offices. A total of 35 questionnaires were sent to OIG Staff.

For OIG Staff only, two different sets of questionnaires were sent. The first was the questionnaires which were the same for the four groups as discussed on page 3. The second was the questionnaires concerning dollar thresholds for audit as discussed in section 1.1 on page 10.

Auditors

The Task Force was unable to develop a method to identify the population of all auditors performing single audits. Therefore we developed a sampling approach which we believe to represent auditors performing single audits.

State Auditors

First, questionnaires were sent to all State Auditors (members of the National State Auditors Association). Although there are only 50 states, 53 questionnaires were sent out because some states have more than one auditor working with single audits.

IPAs

Next, we developed a sample of Independent Public Accountants (IPAs). We started with a random sample of entities having a single audit selected by the Single Audit Clearinghouse (See State and Local Managers on page 85). We sent a questionnaire to the IPA who performed the single audit. In using this selection we eliminated any duplication of the same audit office. State Auditors were also eliminated since we used a separate sample for them.

We supplemented this selection by adding the 15 largest U.S. CPA firms (based on revenue for the most recent fiscal year) as reported by *Accounting Today* (September 24, 1990). We contacted the firms and only sent questionnaires to firms which conducted single audits.

Finally, we asked the Offices of Inspectors General to provide us the name of any audit firms they wished to add to our sample because they did substantial work on their agency's programs. A total of 150 questionnaires were sent out to IPAs.

Federal Program Managers

The Task Force developed a three level approach for sending the questionnaires to Federal Program Managers.

First, from the OMB Compliance Supplement (Revised September 1990) which included audit information covering 78 of the larger Federal programs, we selected every other Federal Program (39 programs).

Second, the 1990/91 U.S. Government Manual was used to judgementally identify nine additional smaller Federal programs from Independent Establishments and Government Corporations which may be involved in single audits.

Third, two additional Federal programs not included in the OMB Compliance Supplement which were administered from larger Federal Agencies were judgementally selected.

Using the Catalog of Federal Domestic Assistance ("CFDA") we identified contact persons for each of the 50 programs selected. We called each contact person to identify for our sample a Federal official who worked in three areas of responsibility for each program. The three areas were administration, funding, and audit resolution. Sometimes one official was responsible for one or more of the functions and in others we sent three separate questionnaires for the program. We sent out a total of 98 questionnaires to Federal Program Managers.

State and Local Governments Managers

First, a sample of single audits submitted to the Single Audit Clearinghouse ("Clearinghouse") during the period July 1, 1990 through June 30, 1991, was randomly selected by the Clearinghouse. The audits selected were primarily of smaller local governments. As a result, 147 questionnaires were sent to small local government managers ("Small Government Managers").

Since this original sample included only small local governments, a separate sample was judgementally selected to represent states and large local governments. Questionnaires were sent to program managers ("State/Local Managers") in all 50 states plus a judgmental selection of the 20 largest local governments. A total of 170 questionnaires was sent out to this group.

EXAMPLE OF GENERIC COMPLIANCE SUPPLEMENT

The OMB Compliance Supplement identifies the significant compliance requirements for most of the larger programs. Compliance requirements are considered significant when noncompliance could have a material effect on the program.

Even though the supplement lists programs which provide over 90 percent of the Federal aid to state and local governments, there are many programs which are not listed. This appendix provides guidance on identifying compliance requirements for programs not listed in the compliance supplement and some generic procedures to test those requirements.

SUGGESTED AUDIT PROCEDURES FOR IDENTIFYING COMPLIANCE REQUIREMENTS

- If the auditor does not know what laws, regulations or other requirements apply to the program, the auditor can determine the applicable requirements by:
 - Discussing the program with the client. (The client's identification of the applicable laws, regulation or other requirements should be corroborated by performing one or more of the other procedures below, as necessary.)
 - Reviewing the program award document or agreement, including any amendments or close out agreements. These documents or agreements may reference particular laws and regulations applicable to the program and identify the name and phone number of a Federal contact person.
 - Reviewing the *Catalog of Federal Domestic Assistance (CFDA)*. The CFDA provides summary information about each program and includes the name and phone number of a Federal contact person.
 - Determining if there is a program audit guide or agency prepared compliance supplement issued by the Federal Agency's Office of Inspector General and, if so, reviewing it. The availability of a program audit guide or compliance supplement can be determined by consulting the PCIE publication, *Program Audit Guide Survey* (available from) or by contacting the appropriate Regional Inspector General office.
- Obtain and review the award document/agreement, applicable laws, regulations and other requirements to identify compliance requirements to be tested. Generally, the auditor should identify for testing any significant requirements in the compliance categories A through J below.
- If the auditor can't determine from this review which requirements are significant, the auditor should call the

contact person identified in the CFDA or award document. This may be particularly important for any compliance requirements that wouldn't fit under the categories A through I below, and thus would be category J, Special Tests and Provisions.

COMPLIANCE REQUIREMENT CATEGORIES

- A. *Types of Services Allowed or Unallowed.* This includes requirements which specify the activities or types of activities that can and can't be funded by the program. It also includes requirements which mandate that certain activities be undertaken.

Suggested Audit Procedures

- Test expenditure and related records to determine that funds were used for allowed activities.
- Scan expenditure records for large transfers out of program accounts and determine if any such transfers went to fund unallowable activities.
- Review financial and project records to determine if required activities were performed.
- If funds are passed through to subrecipients, test approved subrecipient applications or agreements to determine whether approved activities were allowable.

- B. *Allowable Costs/Cost Principles.* Federal cost principles are designed to ensure that Federally assisted programs bear their fair share of recognized costs as determined by allowable cost principles. For a further description of the requirements and the suggested audit procedures see the Allowable Costs\Cost Principle section in the appendix to this Compliance Supplement.³⁰

- C. *Administrative Requirements.* (To be Developed)

- D. *Eligibility.* Many programs have specific eligibility requirements to limit assistance to certain activities or groups of individuals.

Suggested Audit Procedures

- Review a representative sample of participant records, and determine whether prescribed procedures were followed and whether the participants were eligible.

³⁰ This refers to an appendix to the Compliance Supplement that contains those compliance requirements and suggested audit procedures that are applicable to all programs. See recommendation 3.2(a) on page 26 and recommendation 3.2(d) on page 27. Using the current OMB Compliance Supplement, this would refer to the general requirements section.

- E. Matching, Level of Effort, and/or Earmarking Requirements.** Matching requirements include requirements to provide in-kind contributions, or matching funds on a one-to-one or percentage basis.

Level of effort requirements include provisions that require a certain level of service be provided from year to year or that a certain level of expenditures (may be either non-Federal or Federal) for specified activities be maintained from period to period. These requirements frequently specify that certain classes of expenditures are not to be included in the calculations. For example, certain programs only allow operating expenditures to be considered and prohibit capital expenditures or debt service from being included. Grantees are usually required to maintain specific summary records or reports documenting compliance with these type of requirements.

Level of effort requirements also include provisions that require Federal funds to supplement and not supplant non-Federal funding of services and/or requirements that specified services provided prior to Federal funding not be discontinued. Requirements that Federal program beneficiaries receive a comparable level of locally funded benefits/services (comparability) as nonprogram participants may also be included in this category.

Earmarking requirements include requirements that limit the amount of funds that can be used for administrative purposes or specified programmatic activity, including amounts that can be subawarded. They also include requirements that specify amounts or percentage of funds to be used for specified activities.

Suggested Audit Procedures

- **For matching requirements:**
 - Review summary documentation to determine if the required levels of matching were met.
 - Test matching costs claimed for conformity to cost principles and to determine whether they were for services or activities eligible to be counted as matching costs.
 - On a test basis, trace amounts claimed for matching to supporting documentation.
- **For level of effort requirements that relate to maintaining certain funding levels:**
 - Review grantee's summary records or reports documenting level of effort amounts/computations to

determine if appropriate levels were maintained. Verify accuracy of any computations.

- Review types of expenditures included in the computations to determine whether they are the same expenditure categories for each period being compared and to assure that only allowed classes of expenditures are included.
- Trace amounts included in the computations to the books and records from which the audited financial statements were prepared.
- For level of effort requirements requiring certain services be performed or not performed: (Note: Procedures identified above for requirements to maintain funding levels may also be applicable to these requirements.)
 - Review expenditure and other records (e.g. activity reports, budgets, as needed, to determine whether required activities were funded and/or, as applicable, were charged appropriately (i.e., to local or Federal accounts).
- For supplement, not supplant requirements: (Note: Procedures identified above for requirements to maintain funding levels may also be applicable to these requirements.)
 - Determine whether any Federally funded activities in the current year were locally funded in the prior year.
 - When performing other Federal expenditure testing, be alert for expenditures charged to the program that appear to be for activities that the entity would have to carry out or costs that it would have to incur irrespective of the Federal funding. Follow-up on any items to determine if Federal funds supplanted non-Federal funds.
 - Determine whether Federally funded activities received their fair share of non-Federal funds when compared to non-Federal activities (comparability).
- For earmarking requirements:
 - Review financial and related records and determine if expenditure amounts were in accordance with the requirements and limitations.
 - Test sample transactions to assure they are appropriately classified. (This may have been done as part of other testing.)

- F. **Special Reporting Requirements.** Many programs require submission of special financial or performance and evaluation reports.

Suggested Audit Procedures

- Review the procedures for preparing the reports and evaluate for adequacy.
- Trace amounts reported to books and/or supporting documentation as appropriate, to determine that reported data is supported.

- G. **Federal Financial Reporting Requirements.** Most programs require certain common financial reports to be submitted. For a further description of these reporting requirements and related suggested audit procedures, see the Financial Reporting section in the appendix to this Compliance Supplement.³¹

Suggested Audit Procedures

- Review the procedures for preparing the reports and evaluate for adequacy.
- Trace amounts reported to books and/or supporting documentation as appropriate, to determine that reported data is supported.

- H. **Cash Management.** Grantee financial management systems shall include procedures to minimize the time elapsed between the transfer of funds from the U.S. Treasury and the disbursement of funds by the grantee. Advances made by primary recipients to secondary recipients shall conform substantially to the same standards of timing and amount as apply to advances by Federal agencies to primary recipient organizations. For further information and suggested audit procedures see the Cash Management Section of the appendix to the Compliance Supplement.³²

- I. **Subrecipient Monitoring.** (To be Developed)

- J. **Special Tests and Provisions.** Many programs contain significant provisions that don't fit within the above categories. Two such requirements, (*Davis-Bacon and Relocation Assistance/ Real Property Acquisitions requirements*) are the same for all programs to which they apply. A further description of these two requirements and related suggested audit procedures are contained in separate

³¹ See footnote 30.

³² See footnote 30.

sections of the appendix to this Compliance Supplement.”
Because of the variety of programs and compliance requirements
it is not possible to provide specific guidance on *Special
Tests and Provisions*.

Suggested Audit Procedures

- Auditors should follow the guidance above for identifying compliance requirements. In some cases, significant special provisions will be obvious, because they directly relate to or effect purpose of the program. In other cases, the auditor may not be able to identify which, if any, provisions are considered significant for single audit purposes. The auditor is encouraged to contact the Federal program contact(s) identified in the steps outlined above for identifying compliance requirements. The auditor should design appropriate tests for any significant requirements identified.

³³ See footnote 30.

EXAMPLE OF COMPLIANCE MATRIX

Attachment 3

U.S. Department of Agriculture
Major Programs

| CFDA Number | 10.500 | 10.551 | 10.555 |
|--|-------------------------------|-------------|-----------------------|
| Compliance Requirement Types | Cooperative Extension Service | Food Stamps | National School Lunch |
| Types of Services Allowed or Unallowed | Yes | No | Yes |
| Allowable Costs/Cost Principles | Yes | Yes | Yes |
| Administrative Requirements | Yes | Yes | Yes |
| Eligibility | No | Yes | Yes |
| Matching, Level of Effort, or Earmarking | Yes | No | Yes |
| Special Reporting | Yes | Yes | Yes |
| Federal Financial Reports | Yes | Yes | Yes |
| Cash Management | Yes | No | Yes |
| Subrecipient Monitoring | No | Yes | Yes |
| Special Tests and Provisions | Yes | Yes | No |

Yes or No in each block indicates whether internal control and compliance tests were performed.

NOTE: Types of compliance requirements are from recommendation 3.2(a) on page 26.

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