

## **PART 3 – COMPLIANCE REQUIREMENTS**

### **INTRODUCTION**

#### **Overview**

The objectives of most compliance requirements for federal programs administered by states, local governments, Indian tribes, institutions of higher education, and nonprofit organizations (non-federal entities) are generic in nature. For example, many programs have eligibility requirements for individuals or organizations to participate in a particular program. While the criteria for determining eligibility vary by program, the objective of the compliance requirement that only eligible individuals or organizations participate is consistent across programs.

Rather than repeat the compliance requirements, audit objectives, and suggested audit procedures for each of the programs contained in Part 4, “Agency Program Requirements” and Part 5, “Clusters of Programs,” they are provided once in this part. For each program in this Supplement, Part 4 or Part 5 contains additional information about the program and the statutes and regulations governing its administration, and also specifies the compliance requirements to be tested using the guidance in this part, Part 3.

Note that as we considered the transition to the 2 CFR part 200 completed, as it is applicable to all federal awards made on or after December 26, 2014, we removed the “Transition to 2 CFR part 200” section and the Part 3.1 – federal awards made prior to December 26, 2014, from the 2020 Compliance Supplement. On the rare occasions that auditors are reviewing activities for federal awards made prior to December 26, 2014, the 2019 Compliance Supplement should be used for guidance.

## **Relationship between Frequently Asked Questions and the 2 CFR Part 200, Subpart F, Audit**

With the issuance of the 2 CFR Part 200, the Council on Financial Assistance Reform (COFAR) issued Frequently Asked Questions (FAQs) to assist federal agencies and grantees to interpret and implement the guidance. These FAQs are meant to provide additional context, background, and clarification of the policies described in 2 CFR part 200 and should be considered in the single audit work plan and reviews. The complete list of FAQs (updated as of July 2017) is found at <https://cfo.gov/wp-content/uploads/2017/08/July2017-UniformGuidanceFrequentlyAskedQuestions.pdf>. Any FAQs that may be issued or updated after July 2017 will be available upon issuance at the CFO Council website indicated above and also should be considered in the single audit work plan and reviews, as appropriate for the subject matter and the audit period.

### **Use of Terminology in Part 3**

Part 3 presents statements of compliance requirements, related audit objectives, and suggested audit procedures. When restating compliance requirements, Part 3 uses the conventions employed in 2 CFR part 200. For example, when the word “must” is used it indicates a requirement, whereas use of the word “should” indicates a best practice or recommended approach rather than a requirement (see FAQ 303-2). Given that different terminology (e.g., “shall”) was used before the issuance of 2 CFR part 200, the language of Part 3 continues to reflect the way in which the compliance requirements previously were stated. The limited use of the term “should not” (e.g., with respect to improper payments) refers to an action or activity that is non-compliant.

Similarly, when Part 3 speaks to auditors, the word “must,” which is used in limited instances, means that the auditor is required to do what the statement indicates. However, the suggested audit procedures associated with each compliance requirement, which are specifically directed to auditors, uses the term “should,” which indicates a recommended approach. As stated elsewhere (see Part 1 of the Supplement), auditors must judge whether the suggested audit procedures are sufficient to achieve the stated audit objectives or whether alternative audit procedures are needed.

### **REQUIREMENTS UNDER 2 CFR Part 200 FOR FEDERAL AWARDS MADE ON OR AFTER DECEMBER 26, 2014**

2 CFR section 200.101 describes the applicability of 2 CFR part 200. The following table, from 2 CFR section 200.101(b)(1), summarizes the applicability of the subparts of 2 CFR part 200 to different types of federal awards, which includes subawards. Federal contracts and subcontracts under them also are subject to the FAR.

<b>The following portions of 2 CFR part 200:</b>	<b>Are applicable to the following types of federal awards and Fixed-Price Contracts and Subcontracts (except as noted in 2 CFR sections 200.101(d) and (e)):</b>	<b>Are NOT applicable to the following types of federal awards and Fixed-Price Contracts and Subcontracts:</b>
Subpart A - Acronyms and Definitions	All	
Subpart B - General Provisions except for 200.111 English language, 200.112 Conflict of interest, 200.113 Mandatory disclosures	All	
200.111 English language, 200.112 Conflict of interest, and 200.113 Mandatory disclosures	Grant agreements and cooperative agreements	<p>Agreements for loans, loan guarantees, interest subsidies, and insurance</p> <p>Procurement contracts awarded by federal agencies under the FAR subcontracts under those contracts</p>
Subparts C-D, except for 200.202 Requirements to provide public notice of financial assistance programs, 200.303, Internal controls, 200.330-332 Subrecipient Monitoring and Management	Grant agreements and cooperative agreements	<p>Agreements for loans, loan guarantees, interest subsidies, and insurance</p> <p>Procurement contracts awarded by federal agencies under the FAR and subcontracts under those contracts</p>
200.202 Requirements to provide public notice of financial assistance programs	<p>Grant agreements and cooperative agreements</p> <p>Agreements for loans, loan guarantees, interest subsidies, and insurance</p>	Procurement contracts awarded by federal agencies under the FAR and cost-reimbursement subcontracts under those contracts
200.303, Internal controls, 200.330-332 Subrecipient Monitoring and Management	All	
Subpart E - Cost Principles	<p>Grant agreements and cooperative agreements, except those providing food commodities</p> <p>All procurement contracts awarded under the FAR except those that are not negotiated</p>	<p>Grant agreements and cooperative agreements providing food commodities</p> <p>Fixed amount awards</p> <p>Agreements for loans, loan guarantees, interest subsidies, and insurance</p>

<b>The following portions of 2 CFR part 200:</b>	<b>Are applicable to the following types of federal awards and Fixed-Price Contracts and Subcontracts (except as noted in 2 CFR sections 200.101(d) and (e)):</b>	<b>Are NOT applicable to the following types of federal awards and Fixed-Price Contracts and Subcontracts:</b>
		Federal awards to hospitals (see Appendix IX Hospital Cost Principles)
Subpart F - Audit Requirements	<p>Grant agreements and cooperative agreements</p> <p>Contracts and subcontracts, except for fixed price contracts and subcontracts, awarded under the FAR</p> <p>Agreements for loans, loan guarantees, interest subsidies, and insurance and other forms of federal financial assistance as defined by the Single Audit Act Amendments of 1996</p>	Fixed-price contracts and subcontracts awarded under the FAR

Appendix I to the Supplement provides the names and CFDA numbers for programs listed in 2 CFR section 200.101(d) that are excluded from subparts D and E of 2 CFR part 200. In addition, as described in 2 CFR section 200.102 and with the exception of subpart F, Audit Requirements of 2 CFR part 200: (1) OMB may allow exceptions for classes of federal awards or non-federal entities subject to the requirements to 2 CFR part 200 when exceptions are not prohibited by statute, which will be published on the OMB Web site at <https://www.whitehouse.gov/omb/>; and (2) federal awarding agencies or the cognizant agency for indirect costs may authorize exceptions on a case-by-case basis for individual non-federal entities, except where otherwise required by statute or where OMB or other approval is expressly required.

Appendix II to the Supplement provides a list showing the location in the CFR of agencies' adoption or implementation of 2 CFR part 200 in agency regulations, and whether those regulations have been issued as final rules, and, if so, the date of *Federal Register* publication.

## **COMPLIANCE REQUIREMENTS, AUDIT OBJECTIVES, AND SUGGESTED AUDIT PROCEDURES**

Auditors must consider the compliance requirements and related audit objectives in Part 3 and part 4 or 5 (for programs included in this Supplement) in every audit conducted under 2 CFR part 200, subpart F, with the exception of program-specific audits performed in accordance with a federal agency's program-specific audit guide (see Appendix VI to the Supplement). In making a determination not to test a compliance requirement, the auditor must conclude that the requirement either does not apply to the particular non-federal entity's major program or that noncompliance with the requirement could not have a direct and material effect on a major program (e.g., the auditor would not be expected to test Procurement if the non-federal entity charges only small amounts of purchases to a major program). The descriptions of the compliance requirements in parts 3, 4, and 5 generally are a summary of the actual compliance requirements. The auditor must refer to the referenced citations to laws and regulations for the complete statement of the compliance requirements.

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

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

### **Internal Control**

Consistent with the requirements of 2 CFR part 200, subpart F, Part 3 includes generic audit objectives and suggested audit procedures to test internal control. However, the auditor must determine the specific procedures to test internal control on a case-by-case basis considering factors such as the non-federal entity's internal controls, the compliance requirements, the audit objectives for compliance, the auditor's assessment of control risk, and the audit requirement to test internal control as prescribed in 2 CFR part 200, subpart F.

### **Improper Payments**

Under OMB guidance, Public Law (Pub. L.) No. 107-300, the Improper Payments Information Act of 2002, as amended by Pub. L. No. 111-204, the Improper Payments Elimination and Recovery Act, Executive Order 13520 on reducing improper payments, and the June 18, 2010 Presidential memorandum to enhance payment accuracy, federal agencies are required to take actions to prevent improper payments, review federal awards for such payments, and, as applicable, reclaim improper payments. Improper payments include the following:

1. Any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements, such

as overpayments or underpayments made to eligible recipients resulting from inappropriate denials of payment or service, any payment that does not account for credit for applicable discounts, payments that are for the incorrect amount, and duplicate payments.

2. Any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments where authorized by statute).
3. Any payment that an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation.

Auditors must be alert to improper payments, particularly when testing the following parts of section III. – A, "Activities Allowed or Unallowed;" B, "Allowable Costs/Cost Principles;" E, "Eligibility;" and, in some cases, N, "Special Tests and Provisions."

### **Organization and Use of Part 3 of the Supplement**

The remainder of Part 3 divides the types of compliance requirements into Parts A through N.

## **A. ACTIVITIES ALLOWED OR UNALLOWED**

### **Compliance Requirements**

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

### **Source of Governing Requirements**

The requirements for activities allowed or unallowed are contained in program legislation, federal awarding agency regulations, and the terms and conditions of the award.

### **Audit Objectives**

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. Determine whether federal awards were expended only for allowable activities.

### **Suggested Audit Procedures – Internal Control**

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for activities allowed or unallowed and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the remaining risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

**Suggested Audit Procedures – Compliance**

1. Identify the types of activities which are either specifically allowed or prohibited by federal statutes, regulations, and the terms and conditions of the federal award pertaining to the program.
2. When allowability is determined based upon summary level data, perform procedures to verify that:
  - a. Activities were allowable.
  - b. Individual transactions were properly classified and accumulated into the activity total.
3. When allowability is determined based upon individual transactions, select a sample of transactions and perform procedures to verify that the transaction was for an allowable activity.
4. The auditor should be alert for large transfers of funds from program accounts which may have been used to fund unallowable activities.

## **B. ALLOWABLE COSTS/COST PRINCIPLES**

### **Applicability of Cost Principles**

The cost principles in 2 CFR part 200, subpart E (Cost Principles), prescribe the cost accounting requirements associated with the administration of federal awards by:

- a. States, local governments, and Indian tribes
- b. Institutions of higher education (IHEs)
- c. Nonprofit organizations

As provided in 2 CFR section 200.101, the cost principles requirements apply to all federal awards with the exception of grant agreements and cooperative agreements providing food commodities; agreements for loans, loan guarantees, interest subsidies, insurance; and programs listed in 2 CFR section 200.101(d) (see Appendix I of this Supplement). Federal awards administered by publicly owned hospitals and other providers of medical care are exempt from 2 CFR part 200, subpart E, but are subject to the requirements 45 CFR part 75, Appendix IX, the Department of Health and Human Services (HHS) implementation of 2 CFR part 200. The cost principles applicable to a non-federal entity apply to all federal awards received by the entity, regardless of whether the awards are received directly from the federal awarding agency or indirectly through a pass-through entity. For this purpose, federal awards include cost-reimbursement contracts under the Federal Acquisition Regulation (FAR). The cost principles do not apply to federal awards under which a non-federal entity is not required to account to the federal awarding agency or pass-through entity for actual costs incurred.

### **Source of Governing Requirements**

The requirements for allowable costs/cost principles are contained in 2 CFR part 200, subpart E, program legislation, federal awarding agency regulations, and the terms and conditions of the award.

The requirements for the development and submission of indirect (facilities and administration (F&A)) cost rate proposals and cost allocation plans (CAPs) are contained in 2 CFR part 200, appendices III–VII as follows:

- Appendix III to Part 200—Indirect (F&A) Costs Identification and Assignment, and Rate Determination for Institutions of Higher Education (IHEs).
- Appendix IV to Part 200—Indirect (F&A) Costs Identification and Assignment, and Rate Determination for Nonprofit Organizations
- Appendix V to Part 200—State/Local Government-Wide Central Service Cost Allocation Plans
- Appendix VI to Part 200—Public Assistance Cost Allocation Plans

- Appendix VII to Part 200—States and Local Government and Indian Tribe Indirect Cost Proposals

Except for the requirements identified below under “Basic Guidelines,” which are applicable to all types of non-federal entities, this compliance requirement is divided into sections based on the type of non-federal entity. The differences that exist are necessary because of the nature of the non-federal entity organizational structures, programs administered, and breadth of services offered by some non-federal entities and not others.

### **Basic Guidelines**

Except where otherwise authorized by statute, cost must meet the following general criteria in order to be allowable under federal awards;

1. Be necessary and reasonable for the performance of the federal award and be allocable thereto under the principles in 2 CFR part 200, subpart E.
2. Conform to any limitations or exclusions set forth in 2 CFR part 200, subpart E or in the federal award as to types or amount of cost items.
3. Be consistent with policies and procedures that apply uniformly to both federally financed and other activities of the non-federal entity.
4. Be accorded consistent treatment. A cost may not be assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the federal award as an indirect cost.
5. Be determined in accordance with generally accepted accounting principles (GAAP), except for state and local governments and Indian tribes only as otherwise provided for in 2 CFR part 200.
6. Not be included as a cost or used to meet cost-sharing or matching requirements of any other federally financed program in either the current or a prior period.
7. Be adequately documented.

### **Selected Items of Cost**

The 2 CFR sections 200.420 through 200.475 provide the principles to be applied in establishing the allowability of certain items of cost, in addition to the basic considerations identified above. (For a listing of costs, by type of non-federal entity, refer to Exhibit 1 of this part of the Supplement.) These principles apply whether or not a particular item of cost is treated as a direct cost or indirect (F&A) cost. Failure to mention a particular item of cost is not intended to imply that it is either allowable or unallowable; rather, determination of allowability in each case should be based on the treatment provided for similar or related items of cost and the principles described in 2 CFR sections 200.402 through 200.411.

## List of Selected Items of Cost Contained in 2 CFR part 200

The following exhibit provides a listing of selected items of cost contained in the cost principles in 2 CFR part 200, subpart E. Several cost items are unique to one type of entity (e.g., commencement and convocation costs are applicable only to IHEs).

The exhibit lists the selected items of cost along with a brief description of their allowability. The reader is strongly cautioned not to rely exclusively on the summary but to place primary reliance on the referenced 2 CFR part 200 text.

### Selected Items of Cost - Exhibit 1

Selected Cost Item	Uniform Guidance General Reference	Items of Cost Requiring Prior Approval	States, Local Governments, Indian Tribes	Institutions of Higher Education	Nonprofit Organizations	Items of Cost not Treated the Same Across Non-Federal Entities
Advertising and public relations costs	§200.421		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Advisory councils	§200.422		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Alcoholic beverages	§200.423		Unallowable	Unallowable	Unallowable	
Alumni/ae activities	§200.424		Not specifically addressed	Unallowable	Not specifically addressed	X
Audit services	§200.425		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Bad debts	§200.426		Unallowable	Unallowable	Unallowable	
Bonding costs	§200.427		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Collection of improper payments	§200.428		Allowable	Allowable	Allowable	
Commencement and convocation costs	§200.429		Not specifically addressed	Unallowable with exceptions	Not specifically addressed	X
Compensation for personal services	§200.430	X (related to the salaries of administrative and clerical staff)	Allowable with restrictions; Special conditions apply (e.g., §200.430(i)(5))	Allowable with restrictions; Special conditions apply (e.g., §200.430(h))	Allowable with restrictions; Special conditions apply (e.g., §200.430(g))	X

Selected Cost Item	Uniform Guidance General Reference	Items of Cost Requiring Prior Approval	States, Local Governments, Indian Tribes	Institutions of Higher Education	Nonprofit Organizations	Items of Cost not Treated the Same Across Non-Federal Entities
Compensation – fringe benefits	§200.431	X (related to costs for IHEs)	Allowable with restrictions	Allowable with restrictions; Special conditions apply	Allowable with restrictions	X
Conferences	§200.432		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Contingency provisions	§200.433		Unallowable with exceptions	Unallowable with exceptions	Unallowable with exceptions	
Contributions and donations	§200.434		Unallowable (made by non-federal entity); not reimbursable but value may be used as cost sharing or matching (made to non-federal entity)	Unallowable (made by non-federal entity); not reimbursable but value may be used as cost sharing or matching (made to non-federal entity)	Unallowable (made by non-federal entity); not reimbursable, but value may be used as cost sharing or matching (made to non-federal entity); with restrictions, the value of services may be considered when determining an entity’s indirect cost rate under certain circumstances	X
Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringements	§200.435		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Depreciation	§200.436		Allowable with qualifications	Allowable with qualifications	Allowable with qualifications	
Employee health and welfare costs	§200.437		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	

<b>Selected Cost Item</b>	<b>Uniform Guidance General Reference</b>	<b>Items of Cost Requiring Prior Approval</b>	<b>States, Local Governments, Indian Tribes</b>	<b>Institutions of Higher Education</b>	<b>Nonprofit Organizations</b>	<b>Items of Cost not Treated the Same Across Non-Federal Entities</b>
Entertainment costs	§200.438	X	Unallowable with exceptions	Unallowable with exceptions	Unallowable with exceptions	
Equipment and other capital expenditures	§200.439	X	Allowability based on specific requirements	Allowability based on specific requirements	Allowability based on specific requirements	
Exchange rates	§200.440	X	Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Fines, penalties, damages and other settlements	§200.441	X	Unallowable with exception	Unallowable with exception	Unallowable with exception	
Fund raising and investment management costs	§200.442	X	Unallowable with exceptions	Unallowable with exceptions	Unallowable with exceptions	
Gains and losses on disposition of depreciable assets	§200.443		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
General costs of government	§200.444		Unallowable with exceptions	Not specifically addressed	Not specifically addressed	X
Goods or services for personal use	§200.445	X	Unallowable (goods/services); allowable (housing) with restrictions	Unallowable (goods/services); allowable (housing) with restrictions	Unallowable (goods/services); allowable (housing) with restrictions	
Idle facilities and idle capacity	§200.446		Idle facilities - unallowable with exceptions; idle capacity - allowable with restrictions	Idle facilities - unallowable with exceptions; idle capacity - allowable with restrictions	Idle facilities - unallowable with exceptions; idle - capacity allowable with restrictions	
Insurance and indemnification	§200.447	X	Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	

<b>Selected Cost Item</b>	<b>Uniform Guidance General Reference</b>	<b>Items of Cost Requiring Prior Approval</b>	<b>States, Local Governments, Indian Tribes</b>	<b>Institutions of Higher Education</b>	<b>Nonprofit Organizations</b>	<b>Items of Cost not Treated the Same Across Non-Federal Entities</b>
Intellectual property	§200.448		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Interest	§200.449		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	X
Lobbying	§200.450		Unallowable	Unallowable; Special additional restrictions	Unallowable; Special additional restrictions	X
Losses on other awards or contracts	§200.451		Unallowable (however, they are required to be included in the indirect cost rate base for allocation of indirect costs)	Unallowable (however, they are required to be included in the indirect cost rate base for allocation of indirect costs)	Unallowable (however, they are required to be included in the indirect cost rate base for allocation of indirect costs)	
Maintenance and repair costs	§200.452		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Materials and supplies costs, including computing devices	§200.453		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Memberships, subscriptions, and professional activity costs	§200.454	X	Allowable with restrictions; unallowable for lobbying organizations.	Allowable with restrictions; unallowable for lobbying organizations	Allowable with restrictions; unallowable for lobbying organizations.	
Organization costs	§200.455	X	Unallowable except federal prior approval	Unallowable except federal prior approval	Unallowable except federal prior approval	
Participant support costs	§200.456	X	Allowable with prior approval of the federal awarding agency	Allowable with prior approval of the federal awarding agency	Allowable with prior approval of the federal awarding agency	
Plant and security costs	§200.457		Allowable; capital expenditures are subject to	Allowable; capital expenditures are subject to	Allowable; capital expenditures are subject to	

Selected Cost Item	Uniform Guidance General Reference	Items of Cost Requiring Prior Approval	States, Local Governments, Indian Tribes	Institutions of Higher Education	Nonprofit Organizations	Items of Cost not Treated the Same Across Non-Federal Entities
			§200.439	§200.439	§200.439	
Professional service costs	§200.459		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Proposal costs	§200.460		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Publication and printing costs	§200.461		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Rearrangement and reconversion costs	§200.462	X	Allowable (ordinary and normal)	Allowable (ordinary and normal)	Allowable (ordinary and normal)	
Recruiting costs	§200.463		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Relocation costs of employees	§200.464		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Rental costs of real property and equipment	§200.465		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Scholarships and student aid costs	§200.466		Not specifically addressed	Allowable with restrictions	Not specifically addressed	X
Selling and marketing costs	§200.467	X	Unallowable with exceptions	Unallowable with exceptions	Unallowable with exceptions	
Specialized service facilities	§200.468		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Student activity costs	§200.469		Unallowable unless specifically provided for in the federal award	Unallowable unless specifically provided for in the federal award	Unallowable unless specifically provided for in the federal award	
Taxes (including Value Added Tax)	§200.470		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	X
Termination costs	§200.471		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	

Selected Cost Item	Uniform Guidance General Reference	Items of Cost Requiring Prior Approval	States, Local Governments, Indian Tribes	Institutions of Higher Education	Nonprofit Organizations	Items of Cost not Treated the Same Across Non-Federal Entities
Training and education costs	§200.472		Allowable for employee development	Allowable for employee development	Allowable for employee development	
Transportation costs	§200.473		Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Travel costs	§200.474	X	Allowable with restrictions	Allowable with restrictions	Allowable with restrictions	
Trustees	§200.475		Not specifically addressed	Allowable with restrictions	Allowable with restrictions	X

### Suggested Internal Control Audit Procedures

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for allowable costs/cost principles and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum, and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the risk of non-compliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

### Indirect Cost Rate

Except for those non-federal entities described in 2 CFR part 200, Appendix VII, paragraph D.1.b, if a non-federal entity has never received a negotiated indirect cost rate, it may elect to charge a de minimis rate of 10 percent of modified total direct costs (MTDC). Such a rate may be used indefinitely or until the non-federal entity chooses to negotiate a rate, which the non-federal entity may do at any time. If a non-federal entity chooses to use the de minimis rate, that rate must be used consistently for all of its federal awards. Also, as described in 2 CFR section 200.403, costs must be consistently charged as either indirect or direct, but may not be double charged or inconsistently charged as both. In accordance with 2 CFR section 200.400(g), a non-federal entity may not earn or keep any profit resulting from federal financial assistance, unless explicitly authorized by the terms and conditions of the award. A non-federal entity can always choose to charge the federal awards less than the negotiated rates or the de minimis rate.

*Audit Objectives – De Minimis Indirect Cost Rate*

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. Determine that the de minimis rate is applied to the appropriate base amount.
3. Determine that the de minimis rate is used consistently by a non-federal entity under its federal awards.

*Suggested Compliance Audit Procedures – De Minimis Indirect Cost Rate*

The following suggested audit procedures apply to any non-federal entity using a de minimis indirect cost rate, whether as a recipient or subrecipient. None of the procedures related to indirect costs in the sections organized by type of non-federal entity apply when a de minimis rate is used.

1. Determine that the non-federal entity has not previously claimed indirect costs on the basis of a negotiated rate. Auditors are required to test only for the three fiscal years immediately prior to the current audit period.
2. Test a sample of transactions for conformance with 2 CFR section 200.414(f).
  - a. Select a sample of claims for reimbursement of indirect costs and verify that the de minimis rate was used consistently, the rate was applied to the appropriate base, and the amounts claimed were the product of applying the rate to a modified total direct costs base.
  - b. Verify that the costs included in the base are consistent with the costs that were included in the base year, i.e., verify that current year modified total direct costs do not include costs items that were treated as indirect costs in the base year.
3. For a non-federal entity conducting a single function, which is predominately funded by federal awards, determine whether use of the de minimis indirect cost rate resulted in the non-federal entity double-charging or inconsistently charging costs as both direct and indirect.

## 2 CFR PART 200

### COST PRINCIPLES FOR STATES, LOCAL GOVERNMENTS, AND INDIAN TRIBES

#### Introduction

The 2 CFR part 200, subpart E and appendices III–VII establish principles and standards for determining allowable direct and indirect costs for federal awards. This section is organized into the following areas of allowable costs: states and local government and Indian tribe costs (direct and indirect); state/local government central service costs; and state public assistance agency costs.

#### Cognizant Agency for Indirect Costs

The 2 CFR part 200, Appendix V, paragraph F, provides the guidelines to use when determining the federal agency that will serve as the cognizant agency for indirect costs for states, local governments, and Indian tribes. References to the “cognizant agency for indirect costs” are not equivalent to the cognizant agency for audit responsibilities, which is defined in 2 CFR section 200.18. In addition, the change from the term “cognizant agency” in OMB Circular A-87 to the term “cognizant agency for indirect costs” in 2 CFR part 200 was not intended to change the scope of cognizance for central service or public assistance cost allocation plans.

For indirect cost rates and departmental indirect cost allocation plans, the cognizant agency is the federal agency with the largest value of *direct* federal awards (excluding pass-through awards) with a governmental unit or component, as appropriate. In general, unless different arrangements are agreed to by the concerned federal agencies or described in 2 CFR part 200, Appendix V, paragraph F, the cognizant agency for central service cost allocation plans is the federal agency with the largest dollar value of *total* federal awards (including pass-through awards) with a governmental unit.

Once designated as the cognizant agency for indirect costs, the federal agency remains so for a period of five years. In addition, 2 CFR part 200, Appendix V, paragraph F, lists the cognizant agencies for certain specific types of plans and the cognizant agencies for indirect costs for certain types of governmental entities. For example, HHS is cognizant for all public assistance and state-wide cost allocation plans for all states (including the District of Columbia and Puerto Rico), state and local hospitals, libraries, and health districts, and the Department of the Interior (DOI) is cognizant for all Indian tribal governments, territorial governments, and state and local park and recreational districts.

#### Allowable Costs—Direct and Indirect Costs

The individual state/local government/Indian tribe departments or agencies (also known as “operating agencies”) are responsible for the performance or administration of federal awards. In order to receive cost reimbursement under federal awards, the department or agency usually submits claims asserting that allowable and eligible costs (direct and indirect) have been incurred in accordance with 2 CFR part 200, subpart E.

The indirect cost rate proposal (ICRP) provides the documentation prepared by a state/local government/Indian tribe department or agency to substantiate its request for the establishment of

an indirect cost rate. The indirect costs include (1) costs originating in the department or agency of the governmental unit carrying out federal awards, and (2) for states and local governments, costs of central governmental services distributed through the state/local government-wide central service CAP that are not otherwise treated as direct costs. The ICRPs are based on the most current financial data and are used to either establish predetermined, fixed, or provisional indirect cost rates or to finalize provisional rates (for rate definitions refer to 2 CFR part 200, Appendix VII, paragraph B).

### **1. Compliance Requirements – Direct Costs**

- a. Direct costs are those costs that can be identified specifically with a particular final cost objective, such as a federal award or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy.
- b. Costs incurred for the same purpose in like circumstances must be treated consistently as either direct or indirect costs.

### **2. Audit Objectives – Direct Costs**

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. Determine whether the organization complied with the provisions of 2 CFR part 200) as follows:
  - (1) Direct charges to federal awards were for allowable costs.
  - (2) Unallowable costs determined to be direct costs were included in the allocation base for the purpose of computing an indirect cost rate.

### **3. Suggested Compliance Audit Procedures – Direct Costs**

Test a sample of transactions for conformance with the following criteria contained in 2 CFR part 200, as applicable:

- a. If the auditor identifies unallowable direct costs, the auditor should be aware that “directly associated costs” might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would not have been incurred if the other cost had not been incurred. For example, fringe benefits are “directly associated” with payroll costs. When an unallowable cost is incurred, directly associated costs are also unallowable.
- b. Costs were approved by the federal awarding agency, if required (see the above table (Selected Items of Cost, Exhibit 1) or 2 CFR section 200.407 for selected items of cost that require prior written approval).

- c. Costs did not consist of improper payments, including (1) payments that should not have been made or that were made in incorrect amounts (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements; (2) payments that do not account for credit for applicable discounts; (3) duplicate payments; (4) payments that were made to an ineligible party or for an ineligible good or service; and (5) payments for goods or services not received (except for such payments where authorized by law).
- d. Costs were necessary and reasonable for the performance of the federal award and allocable under the principles of 2 CFR part 200, subpart E.
- e. Costs conformed to any limitations or exclusions set forth in 2 CFR part 200, subpart E, or in the federal award as to types or amount of cost items.
- f. Costs were consistent with policies and procedures that apply uniformly to both federally financed and other activities of the state/local government/Indian tribe department or agency.
- g. Costs were accorded consistent treatment. Costs were not assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances was allocated to the federal award as an indirect cost.
- h. Costs were not included as a cost of any other federally financed program in either the current or a prior period.
- i. Costs were not used to meet the cost-sharing or matching requirements of another federal program, except where authorized by federal statute.
- j. Costs were adequately documented.

## **1. Compliance Requirements – Indirect Costs**

- a. *Allocation of Indirect Costs and Determination of Indirect Cost Rates*
  - (1) The specific methods for allocating indirect costs and computing indirect cost rates are as follows:
    - (a) *Simplified Method* – This method is applicable where a governmental unit’s department or agency has only one major function, or where all its major functions benefit from the indirect cost to approximately the same degree. The allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures described in 2 CFR part 200, Appendix VII, paragraph C.2.

- (b) *Multiple Allocation Base Method* – This method is applicable where a governmental unit’s department or agency has several major functions that benefit from its indirect costs in varying degrees. The allocation of indirect costs may require the accumulation of such costs into separate groupings which are then allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. (For detailed information, refer to 2 CFR part 200, Appendix VII, paragraph C.3.)
  - (c) *Special Indirect Cost Rates* – In some instances, a single indirect cost rate for all activities of a department or agency may not be appropriate. Different factors may substantially affect the indirect costs applicable to a particular program or group of programs, e.g., the physical location of the work, the nature of the facilities, or level of administrative support required. (For the requirements for a separate indirect cost rate, refer to 2 CFR part 200, Appendix VII, paragraph C.4.)
  - (d) *Cost Allocation Plans* – In certain cases, the cognizant agency for indirect costs may require a state or local government or unit’s department or agency to prepare a CAP instead of an ICRP. These are infrequently occurring cases in which the nature of the department or agency’s federal awards makes impracticable the use of a rate to recover indirect costs. A CAP required in such cases consists of narrative descriptions of the methods the department or agency uses to allocate indirect costs to programs, awards, or other cost objectives. Like an ICRP, the CAP either must be submitted to the cognizant agency for indirect cost for review, negotiation, and approval, or retained on file for inspection during audits.
- b. *Submission Requirements*
- (1) Submission requirements are identified in 2 CFR part 200, Appendix VII, paragraph D.1. All departments or agencies of a governmental unit claiming indirect costs under federal awards must prepare an ICRP and related documentation to support those costs.
  - (2) A state/local department or agency or Indian tribe that receives more than \$35 million in direct federal funding must submit its ICRP to its cognizant agency for indirect costs. Other state/local government departments or agencies that are not required to submit a proposal to the cognizant agency for indirect costs must develop an ICRP in accordance with the requirements of 2 CFR part 200, and maintain the proposal and related supporting documentation for audit.

- (3) Where a government receives funds as a subrecipient only, the pass-through entity will be responsible for the indirect cost rate used (2 CFR section 200.331(a)(4).
- (4) Each Indian tribe desiring reimbursement of indirect costs must submit its ICRP to the DOI (its cognizant agency for indirect costs).
- (5) ICRPs must be developed (and, when required, submitted) within 6 months after the close of the governmental unit's fiscal year, unless an exception is approved by the cognizant agency for indirect costs.

c. *Documentation and Certification Requirements*

The documentation and certification requirements for ICRPs are included in 2 CFR part 200, Appendix VII, paragraphs D.2 and 3, respectively. The proposal and related documentation must be retained for audit in accordance with the record retention requirements contained in 2 CFR section 200.333(f).

## 2. **Audit Objectives – Indirect Costs**

- a. Obtain an understanding of internal control over the compliance requirements for state/local government/Indian tribe department or agency costs, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. Determine whether the governmental unit complied with the provisions of 2 CFR part 200 as follows:
  - (1) Charges to cost pools used in calculating indirect cost rates were for allowable costs.
  - (2) The methods for allocating the costs are in accordance with the cost principles, and produce an equitable and consistent distribution of costs (e.g., all activities that benefit from the indirect cost, including unallowable activities, must receive an appropriate allocation of indirect costs).
  - (3) Indirect cost rates were applied in accordance with negotiated indirect cost rate agreements (ICRA).
  - (4) For state/local departments or agencies that do not have to submit an ICRP to the cognizant agency for indirect costs (those that receive less than \$35 million in direct federal awards), indirect cost rates were applied in accordance with the ICRP maintained on file.

### 3. Suggested Compliance Audit Procedures – Indirect Costs

- a. If the state/local department or agency is not required to submit an ICRP and related supporting documentation, the auditor should consider the risk of the reduced level of oversight in designing the nature, timing, and extent of compliance testing.
- b. *General Audit Procedures* – The following procedures apply to charges to cost pools that are allocated wholly or partially to federal awards or used in formulating indirect cost rates used for recovering indirect costs under federal awards.
  - (1) Test a sample of transactions for conformance with:
    - (a) The criteria contained in the “Basic Considerations” section of 2 CFR sections 200.402 through 200.411.
    - (b) The principles to establish allowability or unallowability of certain items of cost (2 CFR sections 200.420 through 200.475).
  - (2) If the auditor identifies unallowable costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would have not been incurred if the other cost had not been incurred. When an unallowable cost is incurred, directly associated costs are also unallowable. For example, occupancy costs related to unallowable general costs of government are also unallowable.
- c. *Special Audit Procedures for State, Local Government, and Indian Tribe ICRPs*
  - (1) Verify that the ICRP includes the required documentation in accordance with 2 CFR part 200, Appendix VII, paragraph D.
  - (2) *Testing of the ICRP* – There may be a timing consideration when the audit is completed before the ICRP is completed. In this instance, the auditor should consider performing interim testing of the costs charged to the cost pools and the allocation bases (e.g., determine from management the cost pools that management expects to include in the ICRP and test the costs for compliance with 2 CFR part 200). If there are audit exceptions, corrective action may be taken earlier to minimize questioned costs. In the next year’s audit, the auditor should complete testing and verify management’s representations against the completed ICRP.

The following procedures are some acceptable options the auditor may use to obtain assurance that the costs collected in the cost pools and the allocation methods used are in compliance with 2 CFR part 200, subpart E:

- (a) *Indirect Cost Pool* – Test the indirect cost pool to ascertain if it includes only allowable costs in accordance with 2 CFR part 200.
  - (i) Test to ensure that unallowable costs are identified and eliminated from the indirect cost pool (e.g., capital expenditures, general costs of government).
  - (ii) Identify significant changes in expense categories between the prior ICRP and the current ICRP. Test a sample of transactions to verify the allowability of the costs.
  - (iii) Trace the central service costs that are included in the indirect cost pool to the approved state/local government or central service CAP or to plans on file when submission is not required.
- (b) *Direct Cost Base* – Test the methods of allocating the costs to ascertain if they are in accordance with the applicable provisions of 2 CFR part 200 and produce an equitable distribution of costs.
  - (i) Determine that the proposed base(s) includes all activities that benefit from the indirect costs being allocated.
  - (ii) If the direct cost base is not limited to direct salaries and wages, determine that distorting items are excluded from the base. Examples of distorting items include capital expenditures, flow-through funds (such as benefit payments), and subaward costs in excess of \$25,000 per subaward.
  - (iii) Determine the appropriateness of the allocation base (e.g., salaries and wages, modified total direct costs).
- (c) *Other Procedures*
  - (i) Examine the records for employee compensation to ascertain if they are accurate, and the costs are allowable and properly allocated to the various functional and programmatic activities to which salary and wage costs are charged. (Refer to 2 CFR section 200.430 for additional information on support of salaries and wages.)
  - (ii) For an ICRP using the multiple allocation base method, test statistical data (e.g., square footage, audit hours, salaries and wages) to ascertain if the proposed allocation or rate bases are reasonable, updated as necessary, and do not contain any material omissions.

- (3) *Testing of Charges Based Upon the ICRA* – Perform the following procedures to test the application of charges to federal awards based upon an ICRA:
  - (a) Obtain and read the current ICRA and determine the terms in effect.
  - (b) Select a sample of claims for reimbursement and verify that the rates used are in accordance with the rate agreement, that rates were applied to the appropriate bases, and that the amounts claimed were the product of applying the rate to the applicable base. Verify that the costs included in the base(s) are consistent with the costs that were included in the base year (e.g., if the allocation base is total direct costs, verify that current-year direct costs do not include costs items that were treated as indirect costs in the base year).
- (4) *Other Procedures – No Negotiated ICRA*
  - (a) If an indirect cost rate has not been negotiated by a cognizant agency for indirect costs, the auditor should determine whether documentation exists to support the costs. Where the auditee has documentation, the suggested general audit procedures under paragraph 3.b above should be performed to determine the appropriateness of the indirect cost charges to awards.
  - (b) If an indirect cost rate has not been negotiated by a cognizant agency for indirect costs, and documentation to support the indirect costs does not exist, the auditor should question the costs based on a lack of supporting documentation.

### **Allowable Costs – State/Local Government-Wide Central Service Costs**

Most governmental entities provide services, such as accounting, purchasing, computer services, and fringe benefits, to operating agencies on a centralized basis. Since federal awards are performed within the individual operating agencies, there must be a process whereby these central service costs are identified and assigned to benefiting operating agency activities on a reasonable and consistent basis. The state/local government-wide central service cost allocation plan (CAP) provides that process. (Refer to 2 CFR part 200, Appendix V, for additional information and specific requirements.)

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

Allocated central service costs (referred to as Section I costs) are allocated to benefiting operating agencies on some reasonable basis. These costs are usually negotiated and approved

for a future year on a “fixed-with-carry-forward” basis. Examples of such services might include general accounting, personnel administration, and purchasing. Section I costs assigned to an operating agency through the state/local government-wide central service CAP are typically included in the agency’s indirect cost pool.

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

## **1. Compliance Requirements – State/Local Government-Wide Central Service Costs**

### *a. Submission Requirements*

- (1) Submission requirements are identified in 2 CFR part 200, Appendix V, paragraph D.
- (2) A state is required to submit a state-wide central service CAP to HHS for each year in which it claims central service costs under federal awards.
- (3) A “major local government” is required to submit a central service CAP to its cognizant agency for indirect costs annually. *Major local government* means a local government that receives more than \$100 million in direct federal awards (not including pass-through awards) subject to 2 CFR part 200, subpart E. All other local governments claiming central service costs must develop a CAP in accordance with the requirements described in 2 CFR part 200 and maintain the plan and related supporting documentation for audit. These local governments are not required to submit the plan for federal approval unless they are specifically requested to do so by the cognizant agency for indirect costs.
- (4) All central service CAPs will be prepared and, when required, submitted within the 6 months prior to the beginning of the governmental unit’s fiscal years in which it proposes to claim central service costs. Extensions may be granted by the cognizant agency for indirect costs on a case-by-case basis.

### *b. Documentation Requirements*

- (1) The central service CAP must include all central service costs that will be claimed (either as an allocated or a billed cost) under federal awards. Costs of central services omitted from the CAP will not be reimbursed.
- (2) The documentation requirements for all central service CAPs are contained in 2 CFR part 200 Appendix V, paragraph E. All plans and

related documentation used as a basis for claiming costs under federal awards must be retained for audit in accordance with the record retention requirements contained in 2 CFR section 200.333(f).

- c. *Required Certification* – No proposal to establish a central service CAP, whether submitted to the cognizant agency for indirect costs or maintained on file by the governmental unit, will be accepted and approved unless such costs have been certified by the governmental unit using the Certificate of Cost Allocation Plan as set forth in 2 CFR part 200, Appendix V, paragraph E.4.
- d. *Allocated Central Service Costs (Section I Costs)* – A carry-forward adjustment is not permitted for a central service activity that was not included in the approved plan, or for unallowable costs that must be reimbursed immediately (2 CFR part 200, Appendix V, paragraph G.3).
- e. *Billed Central Service Costs (Section II Costs)*
  - (1) Each billed central service activity must separately account for all revenues (including imputed revenues) generated by the service, expenses incurred to furnish the service, and profit/loss (2 CFR part 200, Appendix V, paragraph G.1).
  - (2) Internal service funds for central service activities are allowed a working capital reserve of up to 60 calendar days cash expenses for normal operating purposes (2 CFR part 200, Appendix V, paragraph G.2). A working capital reserve exceeding 60 calendar days may be approved by the cognizant agency for indirect costs in exceptional cases.
  - (3) Adjustments of billed central services are required when there is a difference between the revenue generated by each billed service and the actual allowable costs (2 CFR part 200, Appendix V, paragraph G.4). A comparison of the revenue generated by each billed service (including total revenues whether or not billed or collected) to the actual allowable costs of the service will be made at least annually, and an adjustment will be made for the difference between the revenue and the allowable costs. The adjustments will be made through one of the following methods, at the option of the cognizant agency:
    - (a) If revenue exceeds costs, a cash refund to the federal government for the federal share of the adjustment, including earned or imputed interest from the date of expenditure and debt interest, if applicable, chargeable in accordance with applicable cognizant agency for indirect costs regulations;
    - (b) Credits to the amounts charged to the individual programs;
    - (c) Adjustments to future billing rates; or

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

(4) Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund), refunds must be made to the federal government for its share of funds transferred, including earned or imputed interest from the date of transfer and debt interest, if applicable, chargeable in accordance with applicable cognizant agency for indirect cost claims collection regulations (2 CFR section 200.447(d)(5)).

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

- a. Obtain an understanding of internal control over the compliance requirements for central service costs, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. Determine whether the governmental unit complied with the provisions of 2 CFR part 200 as follows:
  - (1) Charges to cost pools allocated to federal awards through the central service CAPs were for allowable costs.
  - (2) The methods of allocating the costs are in accordance with the cost principles, and produce an equitable and consistent distribution of costs, which benefit from the central service costs being allocated (e.g., cost allocation bases include all activities, including all state departments and agencies and, if appropriate, non-state organizations which receive services).
  - (3) Cost allocations were in accordance with central service CAPs approved by the cognizant agency for indirect costs or, in cases where such plans are not subject to approval, in accordance with the plan on file.

## 3. **Suggested Compliance Audit Procedures – State/Local Government-Wide Central Service Costs**

- a. For local governments that are not required to submit the central service CAP and related supporting documentation, the auditor should consider the risk of the reduced level of oversight in designing the nature, timing and extent of compliance testing.
- b. *General Audit Procedures for State/Local Government-Wide Central Service CAPs* – The following procedures apply to charges to cost pools that are allocated wholly or partially to federal awards or used in formulating indirect cost rates used for recovering indirect costs under federal awards.

- (1) Test a sample of transactions for conformance with:
    - (a) The criteria contained in the “Basic Considerations” section of 2 CFR part 200, subpart E (sections 200.402 through 200.411).
    - (b) The principles to establish allowability or unallowability of certain items of cost (2 CFR sections 200.420 through 475).
  - (2) If the auditor identifies unallowable costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would have not been incurred if the other cost had not been incurred. When an unallowable cost is incurred, directly associated costs are also unallowable. For example, occupancy costs related to unallowable general costs of government are also unallowable.
- c. *Special Audit Procedures for State/Local Government-Wide Central Service CAPs*
- (1) Verify that the central service CAP includes the required documentation in accordance with 2 CFR part 200 Appendix V, paragraph E.
  - (2) *Testing of the State/Local Government-Wide Central Service CAPs – Allocated Section I Costs*
    - (a) If new allocated central service costs were added, review the justification for including the item as Section I costs to ascertain if the costs are allowable (e.g., if costs benefit federal awards).
    - (b) Identify the central service costs that incurred a significant increase in actual costs from the prior year’s costs. Test a sample of transactions to verify the allowability of the costs.
    - (c) Ascertain if the bases used to allocate costs are appropriate, i.e., costs are allocated in accordance with relative benefits received.
    - (d) Ascertain if the proposed bases include all activities that benefit from the central service costs being allocated, including all users that receive the services. For example, the state-wide central service CAP should allocate costs to all benefiting state departments and agencies, and, where appropriate, non-state organizations, such as local government agencies.
    - (e) Perform an analysis of the allocation bases by selecting agencies with significant federal awards to determine if the percentage of costs allocated to these agencies has increased from the prior year. For those selected agencies with significant allocation percentage

increases, ascertain if the data included in the bases are current and accurate.

- (f) Verify that carry-forward adjustments are properly computed in accordance with 2 CFR part 200, Appendix V, paragraph G.3.
- (3) *Testing of the State/Local Government-Wide Central Service CAPs – Billed Section II Costs*
- (a) For billed central service activities accounted for in separate funds (e.g., internal service funds), ascertain if:
    - (i) Retained earnings/fund balances (including reserves) are computed in accordance with the cost principles;
    - (ii) Working capital reserves are not excessive in amount (generally not greater than 60 calendar days for cash expenses for normal operations incurred for the period exclusive of depreciation, capital costs, and debt principal costs); and
    - (iii) Adjustments were made when there is a difference between the revenue generated by each billed service and the actual allowable costs.
  - (b) Test to ensure that all users of services are billed in a consistent manner. For example, examine selected billings to determine if all users (including users outside the governmental unit) are charged the same rate for the same service.
  - (c) Test that billing rates exclude unallowable costs, in accordance with the cost principles and federal statutes.
  - (d) Test, where billed central service activities are funded through general revenue appropriations, that the billing rates (or charges) were developed based on actual costs and were adjusted to eliminate profits.
  - (e) For self-insurance and pension funds, ascertain if the fund contributions are appropriate for such activities as indicated in the current actuarial report.
  - (f) Determine if refunds were made to the federal government for its share of funds transferred from the self-insurance reserve to other accounts, including imputed or earned interest from the date of the transfer.

## **Allowable Costs – State Public Assistance Agency Costs**

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

2 CFR part 200, Appendix VI, paragraph A, states that, since the federally financed programs administered by state public assistance agencies are funded predominantly by HHS, HHS is responsible for the requirements for the development, documentation, submission, negotiation, and approval of public assistance CAPs. These requirements are specified in 45 CFR part 95, subpart E.

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

### **1. Compliance Requirements – State Public Assistance Agency Costs**

#### *a. Submission Requirements*

Unlike most state/local government-wide central service CAPs and ICRPs, an annual submission of the public assistance CAP is not required. Once a public assistance CAP is approved, state public assistance agencies are required to promptly submit amendments to the plan if any of the following events occur (45 CFR section 95.509):

- (1) The procedures shown in the existing CAP become outdated because of organizational changes, changes to the federal law or regulations, or significant changes in the program levels, affecting the validity of the approved cost allocation procedures.
- (2) A material defect is discovered in the CAP.
- (3) The CAP for public assistance programs is amended so as to affect the allocation of costs.
- (4) Other changes occur which make the allocation basis or procedures in the approved CAP invalid.

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

- b. *Documentation Requirements* – A state may claim federal financial participation for costs associated with a program only in accordance with its approved CAP. The public assistance CAP requirements are contained in 45 CFR section 95.507.
- c. *Implementation of Approved Public Assistance CAPs* – Since public assistance CAPs are of a narrative nature, the federal government needs assurance that the CAP has been implemented as approved. This is accomplished by funding agencies' reviews, single audits, or audits conducted by the cognizant agency for audit (2 CFR part 200 Appendix VI, paragraph E.1).

## **2. Audit Objectives – State Public Assistance Agency Costs**

- a. Obtain an understanding of internal control over the compliance requirements for state public assistance agency costs, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. Determine whether the governmental unit complied with the provisions of 2 CFR part 200 as follows:
  - (1) Direct charges to federal awards were for allowable costs.
  - (2) Charges to cost pools allocated to federal awards through the public assistance CAP were for allowable costs.
  - (3) The approved public assistance CAP correctly describes the actual procedures used to identify, measure, and allocate costs to each of the programs operated by the state public assistance agency. However, the actual procedures or methods of allocating costs must be in accordance with the cost principles, and produce an equitable and consistent distribution of costs.
  - (4) Charges to federal awards are in accordance with the approved public assistance CAP. This does not apply if the auditor first determines that the approved CAP is not in compliance with the cost principles and/or produces an inequitable distribution of costs.
  - (5) The employee compensation reporting systems are implemented and operated in accordance with the methodologies described in the approved public assistance CAP.

## **3. Suggested Compliance Audit Procedures – State Public Assistance Agency Costs**

- a. Since a significant amount of the costs in the public assistance CAP are allocated based on employee compensation reporting systems, it is suggested that the auditor consider the risk when designing the nature, timing, and extent of compliance testing.

- b. *General Audit Procedures* – The following procedures apply to direct charges to federal awards as well as charges to cost pools that are allocated wholly or partially to federal awards.
- (1) Test a sample of transactions for conformance with:
    - (a) The criteria contained in the “Basic Considerations” section of 2 CFR part 200 (sections 200.402 through 200.411).
    - (b) The principles to establish allowability or unallowability of certain items of cost (2 CFR sections 200.420 through 200.475).
  - (2) If the auditor identifies unallowable costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would have not been incurred if the other cost had not been incurred. When an unallowable cost is incurred, directly associated costs are also unallowable. For example, occupancy costs related to unallowable general costs of government are also unallowable.
- c. *Special Audit Procedures for Public Assistance CAPs*
- (1) Verify that the state public assistance agency is complying with the submission requirements, i.e., an amendment is promptly submitted when any of the events identified in 45 CFR section 95.509 occur.
  - (2) Verify that public assistance CAP includes the required documentation in accordance with 45 CFR section 95.507.
  - (3) *Testing of the Public Assistance CAP* – Test the methods of allocating the costs to ascertain if they are in accordance with the applicable provisions of the cost principles and produce an equitable distribution of costs. Appropriate detailed tests may include:
    - (a) Examining the results of the employee compensation system or in addition the records for employee compensation to ascertain if they are accurate, allowable, and properly allocated to the various functional and programmatic activities to which salary and wage costs are charged.
    - (b) Since the most significant cost pools in terms of dollars are usually allocated based upon the distribution of income maintenance and social services workers’ efforts identified through random moment time studies, determining whether the time studies are implemented and operated in accordance with the methodologies described in the approved public assistance CAP. For example, verifying the adequacy of the controls governing the conduct and evaluation of the study, and determining that the sampled

observations were properly selected and performed, the documentation of the observations was properly completed, and the results of the study were correctly accumulated and applied. Testing may include observing or interviewing staff who participate in the time studies to determine if they are correctly recording their activities.

- (c) Testing statistical data (e.g., square footage, case counts, salaries and wages) to ascertain if the proposed allocation bases are reasonable, updated as necessary, and do not contain any material omissions.
- (4) *Testing of Charges Based Upon the Public Assistance CAP* – If the approved public assistance CAP is determined to be in compliance with the cost principles and produces an equitable distribution of costs, verify that the methods of charging costs to federal awards are in accordance with the approved CAP and the provisions of the approval documents issued by HHS. Detailed compliance tests may include:
- (a) Verifying that the cost allocation schedules, supporting documentation and allocation data are accurate and that the costs are allocated in compliance with the approved CAP.
  - (b) Reconciling the allocation statistics of labor costs to employee compensation records (e.g., random moment sampling observation forms).
  - (c) Reconciling the allocation statistics of non-labor costs to allocation data, (e.g., square footage or case counts).
  - (d) Verifying direct charges to supporting documents (e.g., purchase orders).
  - (e) Reconciling the costs to the federal claims.

## **2 CFR PART 200**

### **COST PRINCIPLES FOR INSTITUTIONS OF HIGHER EDUCATION**

#### **Introduction**

2 CFR part 200 establishes principles for determining the costs applicable to research and development, training, and other sponsored work performed by institutions of higher education (IHEs) under federal awards. These federal awards are referred to as sponsored agreements. This section is organized into the following areas of allowable costs: Direct Costs; Indirect Costs; Cost Accounting Standards (CAS) and Disclosure Statements and Special Requirements – Internal Service, Central Service, Pension, or Similar Activities or Funds.

At IHEs, indirect costs are accounted for through F&A cost proposals. F&A costs, for the purpose of 2 CFR part 200 and as defined at 2 CFR section 200.56, are synonymous with “indirect costs” and include costs that are incurred for common or joint objectives and, therefore, cannot be identified readily and specifically with a particular sponsored project, an instructional activity, or any other institutional activity. As described in 2 CFR section 200.414(a), the F&A cost categories include building and equipment depreciation; operations and maintenance expenses; interest expenses; general administrative expenses; departmental administration expenses; sponsored project administration expenses; library expenses; and student administration expenses. F&A costs are referred to as “indirect costs” in this section.

#### **Cognizant Agency for Indirect Costs**

2 CFR section 200.19 defines “cognizant agency for indirect costs” as the federal agency responsible for reviewing, negotiating, and approving indirect (F&A) costs rates on behalf of all federal agencies. References to the “cognizant agency for indirect costs” in this section are not equivalent to the cognizant agency for audit responsibilities, which is defined in 2 CFR section 200.18. 2 CFR part 200, Appendix III, paragraph C.11, assigns indirect cost cognizance to HHS or the Department of Defense (DoD), Office of Naval Research, normally depending on which of the two agencies (HHS or DoD) provides more funds to the educational institution for the most recent three years. Once designated as the cognizant agency for indirect costs, the federal agency remains so for a period of five years.

#### **Allowable Costs – Direct Costs**

##### **1. Compliance Requirements – Direct Costs**

- a. Direct costs are those costs that can be identified specifically with a particular final cost objective, such as a federal award, or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy.
- b. Costs incurred for the same purpose in like circumstances must be treated consistently as either direct or indirect (F&A) costs.

**2. Audit Objectives – Direct Costs**

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. Determine whether the organization complied with the provisions of 2 CFR part 200 and CAS (if applicable) as follows:
  - (1) Direct charges to federal awards were for allowable costs.
  - (2) Unallowable costs determined to be direct costs were included in the allocation base for the purpose of computing an indirect cost rate.

**3. Suggested Compliance Audit Procedures – Direct Costs**

Test a sample of transactions for conformance with the following criteria contained in 2 CFR part 200 and CAS, as applicable:

- a. If the auditor identifies unallowable direct costs, the auditor should be aware that “directly associated costs” might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would not have been incurred if the other cost had not been incurred. For example, fringe benefits are “directly associated” with payroll costs. When an unallowable cost is incurred, directly associated costs are also unallowable.
- b. Costs were approved by the federal awarding agency, if required (see 2 CFR section 200.407 for selected items of cost that require prior written approval and Exhibit 1 in this part of the Supplement for selected items of cost that require cognizant agency for indirect cost approval or federal awarding agency approval when charged to an award as direct costs).
- c. Costs did not include (1) improper payments that should not have been made or that were made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements; (2) overpayments and underpayments that were made to eligible recipients (e.g., payment that does not account for credit for applicable discounts, duplicate payment); and (3) payments that were made to an ineligible recipient or for ineligible goods or services, or payments for goods and services not received (except for such payments where authorized by law).
- d. Costs were necessary and reasonable for the performance of the federal award and allocable under the principles of 2 CFR part 200, subpart E.
- e. Costs conformed to any limitations or exclusions set forth in 2 CFR part 200, subpart E, or in the federal award as to types or amount of cost items.
- f. Costs were consistent with policies and procedures that apply uniformly to both federally financed and other activities of the IHE.

- g. Costs were accorded consistent treatment. Cost were not assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances was allocated to the federal award as an indirect cost.
- h. Costs were not 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.
- i. Costs were adequately documented.
- j. Departmental costs charged direct to institutional activities (i.e., research and development, instruction, other institutional activities) are consistently charged directly in like circumstances and are in accordance with the provisions of 2 CFR part 200 and CAS. Salaries of administrative and clerical staff normally should be treated as indirect costs. Direct charging of these costs may be appropriate only when certain conditions are met (2 CFR section 200.413(c)).
- k. Costs for general-purpose equipment charged as direct costs to institutional activities (i.e., research and development, instruction, other institutional activities) are consistently charged as direct, were approved by the federal awarding agency, and are in accordance with the provisions of 2 CFR part 200 and CAS.

### **Allowable Costs – Indirect Costs**

Indirect costs are those costs that are incurred for common or joint objectives and, therefore, cannot be identified readily and specifically with a particular sponsored project, an instructional activity, or any other institutional activity (2 CFR section 200.56).

Indirect costs are defined into two broad categories in 2 CFR section 200.414(a).

- “Facilities” is defined as depreciation on buildings, equipment and capital improvement, interest on debt associated with certain buildings, equipment and capital improvements, operations and maintenance expenses, and library expenses.
- “Administration” is defined as general administration and general expenses such as the director's office, accounting, personnel, and all other types of expenditures not listed specifically under one of the subcategories of “Facilities” (including cross allocations from other pools, where applicable).

**Note: Auditors are reminded that, for educational institutions, the F&A rate in effect at the time of an award is effective for the life of the award and, therefore, even if an award(s) has changed terms and conditions at the time of incremental funding based on 2 CFR part 200, the F&A rate might have been negotiated under OMB Circular A-21.**

## 1. Compliance Requirements – Indirect Costs

- a. In order to recover indirect costs, IHEs must prepare indirect cost rate proposals (ICRPs) in accordance with the guidelines provided in 2 CFR part 200, Appendix III, and submit them to the cognizant agency for indirect costs for approval (2 CFR part 200, Appendix III, paragraph C.11).
- b. ICRPs prepared by IHEs are based on the most current financial data supported by the institution's accounting system and audited financial statements. These ICRPs can be used to establish either predetermined rates, negotiated fixed rates with carry-forward provisions, or provisional rates (2 CFR part 200, Appendix III, paragraphs C.4, C.5, and C.6). The ICRP to be used to establish indirect cost rates must be certified by the IHE in accordance with 2 CFR part 200, Appendix III, paragraph F.2.
- c. As described in 2 CFR section 200.414(a), the indirect cost (F&A) categories include: depreciation on buildings, equipment and capital improvement, interest on debt associated with certain buildings, and operation and maintenance expenses. In general, the cost groupings established within a category should constitute a pool of items of expense that are considered to be of like nature in terms of their relative contribution to the particular cost objectives to which distribution is appropriate (2 CFR part 200, Appendix III, paragraph C.1.a). Cost categories should be established considering the general guidelines in 2 CFR part 200, Appendix III, section B.
- d. Each IHE's indirect cost rate process must be appropriately designed to determine that federal sponsors do not in any way subsidize the indirect costs of other sponsors, specifically activities sponsored by industry and foreign governments (2 CFR part 200, Appendix III, paragraph C.1.a.(3)).
- e. Administrative costs charged to sponsored agreements awarded or amended with effective dates beginning on or after the start of the IHE's first fiscal year which begins on or after October 1, 1991, must be limited to 26 percent of modified total direct costs, as defined in 2 CFR part 200, Appendix III, paragraph C.8.a. IHEs should not change their accounting or cost allocation methods which were in effect on May 1, 1991, if the effect is to (1) change the charging of a particular type of cost from indirect to direct or (2) reclassify or increase allocations from the administrative pools to the facilities pools or fringe benefits cost pools (but also see 2 CFR part 200, Appendix III, paragraph C.8.b).
- f. *Submission Requirement for Standard Format for Long-Form Proposals* – IHEs must use the standard format in accordance with 2 CFR 200 Appendix III, Paragraph E to submit ICRP to the cognizant agency for indirect costs. The cognizant agency for indirect costs may, on an institution-by-institution basis, grant exceptions from all or portions of Part II of the standard format. This requirement does not apply to IHEs that use the simplified method for calculating indirect cost rates, as described in 2 CFR part 200, Appendix III, paragraph C.12.

## 2. Audit Objectives – Indirect Costs

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. *If the institution has a negotiated indirect cost rate agreement*, determine that the rate(s) used to charge indirect costs is consistent with the appropriate ICRP (2 CFR part 200, Appendix III, paragraph C.11) or agreement with a pass-through entity (2 CFR section 200.331(a)(4)).
- c. *If the institution does not have a negotiated indirect cost rate agreement*, determine whether an ICRP was prepared, certified, and submitted by the educational institution to their cognizant agency for indirect costs. (The cognizant agency for indirect costs is responsible for negotiating and approving indirect cost rates; see 2 CFR part 200, Appendix III, paragraph C.11.) Verify that billings are based on the ICRP.
- d. *If the institution charges indirect costs to federal awards based on award-specific rate(s) required by a federal awarding agency*, determine that the award-specific rate(s) are the result of special circumstances such as required by law or regulation (2 CFR section 200.414(c)).
- e. Determine that the negotiated (or submitted) rate in effect at the time of the initial award is applied throughout the life of the sponsored agreement. “Life” means each competitive segment of a project. A competitive segment is a period of years approved by the federal awarding agency at the time of the award (2 CFR part 200, Appendix III, paragraph C.7).
- f. Determine that the negotiated (or submitted) rate(s) was applied to the appropriate distribution base (2 CFR part 200, Appendix III, paragraph C.2).
- g. Determine that indirect costs billed to sponsored agreements are the result of applying the negotiated (or submitted) rate(s) to the appropriate base amount(s). **Note:** When the maximum amount of allowable indirect costs under a limitation (i.e., an award-specific rate) is less than the total amount determined in accordance with the principles in 2 CFR part 200, the amount not recoverable under a sponsored agreement may not be charged to other sponsored agreements (2 CFR section 200.408).

## 3. Suggested Compliance Audit Procedures – Indirect Costs

- a. Test a sample of transactions for conformance with the following criteria contained in 2 CFR part 200 and CAS, as applicable.

- b. *For IHEs that charge indirect cost to federal awards based on a federally negotiated rate(s):*
- (1) Ascertain if indirect costs or centralized or administrative services costs were allocated or charged to a major program. If not, the following suggested audit procedures do not apply.
  - (2) Obtain and read the current indirect cost rate agreement and determine the terms in effect.
  - (3) Select a sample of claims for reimbursement and verify that the rates used are in accordance with the rate agreement, that rates were applied to the appropriate bases, and that the amounts claimed were the product of applying the rate to the applicable base. Verify that the costs included in the base(s) are consistent with the costs that were included in the base year (e.g., if the allocation base is total direct costs, verify that current year direct costs do not include costs items that were treated as indirect costs in the base year).
- c. *For IHEs that charge indirect costs to federal awards based on rate(s) which are not negotiated by the cognizant agency for indirect costs:*
- (1) If the ICRP has been certified and submitted to the cognizant agency for indirect costs and is based on costs incurred in the year being audited, then the ICRP should be audited for compliance with the provisions of 2 CFR part 200.
  - (2) If the IHE has a certified ICRP, which is based on costs incurred in the year being audited, but has not submitted it to their cognizant agency for indirect costs, then the ICRP should be audited using the procedures listed below:
    - (a) Test the indirect cost pool groupings for compliance with 2 CFR section 200.414 and 2 CFR part 200, Appendix III.
    - (b) Test the indirect cost pools to determine if costs are allowable.
    - (c) Test that indirect costs have been treated consistently when incurred for the same purpose, in like circumstances, as indirect costs only with respect to final cost objectives. No final cost objective may have allocated to it as a cost any cost, if another cost incurred for the same purpose, in like circumstances, has been included as a direct cost of that or any other final cost objective (2 CFR section 200.412).
    - (d) Test that the indirect cost pools in the rate proposal were developed consistent with the educational institution's disclosed

practices as described in its DS-2, if applicable (2 CFR section 200.419).

- (e) Test the *depreciation* cost pool to determine if:
  - (i) Computations of depreciation are based on the acquisition cost of the assets. Acquisition costs exclude (A) the cost of land; (B) any portion of the cost of buildings and equipment borne by the federal government, irrespective of where title was originally vested or where it is presently located; (C) any portion of the cost of buildings and equipment contributed by or for the educational institution where law or agreement prohibit recovery; and (D) any asset acquired solely for the performance of a non-federal award (2 CFR section 200.436(c)).
  - (ii) The depreciation method used to charge the cost of an asset (or group of assets) to accounting periods reflects the pattern of consumption of the asset during its useful life (2 CFR section 200.436(d)(2)).
  - (iii) The depreciation methods used to calculate the depreciation amounts for the ICRP are the same methods used by the educational institution for its financial statements (2 CFR section 200.436(d)(2)).
  - (iv) Charges for depreciation are supported by adequate property records and physical inventories, which must be taken at least once every two years (2 CFR section 200.436(e)).
  - (v) The allocation method for the depreciation cost pool complies with 2 CFR part 200, Appendix III, paragraph B.2.
  - (vi) Gains and losses on the sale, retirement, or other disposition of depreciable property have been appropriately accounted for and complies with 2 CFR section 200.443.
- (f) Test the *interest* cost pool to determine if:
  - (i) Computations for interest comply with the provisions of 2 CFR section 200.449.
  - (ii) The allocation method for the interest cost pool complies with 2 CFR part 200, Appendix III, paragraph B.3.

- (g) Test the *operations and maintenance* cost pool to determine if:
  - (i) Costs are appropriately classified in this cost pool (2 CFR part 200, Appendix III, paragraph B.4).
  - (ii) Rental costs comply with the provisions of 2 CFR section 200.465.
  - (iii) The IHE's accounting practices for classifying
    - (A) rearrangement and alteration costs, and
    - (B) reconversion costs, either as direct or indirect, result in consistent treatment in like circumstances.
  - (iv) The allocation method for the operations and maintenance cost pool complies with 2 CFR part 200, Appendix III, paragraph B.4.
  - (v) If a utility cost adjustment has been included in the negotiated indirect cost rate, the adjustment complies with the provisions of 2 CFR part 200, Appendix III, paragraph B.4.c.
  
- (h) Test the *library* cost pool to determine if:
  - (i) Costs are appropriately classified in this cost pool (2 CFR part 200, Appendix III, paragraph B.8).
  - (ii) The allocation method for the library cost pool complies with 2 CFR part 200, Appendix III, paragraph B.8.
  - (iii) If the allocation method is based on a cost analysis study in accordance with 2 CFR part 200, Appendix III, paragraph A.2.d, determine that the study:
    - (A) Results in an equitable distribution of costs and represents the relative benefits derived;
    - (B) Is appropriately documented in sufficient detail for review by the cognizant agency for indirect costs;
    - (C) Is statistically sound;
    - (D) Is performed specifically at the educational institution;
    - (E) Is reviewed periodically, but not less frequently than rate negotiations, updated if necessary, and used; and

- (F) Assumptions are clearly stated and adequately explained.
- (i) Test the *administrative* cost pools to determine if:
- (i) Costs are appropriately classified in these cost pools and the distribution bases are compliant with 2 CFR part 200, Appendix III, paragraphs B.5, B.6, and B.7.
  - (ii) The administrative cost components comply with the limitation on reimbursement of administrative costs in 2 CFR part 200, Appendix III, paragraph C.8. If the proposal is based on the alternative method for administrative costs in 2 CFR part 200, Appendix III, paragraph C.9, then the limitation does not apply. If the proposal is based on the alternative method for administrative costs, determine that the educational institution meets the criteria of paragraph C.9 and that this is adequately documented in the proposal.
  - (iii) *Departmental administration expense pool* – Test to determine that this cost pool complies with 2 CFR part 200, Appendix III, paragraph B.6.
  - (iv) *Academic Deans' Offices* – Test that salaries and operating expenses are limited to those attributable to administrative functions.
  - (v) *Academic Departments* – Salaries and fringe benefits attributable to the administrative work (including bid and proposal preparation) of faculty (including department heads), and other professional personnel conducting research and/or instruction, are allowed at a rate of 3.6 percent of modified total direct costs. This category must not include professional business or administrative officers. Determine that this allowance is added to the computation of the indirect cost rate for major functions. Test to determine that the expenses covered by this allowance are excluded from the departmental cost pool (2 CFR part 200, Appendix III, paragraph B.6).

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

- (3) If the ICRP has been certified and submitted to the cognizant agency for indirect costs, but is based on costs incurred in a fiscal year prior to the fiscal year being audited, a review of the ICRP is not required.
  - (4) If an ICRP has not been prepared and, therefore, the indirect costs charged to federal awards are not based on a certified ICRP, this may be required to be reported as an audit finding, in accordance with 2 CFR section 200.516(a)(5).
  - (5) *Application of an indirect cost rate(s) not negotiated by the cognizant agency for indirect costs* – Even though the rate(s) has not been approved by the cognizant agency for indirect costs, an unapproved indirect cost rate(s) should be reviewed for consistent application of the submitted rates to direct cost bases to ensure that the indirect cost rate(s) is applied consistent with the educational institution’s policies and procedures that apply uniformly to both federally funded and other activities of the institution.
- d. *For IHEs that also have awards containing award-specific rates used by the federal awarding agency that take precedence over the negotiated rate for purposes of indirect cost recovery:*
- (1) Ascertain that the award-specific rate is in accordance with special circumstances required by law, regulation, or other circumstance specified in 2 CFR section 200.414(c)(1).
  - (2) Obtain and review the award terms used to establish an award-specific indirect cost rate(s).
  - (3) Select a sample of claims for reimbursement and verify that the award-specific rate(s) used are in accordance with the terms of the award, that rate(s) were applied to the appropriate bases, and that the amounts claimed were the product of applying the rate to the applicable base. Verify that the costs included in the base(s) are consistent with the terms of the agreement.

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

FAR Appendix, 48 CFR section 9903.201-2(c), Types of CAS Coverage, requires IHEs to comply with all of the CAS specified in 48 CFR part 9905 that are in effect on the effective date of a covered contract. Negotiated contracts in excess of \$750,000 are CAS-covered, except for CAS-covered contracts awarded to Federally Funded Research and Development Centers (FFRDCs) operated by IHEs, which are subject to 48 CFR part 9904.

**1. Compliance Requirements – CAS and Disclosure Statements**

- a. The 2 CFR section 200.419 requires IHEs that receive more than \$50 million in federal awards subject to 2 CFR part 200 in a fiscal year to prepare and submit a Disclosure Statement (DS-2) that describes the institution's cost accounting practices. These institutions are required to submit a DS-2 within six months after the end of the institution's fiscal year that begins after May 8, 1996, unless the institution is required to submit a DS-2 earlier due to a receipt of a CAS-covered contract in accordance with 48 CFR section 9903.202-1.
- b. These institutions are responsible for maintaining an accurate DS-2 and complying with disclosed cost accounting practices. They also are responsible for filing amendments to the DS-2 with the cognizant agency for indirect costs 6 months in advance of a disclosed practice being changed to comply with a new or modified standard, or when a practice is changed for other reasons. (See COFAR FAQ .110-3 for an exception.) An IHE may proceed with implementing the change only if it has not been notified by the cognizant agency for indirect costs within the six-month period that either a longer period will be needed for review or there are concerns with the potential change.

**2. Audit Objectives – CAS and Disclosure Statements**

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. Determine whether the IHE's DS-2 is current, accurate, and complete and that it has been approved by the cognizant agency for indirect costs as adequate and compliant with 2 CFR part 200 and CAS (48 CFR part 9905).
- c. Determine whether the IHE's actual accounting practices are consistent with its disclosed accounting practices.
- d. Determine whether amendments have been filed with the cognizant agency for indirect costs. Amendments must be approved by the cognizant agency for indirect costs if the IHE has CAS-covered contracts subject to 48 CFR part 9903.
- e. Determine whether the IHE's accounting practices for direct and indirect costs comply with CAS applicable to educational institutions (2 CFR section 200.419; 48 CFR part 9905).

**3. Suggested Compliance Audit Procedures – CAS and Disclosure Statements**

- a. Obtain a copy of the IHE's DS-2, amendments, notifications, and, as applicable, approvals from the cognizant agency for indirect costs.
- b. Read the DS-2 and its amendments and ascertain if the disclosure agrees with the policies prescribed in the IHE's current policies and procedures documents.

- c. Test that the disclosed practices agree with actual practices for the period covered by the audit, including whether the practices were consistent throughout the period.
- d. Test direct and indirect charges to federal awards to determine that the IHE's practices used in estimating the costs in the proposal were consistent with the IHE's cost accounting practices used in accumulating and reporting the costs (FAR appendix, 48 CFR section 9905.501).
- e. For those costs which are sometimes charged as direct and sometimes charged as indirect, test for consistent classification of these costs when incurred for the same purpose and under like circumstances (2 CFR section 200.403(d) and FAR appendix, 48 CFR section 9905.502). For example:
  - (1) Salaries of administrative and clerical staff are normally treated as indirect costs; however, direct charging may be appropriate if all of the conditions in 2 CFR section 200.413(c) are met. When charged as direct costs to federal awards, test a sample of these costs to determine whether they are treated consistently with charges to non-federal awards, instructional activity, or other institutional activity (2 CFR part 200, Appendix III, paragraph B.6).
  - (2) Office supplies, postage, local telephone costs and memberships are normally treated as indirect costs. Sample these costs when they have been charged as direct costs to federal awards to determine whether they are consistently treated for non-federal awards, instructional activity, or other institutional activity (2 CFR part 200, Appendix III, paragraph B.6).
- f. Test for adequate accounting in the IHE's accounting system of unallowable costs for costs charged directly to federal awards, as well as indirect costs accumulated in cost pools (2 CFR section 200.403(g) and FAR Appendix, 48 CFR section 9905.505).
- g. Determine that the IHE's cost accounting period for accumulating direct and indirect costs charged to federal awards is consistent with the institution's fiscal year. If not, determine whether the institution met the criteria for an exception described in 2 CFR part 200, Appendix III, paragraph A.2.d. See also FAR Appendix, 48 CFR section 9905.506.

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

#### **1. Compliance Requirements**

Charges made from internal service, central service, pension, or similar activities or funds must follow the cost principles provided in 2 CFR part 200, subpart E.

**2. Audit Objectives**

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. Determine whether charges made from internal service, central service, pension, or similar activities or funds are in accordance with 2 CFR part 200, subpart E.

**3. Suggested Compliance Audit Procedures**

- a. For activities accounted for in separate funds, ascertain if (1) retained earnings/fund balances (including reserves) were computed in accordance with 2 CFR part 200; (2) working capital reserves were not excessive in amount (generally not greater than 60 days for cash expenses for normal operations incurred for the period exclusive of depreciation, capital costs and debt principal costs); and (3) refunds were made to the federal government for its share of any amounts transferred or borrowed from internal service, central service, pension, insurance, or other similar activities or funds for purposes other than to meet the operating liabilities, including interest on debt, of the fund.
- b. Test that all users of services are billed in a consistent manner.
- c. Test that billing rates exclude unallowable costs, in accordance with 2 CFR part 200.
- d. Test, where activities are not accounted for in separate funds, that billing rates (or charges) are developed based on actual costs and were adjusted to eliminate profits.
- e. For IHEs that have self-insurance and certain types of fringe benefit programs (e.g., pension funds), ascertain if independent actuarial studies appropriate for such activities are performed at least biennially and that current period costs were allocated based on an appropriate study which is not over two years old.

## **2 CFR PART 200**

### **COST PRINCIPLES FOR NONPROFIT ORGANIZATIONS**

#### **Introduction**

2 CFR part 200 establishes cost principles for determining costs applicable to federal awards with nonprofit organizations (NPOs). The principles are designed to ensure that the federal government bear its fair share of costs except where restricted or prohibited by law. These principles are used by all federal agencies in determining the allowable costs of work performed by NPOs under federal awards. Some NPOs must operate under federal cost principles applicable to for-profit entities located at 48 CFR section 31.2. A listing of these organizations is contained in Appendix VIII to 2 CFR part 200.

In addition to the cost principles established by 2 CFR part 200, subpart E, the Cost Accounting Standards Board (CASB) has promulgated certain cost accounting standards (CAS) that must be followed by nonprofit organizations receiving procurement contracts that meet a defined dollar threshold. Generally, organizations are exempt from coverage under CAS unless they receive a single CAS-covered contract or subcontract of at least \$7.5 million. After receipt of this trigger contract, CAS coverage is applied to all negotiated awards that exceed the Truth in Negotiations Act threshold, currently \$700,000, unless they meet certain exemptions. These exemptions and the requirements of CAS can be found in 48 CFR chapter 99.

#### **Cognizant Agency for Indirect Costs**

The 2 CFR section 200.19 defines “cognizant agency for indirect costs” as the federal agency responsible for reviewing, negotiating, and approving cost allocation plans or indirect cost proposals on behalf of all federal agencies. References to the “cognizant agency for indirect costs” in this section are not equivalent to the cognizant agency for audit, which is defined in 2 CFR section 200.18. The 2 CFR part 200, Appendix IV, paragraph C.2 clarifies that the cognizant agency for indirect costs is the federal agency with the largest dollar value of federal awards with an organization, unless different arrangements are agreed to by federal agencies.

#### **Allowable Costs – General Criteria – Direct Costs**

##### **1. Compliance Requirements – Direct Costs**

Direct costs are those costs that can be identified specifically with a particular final cost objective, such as a federal award, or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy.

Costs incurred for the same purpose in like circumstances must be treated consistently as either direct or indirect (F&A) costs.

For nonprofit organizations, the cost of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs—whether or not allowable—and be allocated an equitable share of indirect costs. Examples can be found in 2 CFR section 200.413(f).

If the auditor identifies unallowable direct costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost that would not have been incurred if the other cost had not been incurred. For example, fringe benefits are directly associated with payroll costs. When a payroll cost is determined to be unallowable, then the directly associated fringe benefit would be determined unallowable as well.

## **2. Audit Objectives – Direct Costs**

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. Determine whether the organization complied with the provisions of 2 CFR part 200 and CAS (if applicable) as follows:
  - (1) Direct charges to federal awards were for allowable costs.
  - (2) Unallowable costs determined to be direct costs were included in the allocation base for the purpose of computing an indirect cost rate.

## **3. Suggested Compliance Audit Procedures – Direct Costs**

Test direct costs charged to federal awards with the following criteria:

- a. Costs were approved by the federal awarding agency, if required. (See 2 CFR section 200.407 for items of cost that require prior written approval and Exhibit 1, Selected Items of Cost, in this part of the Supplement.)
- b. Costs were necessary and reasonable for the performance of the federal award and allocable under the principles of 2 CFR 200, subpart E.
- c. Costs conformed to any limitations or exclusions set forth in 2 CFR 200, subpart E, or in the federal award as to types or amount of cost items.
- d. Costs were consistent with policies and procedures that apply uniformly to both federally financed and other activities of the NPO.
- e. Costs were accorded consistent treatment. Cost were not assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances was allocated to a federal award as an indirect cost.

- f. Costs were not included as a cost of any other federally financed program in either the current or a prior period.
- g. Costs were not used to meet the cost-sharing or matching requirements of another federal program, except where authorized by federal statute.
- h. Costs were adequately documented.

## **Allowable Costs – Indirect Costs**

### **1. Compliance Requirements – Indirect Costs**

- a. 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 costs of minor amounts may be treated as indirect costs under the conditions described in 2 CFR section 200.413(d). 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 benefitting cost objectives. A cost may not be allocated to a federal award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to a federal award as a direct cost. If an organization receives more than \$10 million in direct federal funding in a fiscal year, a breakout of the indirect cost component into two broad categories, Facilities and Administration, as defined in 2 CFR section 200.414(a), is required.
- b. Indirect cost rate proposals (ICRPs) are used to either establish predetermined rates, fixed rates with carry-forward provision, provisional, or final rates (2 CFR part 200, Appendix IV, paragraph C.1).
  - (1) *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.
  - (2) *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.
  - (3) *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 federal awards pending the establishment of a final rate for the period.
  - (4) *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.

- c. Some federal awards may contain cost limitations on recovery of indirect costs that differ from the federally negotiated indirect cost rates. In these cases, the indirect cost rate will be specified in the award, as described in 2 CFR sections 200.210(a)(15) and 200.331(a)(1)(xiii).
- d. To recover indirect costs, NPOs prepare ICRPs for the cognizant agency for indirect costs. NPOs that have not previously established indirect costs rates and are not using the de minimis indirect cost rate must submit an ICRP immediately upon notification that a federal award has been made and, in no event, later than three months after the effective date of the award. NPOs that have previously established indirect cost rates must submit a new ICRP within six months after the close of each fiscal year. The ICRP is the documentation prepared by an organization to substantiate its claims for the reimbursement of indirect costs. The proposal provides the basis for the review and negotiation leading to the establishment of an organization's indirect cost rate. NPOs can select one of three different methods to allocate indirect costs and compute the indirect cost rate.
- (1) *Simplified Allocation Method* -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 (a) separating the organization's total costs for the base period as either direct or indirect, and (b) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. A full discussion of the simplified allocation method can be found in 2 CFR part 200, Appendix IV, paragraph B.2.
  - (2) *Multiple Allocation Base Method* - Where an organization's indirect costs benefit its major functions in varying degrees, indirect costs must be accumulated into separate cost groupings, as described in 2 CFR part 200, Appendix IV, paragraph B.3.b. Each grouping must then be allocated individually to benefiting functions by means of a base that best measures the relative benefits. The allocation bases for each grouping are described in 2 CFR part 200, Appendix IV, paragraph B.3.c. A full discussion of the multiple allocation base method can be found in 2 CFR part 200, Appendix IV, paragraph B.3.
  - (3) *Direct Allocation Method* - Some NPOs treat all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: (a) general administration and general expenses, (b) fundraising, and (c) other direct functions (including projects performed under federal awards). Joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as direct costs to each category and to each award or other activity using a base most appropriate to the particular cost being prorated. A full discussion of the direct allocation base method can be found in 2 CFR part 200, Appendix IV, paragraph B.4.

**2. Audit Objectives – Indirect Costs**

- a. Obtain an understanding of internal controls, assess risk, and test internal controls as required by 2 CFR section 200.514(c).
- b. Determine whether the NPO charged indirect costs to federal awards in compliance with the cost principles in 2 CFR part 200, subpart E, Appendix IV, and CAS (if applicable), and in accordance with any negotiated rate agreements and specific award conditions/limitations.

**3. Suggested Compliance Audit Procedures – Indirect Costs**

- a. Test whether indirect costs comply with the following criteria:
  - (1) Conform to the allowability of cost provisions in 2 CFR part 200, subpart E.
  - (2) Are supported by appropriate documentation, such as purchase orders, receiving reports, contractor invoices, canceled checks, and time and attendance records that meet the documentation standards of 2 CFR section 200.430(i), and are correctly charged as to account, amount, and period.
  - (3) Are calculated in conformity with generally accepted accounting principles or CAS, as required.
  - (4) Are not used to meet cost-sharing or matching requirements of other federally supported activities.
  - (5) Be given consistent accounting treatment within and between accounting periods. Consistency in accounting requires that costs incurred for the same purpose, in like circumstances, be treated as either direct costs only or indirect costs only with respect to final cost objectives.
- b. *For NPO's that charge indirect costs to federal awards based on federally negotiated rates*, obtain the current indirect cost rate agreement, including the proposal used in the negotiation of the agreement, and determine the type of rates (i.e., pre-determined, fixed rate, provisional rate, or final rate as described in 2 CFR part 200, Appendix IV, section C) and terms in effect for the year being audited.
  - (1) If a fixed rate agreement with carry-forward provisions has been negotiated with the cognizant agency for indirect cost, determine that the difference between the estimated indirect costs and the actual indirect costs of the period was correctly calculated and carried forward to the rate computation in the current year.

- (2) If a provisional rate was used to bill for indirect costs, determine whether a final rate has been negotiated and appropriate billing adjustments have been made based on the final negotiated rate.
- c. *For NPOs that charge indirect costs to federal awards based on rates that are not federally negotiated, review the ICRP or methodology used to allocate indirect costs for the year being audited to ensure it meets the requirements of 2 CFR part 200, subpart E, and CAS, when applicable, to verify the following.*
- (1) Indirect costs are charged uniformly to both federally funded and other activities of the NPO, and are consistent with the NPO's policies and procedures.
  - (2) Costs in the indirect costs pool are allowable and the composition of the pool allows allocation over a base that is best suited for assigning the pool of indirect costs to cost objectives in accordance with the benefits received.
  - (3) The allocation base provides for an equitable allocation of indirect costs and include unallowable costs, as appropriate, so that unallowable costs will receive their proportionate share of indirect costs.
  - (4) Costs have been given consistent accounting treatment within and between accounting periods.
  - (5) The cost of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the NPO's mission are treated as direct costs—whether or not allowable—and are allocated an equitable share of indirect costs. See examples in 2 CFR section 200.413(f).
- d. Select a sample of claims for indirect cost reimbursement:
- Verify that the rates used were in accordance with the terms and conditions of the award and the amounts claimed were applied to the appropriate base.

## **Special Requirements – Disclosure Statements (DS-1) Required by Cost Accounting Standards**

### **1. Compliance Requirements – CAS and Disclosure Statements**

- a. Pub. L. No. 100-679 (41 USC 422) requires certain contractors and subcontractors (which includes NPOs) to comply with CAS and to disclose in writing and follow consistently their cost accounting practices.
- b. The 48 CFR section 9903.201-1 (FAR appendix) describes the rules for determining whether a proposed contract or subcontract is exempt from CAS. Negotiated contracts not exempt in accordance with 48 CFR section 9903.201-

1(b) are subject to CAS. A CAS-covered contract may be subject to either full or modified coverage. The rules for determining whether full or modified coverage applies are in 48 CFR section 9903.201-2 (FAR appendix).

- (1) Full coverage requires that a business unit comply with all the CAS specified in 48 CFR part 9904 that are in effect on the date of the contract award and with any CAS that become applicable because of later award of a CAS-covered contract. Full coverage applies to contractor business units that (a) receive a single CAS-covered contract award of \$50 million or more; or (b) receive \$50 million or more in net CAS-covered awards during their preceding cost accounting period (48 CFR section 9903.201-2(a)).
  - (2) Modified CAS coverage requires only that the contractor comply with Standard 9904.401, Consistency in Estimating, Accumulating, and Reporting Costs; Standard 9904.402, Consistency in Allocating Costs Incurred for the Same Purpose; Standard 9904.405, Accounting for Unallowable Costs; and Standard 9904.406, Cost Accounting Standard—Cost Accounting Period. Modified, rather, than full, CAS coverage may be applied to a covered contract of less than \$50 million awarded to a business unit that received less than \$50 million in net CAS-covered awards in the immediately preceding cost accounting period.
- c. The 48 CFR section 9903.202 (FAR Appendix) describes the general Disclosure Statement requirements. A Disclosure Statement is a written description of a contractor's cost accounting practices and procedures and are required under the following circumstances:
- (1) Any business unit that is selected to receive a CAS-covered contract or subcontract of \$50 million or more must submit a Disclosure Statement before award.
  - (2) Any company which, together with its segments, receive net awards of negotiated prime contracts and subcontracts subject to CAS totaling \$50 million or more in its most recent cost accounting period, must submit a Disclosure Statement before award of its first CAS-covered contract in the immediately following cost accounting period.

## **2. Audit Objectives – CAS and Disclosure Statements**

- a. Determine whether the NPO's Disclosure Statement (including amendments) is current, accurate, complete, and properly filed with the cognizant federal Administrative Contracting Officer in accordance with 48 CFR section 9903.202-5.
- b. Determine whether the NPO's actual accounting practices are consistent with its disclosed practices.

- c. Determine whether the NPO's accounting practices, for direct and indirect costs, are compliant with CAS, based on its required CAS coverage (full or modified).

### **3. Suggested Compliance Audit Procedures – CAS and Disclosure Statements**

- a. Ascertain whether the NPO has any CAS-covered contract or subcontracts. If so, determine which type of CAS coverage is applicable (full or modified) and if a Disclosure Statement is required to be submitted to the cognizant agency for indirect cost.
- b. If a Disclosure Statement is required, obtain a copy and any amendments:
  - (1) Determine if the cognizant agency for indirect costs has approved the Disclosure Statement and/or has been appropriately notified of changes in the cost accounting practices that occurred during the year to which indirect cost rate agreements are being applied.
  - (2) Test whether the NPO's actual accounting practices are consistent with the disclosed practices.
  - (3) Test the NPO's actual accounting practices for direct and indirect costs are compliant with applicable CAS.

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

#### **1. Compliance Requirements**

NPOs using internal service, central service, pension, or similar activities or funds must follow the applicable cost principles found in 2 CFR part 200.

#### **2. Audit Objectives**

- a. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
- b. Determine whether charges made from internal service, central service, pension, or similar activities or funds are in accordance with 2 CFR part 200.

#### **3. Suggested Compliance Audit Procedures**

- a. For activities accounted for in separate funds, ascertain if (1) retained earnings/fund balances (including reserves) were computed in accordance with 2 CFR part 200; (2) working capital reserves were not excessive in amount (generally not greater than 60 days for cash expenses for normal operations incurred for the period exclusive of depreciation, capital costs and debt principal costs); and (3) refunds were made to the federal government for its share of any amounts transferred or borrowed from internal service, central service, pension,

insurance, or other similar activities or funds for purposes other than to meet the operating liabilities, including interest on debt, of the fund.

- b. Test that all users of services are billed in a consistent manner.
- c. Test that billing rates exclude unallowable costs, in accordance with 2 CFR part 200.
- d. Test, where activities are not accounted for in separate funds, that billing rates (or charges) are developed based on actual costs and were adjusted to eliminate profits.
- e. For NPOs that have self-insurance and certain types of fringe benefit programs (e.g., pension funds), ascertain if independent actuarial studies appropriate for such activities are performed at least biennially and that current period costs were allocated based on an appropriate study which is not over two years old.

## C. CASH MANAGEMENT

### Compliance Requirements

#### *Grants and Cooperative Agreements*

##### *All Non-Federal Entities*

Non-federal entities must establish written procedures to implement the requirements of 2 CFR section 200.305 (2 CFR section 200.302(b)(6)).

##### *States*

U.S. Department of the Treasury (Treasury) regulations at 31 CFR part 205 implement the Cash Management Improvement Act of 1990 (CMIA), as amended (Pub. L. No. 101-453; 31 USC 6501 *et seq.*). Subpart A of those regulations requires state recipients to enter into Treasury-State Agreements that prescribe specific methods of drawing down federal funds (funding techniques) for federal programs listed in the Catalog of federal Domestic Assistance that meet the funding threshold for a major federal assistance program under the CMIA. Treasury-State Agreements also specify the terms and conditions under which an interest liability would be incurred. Programs not covered by a Treasury-State Agreement are subject to procedures prescribed by Treasury in subpart B of 31 CFR part 205 (subpart B), which at 31 CFR section 205.33(a) include the requirement for a state to minimize the time between the drawdown of federal funds and their disbursement for federal program purposes.

##### *Non-Federal Entities Other Than States*

Non-federal entities must minimize the time elapsing between the transfer of funds from the U.S. Treasury or pass-through entity and disbursement by the non-federal entity for direct program or project costs and the proportionate share of allowable indirect costs, whether the payment is made by electronic funds transfer, or issuance or redemption of checks, warrants, or payment by other means (2 CFR section 200.305(b)).

What constitutes minimized elapsed time for funds transfer will depend on what payment system/method a non-federal entity uses. For example:

- The U.S. Department of Health and Human Service (HHS) processes its financial transactions with non-federal entities through HHS's Program Support Center (PCS), which uses the Payment Management System (PMS). Usually, payments from PMS process overnight and the funds would be available in a non-federal entity's account the next business day. HHS also processes payments through same day wires (mostly state governments).
- Federal agencies, such as the U.S. Department of Commerce, and U.S. Department of the Interior, use the U.S. Treasury's Automated Standard Application for Payments (ASAP) system for grant and cooperative agreement payments. Non-federal entities can use the ASAP on-line process to request and receive same-day payment.

Under the advance payment method, federal awarding agency or pass-through entity payment is made to the non-federal entity before the non-federal entity disburses the funds for program purposes (2 CFR section 200.3). A non-federal entity must be paid in advance provided that it maintains, or demonstrates the willingness to maintain, both written procedures that minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by the non-federal entity, as well as a financial management system that meets the specified standards for fund control and accountability (2 CFR section 200.305(b)(1)).

The reimbursement payment method is the preferred payment method if (a) the non-federal entity cannot meet the requirements in 2 CFR section 200.305(b)(1) for advance payment, (b) the federal awarding agency sets a specific condition for use of the reimbursement or (3) if requested by the non-federal entity (2 CFR sections 200.305(b)(3) and 200.207)). The reimbursement payment method also may be used on a federal award for construction or for other construction activity as specified in 2 CFR section 200.305(b)(3), program costs must be paid by non-federal entity funds before submitting a payment request (2 CFR section 200.305(b)(3)), i.e., the non-federal entity must disburse funds for program purposes before requesting payment from the federal awarding agency or pass-through entity.

To the extent available, the non-federal entity must disburse funds available from program income (including repayments to a revolving fund), rebates, refunds, contract settlements, audit recoveries, and interest earned on such funds before requesting additional federal cash draws (2 CFR section 200.305(b)(5)).

Except for interest exempt under the Indian Self-Determination and Education Assistance Act (23 USC 450), interest earned by non-federal entities other than states on advances of federal funds is required to be remitted annually to the U.S. Department of Health and Human Services, Payment Management System, P.O. Box 6021, Rockville, MD 20852. Up to \$500 per year may be kept for administrative expenses (2 CFR section 200.305(b)(9)).

### **Cost-Reimbursement Contracts under the Federal Acquisition Regulation**

For cost-reimbursement contracts under the FAR, reimbursement payment is the predominant method of funding. Advance payments under FAR-based contracts are rare. The FAR clause at 48 CFR section 52.216-7 applies to reimbursement payment. Paragraph (b)(1) of that clause requires that the non-federal entity request reimbursement for (a) only allocable, allowable, and reasonable contract costs that have already been paid, or (b) if the non-federal entity is not delinquent in paying costs of contract performance in the ordinary course of business, costs incurred, but not necessarily paid. As defined in 48 CFR section 52.216-7(b)(1), with relation to supplies and services purchased for use on the contract, “ordinary course of business” would be in accordance with the terms and conditions of a subcontract or invoice, and ordinarily within 30 days of the request to the federal government for reimbursement.

For cost-reimbursement contracts using advance payment, the requirements are contained in the FAR clause at 48 CFR section 52.232-12. The non-federal entity is required to account for interest earned on advances from the federal government in accordance with paragraph (f) of that clause.

## **Loans, Loan Guarantees, Interest Subsidies, and Insurance**

Non-federal entities must comply with applicable program requirements for payment under loans, loan guarantees, interest subsidies, and insurance.

### **Pass-through Entities**

Pass-through entities must monitor cash drawdowns by their subrecipients to ensure that the time elapsing between the transfer of federal funds to the subrecipient and their disbursement for program purposes is minimized as required by the applicable cash management requirements in the federal award to the recipient (2 CFR section 200.305(b)(1)).

### **Source of Governing Requirements**

The requirements for cash management are contained in 2 CFR sections 200.302(b)(6) and 200.305, 31 CFR part 205, 48 CFR sections 52.216-7(b) and 52.232-12, program legislation, federal awarding agency regulations, and the terms and conditions of the federal award.

### **Availability of Other Information**

Treasury's Financial Management Service maintains a Cash Management Improvement Act web page (<http://www.fms.treas.gov/cmia/>). Information about the Department of Health and Human Services Payment Management System and the Department of the Treasury's Automated Standard Application for Payments is available at <https://pms.psc.gov/> and <http://fms.treas.gov/asap/index.html>, respectively.

### **Audit Objectives**

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. For grants and cooperative agreements to states, determine whether states have complied with the terms and conditions of the Treasury-State Agreement or subpart B procedures.
3. For grants and cooperative agreements to non-federal entities other than states, determine whether payment methods minimized the time elapsing between transfer of federal funds from the U.S. Treasury or the pass-through entity and the disbursement by the non-federal entity and any interest earned on advances was properly remitted.
4. For grants and cooperative agreements to non-federal entities that are paid on a reimbursement basis, supporting documentation shows that the costs for which reimbursement was requested were paid prior to the date of the reimbursement request.
5. Determine whether non-federal entities that receive reimbursement payments under cost-reimbursement contracts under the FAR and cost-reimbursement subcontracts under these contracts requested payments in compliance with 48 CFR section 52.216-7(b).

6. Determine whether non-federal entities complied with applicable program requirements for loans, loan guarantees, interest subsidies, and insurance.
7. Determine whether pass-through entities implemented procedures to ensure that payments to subrecipients minimized the time elapsing between transfer of federal funds from the pass-through entity to the subrecipient and the disbursement of such funds for program purposes by the subrecipient, as required by applicable cash management requirements in the federal award to the recipient.

### **Suggested Audit Procedures – Internal Control**

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for cash management and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c) 4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the remaining risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

### **Suggested Audit Procedures – Compliance**

**Note:** The following procedures are intended to be applied to each program determined to be major. However, due to the nature of cash management and the system of cash management in place in a particular entity, it may be appropriate and more efficient to perform these procedures for all programs collectively rather than separately for each program.

#### *Grants and cooperative agreements to states*

1. For programs tested as major, verify which of those programs are covered by the Treasury-State Agreement in accordance with the materiality thresholds in 31 CFR section 205.5, Table A.
2. For those programs identified in procedure 1, determine the funding techniques used for those programs. For those funding techniques that require clearance patterns to schedule the transfer of federal funds to the state, review documentation supporting the clearance pattern and verify that the clearance pattern conforms to the requirements for developing and maintaining clearance patterns as specified in the Treasury-State Agreement (31 CFR sections 205.12, 205.20, and 205.22).

3. Select a sample of federal cash draws and verify that the timing of the federal cash draws was in compliance with the applicable funding techniques specified in the Treasury-State Agreement or Subpart B procedures, whichever is applicable (31 CFR sections 205.11 and 205.33).
4. Review the calculation of the interest obligation owed to or by the federal government, reported on the annual report submitted by the state to ascertain that the calculation was in accordance with Treasury regulations and the terms of the Treasury-State Agreement. Trace amounts used in the calculation to supporting documentation.

*Grants and cooperative agreements to non-federal entities other than states*

5. Review trial balances related to federal funds for unearned revenue. If unearned revenue balances are identified, consider if such balances are consistent with the requirement to minimize the time between drawing and disbursing federal funds.
6. Select a sample of advance payments and verify that the non-federal entity minimized the time elapsing between the transfer of funds from the U.S. Treasury or pass-through entity and disbursement by the non-federal entity.
7. When non-federal entities are funded under the reimbursement method, select a sample of transfers of funds from the U.S. Treasury or pass-through entity and trace to supporting documentation and ascertain if the entity paid for the costs for which reimbursement was requested prior to the date of the reimbursement request (2 CFR section 200.305(b)(3)).
8. When a program receives program income (including repayments to a revolving fund), rebates, refunds, contract settlements, audit recoveries, or interest earned on such funds; perform tests to ascertain if these funds were disbursed before requesting additional federal cash draws (2 CFR section 200.305(b)(5)).
9. Review records to determine if interest in excess of \$500 per year was earned on federal cash draws. If so, determine if it was remitted annually to the Department of Health and Human Services, Payment Management System (2 CFR section 200.305(9)).

*Cost-reimbursement contracts under the Federal Acquisition Regulation*

10. Perform tests to ascertain if the non-federal entity requesting reimbursement (a) disbursed funds prior to the date of the request, or (b) meets the conditions allowing for the request for costs incurred, but not necessarily paid for, i.e., ordinarily within 30 days of the request (48 CFR section 52.216-7(b)).

*Loans, Loan Guarantees, Interest Subsidies, and Insurance*

11. Perform tests to ascertain if the non-federal entity complied with applicable program requirements.

*All Pass-Through Entities*

12. For those programs where a pass-through entity passes federal funds through to subrecipients, select a representative sample of subrecipient payments and ascertain if the pass-through entity implemented procedures to ensure that the time elapsing between the transfer of federal funds to the subrecipient and the disbursement of such funds for program purposes by the subrecipient was minimized (2 CFR section 200.305(b)(1)).

**D. [RESERVED]**

**Note: Wage Rate Determination (Davis-Bacon) Act coverage has been moved to 20.001.**

## **E. ELIGIBILITY**

### **Compliance Requirements**

The specific requirements for eligibility are unique to each federal program and are found in the statutes, regulations, and the terms and conditions of the federal award pertaining to the program. For programs listed in the Supplement, these specific requirements are in Part 4, “Agency Program Requirements,” or Part 5, “Clusters of Programs,” as applicable. This compliance requirement specifies the criteria for determining the individuals, groups of individuals (including area of service delivery), or subrecipients that can participate in the program and the amounts for which they qualify.

### **Source of Governing Requirements**

The requirements for eligibility are contained in program legislation, federal awarding agency regulations, and the terms and conditions of the award.

### **Audit Objectives**

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. Determine whether required eligibility determinations were made (including obtaining any required documentation/verification), that individual program participants or groups of participants (including area of service delivery) were determined to be eligible, and that only eligible individuals or groups of individuals participated in the program.
3. Determine whether subawards were made only to eligible subrecipients.
4. Determine whether amounts provided to or on behalf of eligible participants or groups of participants were calculated in accordance with program requirements.

### **Suggested Audit Procedures – Internal Control**

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control over compliance to support a low assessed level of control risk for eligibility and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the remaining risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

## Suggested Audit Procedures – Compliance

### 1. *Eligibility for Individuals*

a. For some federal programs with a large number of people receiving benefits, the non-federal entity may use a computer system for processing individual eligibility determinations and delivery of benefits. Often these computer systems are complex and will be separate from the non-federal entity's regular financial accounting system. Typical functions that a computer system used for determining eligibility may perform are:

- Perform calculations to assist in determining who is eligible and the amount of benefits
- Pay benefits (e.g., write checks)
- Maintain eligibility records, including information about each individual and benefits paid to or on behalf of the individual (regular payments, refunds, and adjustments)
- Track the period of time during which an individual is eligible to receive benefits, i.e., from the beginning date of eligibility through the date when those benefits stop, generally at the end of a predetermined period, unless there is a redetermination of eligibility
- Perform matches with other computer databases to verify eligibility (e.g., matches to verify earnings or identify individuals who are deceased)
- Control who is authorized to approve benefits for eligible individuals (e.g., an employee may be approving benefits on-line and this process may be controlled by passwords or other access controls)
- Produce exception reports indicating likely errors that need follow-up (e.g., when benefits exceed a certain amount, would not be appropriate for a particular classification of individuals, or are paid more frequently than normal)

Because of the diversity of computer systems, both hardware and software, it is not practical for this Supplement to provide suggested audit procedures to address each system. However, generally accepted auditing standards provide guidance for the auditor when computer processing relates to accounting information that can materially affect the financial statements being audited. Similarly, when eligibility is material to a major program, and a computer system is integral to eligibility compliance, the auditor should follow this guidance and consider the non-federal entity's computer processing. The auditor should perform audit procedures relative to the computer system for eligibility as necessary to support the opinion on compliance for the major program. Due to the nature and controls

of computer systems, the auditor may choose to perform these tests of the computer systems as part of testing the internal controls for eligibility.

b. *Split Eligibility Determination Functions*

- (1) *Background* – Some non-federal entities pay the federal benefits to the eligible participants but arrange with another entity to perform part or all of the eligibility determination. For example, a state arranges with local government social services agencies to perform the “intake function” (e.g., the meeting with the social services client to determine income and categorical eligibility), while the state maintains the computer systems supporting the eligibility determination process and actually pays the benefits to the participants. In such cases, the state is fully responsible for federal compliance for the eligibility determination, as the benefits are paid by the state. Moreover, the state shows the benefits paid as federal awards expended on the state’s Schedule of Expenditures of Federal Awards. Therefore, the auditor of the state is responsible for meeting the internal control and compliance audit objectives for eligibility. This may require the auditor of the state to perform, coordinate, or arrange for additional procedures to ensure compliant eligibility determinations when another entity performs part of the eligibility determination functions. The responsibility of the auditor of the state for auditing eligibility does not relieve the auditor of the other entity (e.g., local government) from responsibility for meeting those internal control and compliance audit objectives for eligibility that apply to the other entity’s responsibilities. An exception occurs when the auditor of the other entity confirms with the auditor of the state that certain procedures are not necessary.
- (2) Ensure that eligibility testing includes all benefit payments regardless of whether another entity, by arrangement, performs part of the eligibility determination functions.

- c. Perform procedures to ascertain if the non-federal entity’s records/database includes all individuals receiving benefits during the audit period (e.g., that the population of individuals receiving benefits is complete).
- d. Select a sample of individuals receiving benefits and perform tests to ascertain if
  - (1) The required eligibility determinations and redeterminations, (including obtaining any required documentation/verifications) were performed and the individual was determined to be eligible in accordance with the compliance requirements of the program. (Note that some programs have both initial and continuing eligibility requirements and the auditor should design and perform appropriate tests for both. Also, some programs require periodic redeterminations of eligibility, which should also be tested.)

- (2) Benefits paid to or on behalf of the individuals were calculated correctly and in compliance with the requirements of the program.
    - (3) Benefits were discontinued when the period of eligibility expired.
  - e. In some programs, the non-federal entity is required to use a quality control process to obtain assurances about eligibility. Review the quality control process and perform tests to ascertain if it is operating to effectively meet the objectives of the process and in compliance with applicable program requirements.
- 2. *Eligibility for Group of Individuals or Area of Service Delivery*
  - a. In some cases, the non-federal entity may be required to perform procedures to determine whether a population or area of service delivery is eligible. Test information used in determining eligibility and ascertain if the population or area of service delivery was eligible.
  - b. Perform tests to ascertain if:
    - (1) The population or area served was eligible.
    - (2) The benefits paid to or on behalf of the individuals or area of service delivery were calculated correctly.
- 3. *Eligibility for Subrecipients*
  - a. If the determination of eligibility is based upon an approved application or plan, obtain a copy of this document and identify the applicable eligibility requirements.
  - b. Select a sample of the awards to subrecipients and perform procedures to verify that the subrecipients were eligible and amounts awarded were within funding limits.

## F. EQUIPMENT AND REAL PROPERTY MANAGEMENT

### Compliance Requirements

#### Equipment Management -- Grants and Cooperative Agreements

Equipment means tangible personal property, including information technology systems, having a useful life of more than one year and a per-unit acquisition cost which equals or exceeds the lesser of the capitalization level established by the non-federal entity for financial statement purposes or \$5,000 (2 CFR section 200.33). Title to equipment acquired by a non-federal entity under grants and cooperative agreements vests in the non-federal entity subject to certain obligations and conditions (2 CFR section 200.313(a)).

#### *States*

A state must use, manage, and dispose of equipment acquired under a federal award in accordance with state laws and procedures (2 CFR section 200.313(b)).

#### *Non-Federal Entities Other than States*

Non-federal entities other than states must follow 2 CFR sections 200.313(c) through (e) which require that:

1. Equipment, including replacement equipment, be used in the program or project for which it was acquired as long as needed, whether or not the project or program continues to be supported by the federal award or, when appropriate, under other federal awards; however, the non-federal entity must not encumber the equipment without prior approval of the federal awarding agency (2 CFR sections 200.313(c) and (e)).
2. Property records must be maintained that include a description of the property, a serial number or other identification number, the source of funding for the property (including the federal award identification number), who holds title, the acquisition date, cost of the property, percentage of federal participation in the project costs for the federal award under which the property was acquired, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sales price of the property (2 CFR section 200.313(d)(1)).
3. A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years (2 CFR section 200.313(d)(2)).
4. A control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property. Any loss, damage, or theft must be investigated (2 CFR section 200.313(d)(3)).
5. Adequate maintenance procedures must be developed to keep the property in good condition (2 CFR section 200.313(d)(4)).

6. If the non-federal entity is authorized or required to sell the property, proper sales procedures must be established to ensure the highest possible return (2 CFR section 200.313(d)(5)).
7. When original or replacement equipment acquired under a federal award is no longer needed for a federal program (whether the original project or program or other activities currently or previously supported by the federal government), the non-federal entity must request disposition instructions from the federal awarding agency if required by the terms and conditions of the award. Items of equipment with a current per-unit fair market value of \$5,000 or less may be retained, sold, or otherwise disposed of with no further obligation to the federal awarding agency. If the federal awarding agency fails to provide requested disposition instructions within 120 days, items of equipment with a current per-unit fair market value in excess of \$5,000 may be retained or sold. The federal awarding agency is entitled to the federal interest in the equipment, which is the amount calculated by multiplying the current market value or sale proceeds by the federal agency's participation in total project costs (2 CFR section 200.313(e) and 200.41).

The COFAR's Frequently Asked Questions includes the following, which addresses the relationship between the requirement for property records to show the percentage of federal participation in the project costs and the calculation of the federal interest.

.313-2 Changes to Equipment Inventory Systems.

*Section 200.313(d)(1) of the guidance specifies the attributes that must be maintained in property records of the non-federal entity. For non-federal entities that have followed Circular A-110, there are two changes: "percentage of Federal participation in the project costs" (Uniform Guidance) versus "information from which one can calculate the percentage of Federal participation in the cost of the equipment" (A-110.34(f)(1)(vi), and "the location, use and condition of the property" (Uniform Guidance) versus "location and condition of the equipment and the date the information was reported" (A-110.34(f)(1)(vii). Are non-federal entities expected to change the attributes of their property records and ultimately be required to implement costly changes to their existing equipment inventory systems?*

No. The requirements for property records have not substantively changed in the Uniform Guidance. The requirements for property records are meant to ensure that the non-federal entity maintains an equipment inventory system that demonstrates the federal entity has an effective system of controls to account for and track equipment that has been acquired with federal funds. Non-federal entities are not expected to change their equipment inventory systems or the data elements contained in those systems, if they are in compliance with the current requirements in Circular A-110. In the examples in question:

- The percentage of federal participation in the cost of equipment in Circular A-110 was identical to the percentage of federal participation in the cost of the original project or program. One could infer that from the amount of compensation a recipient was required under 2 CFR 215.34(g) to make to a federal agency at the time of disposition—i.e., “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 equipment.” The A-110 requirement in 2 CFR 215.34 for the recipient’s records to have information from which one could calculate the percentage of federal participation in the cost of the equipment then required two numbers, the percentage of federal participation in the original project or program and information from which one could derive the current fair market value. The Uniform Guidance makes that more explicitly clear through the definition of federal interest in 2 CFR 200.41; and
- “the location, use and condition of the property” is referring to an indicator in the property records that the specific equipment item is active and linked with the appropriate federal award, identical to the requirement in Circular A-110.

**Note:** Intangible property that is acquired under a federal award, rather than developed or produced under the award, is subject to the requirements of 2 CFR section 200.313(e) regarding disposition (2 CFR section 200.315(a)).

### **Real Property Management – Grants and Cooperative Agreements**

Title to real property acquired or improved by non-federal entities under grants and cooperative agreements vests in the non-federal entity subject to the obligations and conditions specified in 2 CFR section 200.311 (2 CFR section 200.311(a)). Real property will be used for the originally authorized purpose as long as needed for that purpose, during which time the non-federal entity must not dispose of or encumber title to or other interests in the real property (2 CFR section 200.311(b)).

When real property is no longer needed for the originally authorized purpose, the non-federal entity must obtain disposition instructions from the federal awarding agency or the pass-through entity, as applicable. When real property is sold, sales procedures must be followed that provide for competition to the extent practicable and result in the highest possible return. If sold, non-federal entities must compensate the federal awarding agency for the portion of the net sales proceeds that represents the federal agency’s interest in the real property, which is the amount calculated by multiplying the current market value or sale proceeds by the federal agency’s participation in total project costs. If the property is retained, the non-federal entity must compensate the federal awarding agency for the federal portion of the current fair market value of the property. Disposition instructions may also provide for transfer of title to the federal awarding agency or a designated third party, in which case the non-federal entity is entitled to the non-federal interest in the property, which is calculated by multiplying the current market value or sale proceeds by the non-federal entity’s share in total project costs (2 CFR section 200.311(c)(3)).

## **Equipment and Real Property Management – Cost-Reimbursement Contracts under the Federal Acquisition Regulation**

Equipment and real property management requirements for cost-reimbursement contracts are specified in the FAR clause at 48 CFR section 52.245-1. Federal government property as defined in the FAR includes both equipment and real property. Title to federal government property acquired by a non-federal entity normally vests in the federal government, unless otherwise noted in the contract terms and conditions. The FAR requires:

1. A system of internal controls to manage (control, use, preserve, protect, repair, and maintain) federal government property and a process to enable the prompt recognition, investigation, disclosure and reporting of loss of federal government property.
2. Federal government property must be used for performing the contract for which it was acquired unless otherwise provided for in the contract or approved by the federal awarding agency.
3. Property records must be maintained and include the name, part number and description, and other elements as necessary and required in accordance with the terms and conditions of the contract, quantity received, unit acquisition cost, unique-item identifier, accountable contract number, location, disposition, and posting reference and date of transaction.
4. A physical inventory must be periodically performed, recorded, and disclosed. Except as provided for in the contract, the non-federal entity must not dispose of inventory until authorized by the federal awarding agency. The non-federal entity may purchase the property at the unit acquisition cost if desired or make reasonable efforts to return unused property to the appropriate supplier at fair market value.

### **Source of Governing Requirements**

The requirements for equipment and real property are contained in 2 CFR section 200.313 (equipment), 2 CFR section 200.311 (real property), 48 CFR section 52.245-1 (equipment and real property), program legislation, federal awarding agency regulations, and the terms and conditions of the federal award.

### **Audit Objectives**

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. Determine whether the non-federal entity maintains proper records for equipment and adequately safeguards and maintains equipment.

3. Determine whether disposition or encumbrance of any equipment or real property acquired or improved under federal awards is in accordance with federal requirements and that the federal awarding agency was properly compensated for its portion of any property sold or converted to non-federal use.

### **Suggested Audit Procedures – Internal Control**

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for equipment and real property management and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the remaining risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

### **Suggested Audit Procedures – Compliance**

#### *States – Grants and Cooperative Agreements Only*

1. Select a sample of equipment transactions acquired under federal awards and test for compliance with the state's policies and procedures for management and disposition of equipment.

#### *Non-Federal Entities Other than States and States with Cost-Reimbursement Contracts under the FAR*

2. Inventory Management of Equipment Acquired Under Federal Awards
  - a. Identify equipment acquired and trace selected purchases to the property records. Verify that the property records contain the required information.
  - b. Verify that the required physical inventory of equipment was performed. Test whether any differences between the physical inventory and equipment records were resolved.
  - c. Select a sample from all equipment acquired under federal awards from the property records and physically inspect the equipment and determine whether the equipment is appropriately safeguarded and maintained.

3. Disposition of Equipment Acquired Under Federal Awards
  - a. Identify equipment dispositions for the audit period and perform procedures to verify that the dispositions of equipment acquired under federal awards were properly reflected in the property records.
  - b. For dispositions of equipment acquired under grants and cooperative agreements with a current per-unit fair market value of \$5,000 or more, verify whether the federal awarding agency was reimbursed for the federal portion of the current market value or sales proceeds.
  - c. For dispositions of equipment acquired under cost-reimbursement contracts, verify that the non-federal entity followed federal awarding agency disposition instructions.
  
4. Disposition of Real Property Acquired Under Federal Awards
  - a. Identify real property dispositions for the audit period and determine whether such real property was acquired or improved under federal awards.
  - b. For dispositions of real property acquired or improved under federal awards, perform procedures to verify that the non-federal entity followed the instructions of the federal awarding agency or pass-through entity, which normally require reimbursement to the federal awarding agency for the federal portion of net sales proceeds or fair market value at the time of disposition, as applicable.

## G. MATCHING, LEVEL OF EFFORT, EARMARKING

### Compliance Requirements

The specific requirements for matching, level of effort, and earmarking are unique to each federal program and are found in the statutes, regulations, and the terms and conditions of awards pertaining to the program. For programs listed in this Supplement, these specific requirements are in Part 4, “Agency Program Requirements,” or Part 5, “Clusters of Programs,” as applicable.

However, for matching, 2 CFR section 200.306 provides detailed criteria for acceptable costs and contributions. The following is a list of the basic criteria for acceptable matching:

- Are verifiable from the non-federal entity’s records;
- Are not included as contributions for any other federal award;
- Are necessary and reasonable for accomplishment of project or program objectives;
- Are allowed under 2 CFR part 200, subpart E (Cost Principles);
- Are not paid by the federal government under another award, except where the federal statute authorizing a program specifically provides that federal funds made available for such program can be applied to matching or cost sharing requirements of other federal programs;
- Are provided for in the approved budget when required by the federal awarding agency; and
- Conform to other provisions of this part, as applicable.

“Matching,” “level of effort,” and “earmarking” are defined as follows:

1. *Matching* or cost sharing includes requirements to provide contributions (usually non-federal) of a specified amount or percentage to match federal awards. Matching may be in the form of allowable costs incurred or in-kind contributions (including third-party in-kind contributions).
2. *Level of effort* includes requirements for (a) a specified level of service to be provided from period to period, (b) a specified level of expenditures from non-federal or federal sources for specified activities to be maintained from period to period, and (c) federal funds to supplement and not supplant non-federal funding of services.
3. *Earmarking* includes requirements that specify the minimum and/or maximum amount or percentage of the program’s funding that must/may be used for specified activities, including funds provided to subrecipients. Earmarking may also be specified in relation to the types of participants covered.

## Source of Governing Requirements

The requirements for matching are contained in 2 CFR section 200.306, program legislation, federal awarding agency regulations, and the terms and conditions of the award. The requirements for level of effort and earmarking are contained in program legislation, federal awarding agency regulations, and the terms and conditions of the award.

## Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. *Matching* – Determine whether the minimum amount or percentage of contributions or matching funds was provided.
3. *Level of Effort* – Determine whether specified service or expenditure levels were maintained.
4. *Earmarking* – Determine whether minimum or maximum limits for specified purposes or types of participants were met.

## Suggested Audit Procedures – Internal Control

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for matching, level of effort, earmarking and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the remaining risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

## Suggested Audit Procedures – Compliance

### 1. Matching

- a. Perform tests to verify that the required matching contributions were met.
- b. Ascertain the sources of matching contributions and perform tests to verify that they were from an allowable source.

- c. Test records to corroborate that the values placed on in-kind contributions (including third party in-kind contributions) are in accordance with 2 CFR sections 200.306, 200.434, and 200.414, and the terms and conditions of the award.
- d. Test transactions used to match for compliance with the allowable costs/cost principles requirements. This test may be performed in conjunction with the testing of the requirements related to allowable costs/cost principles.

## **2. Level of Effort**

### **2.1 Level of Effort – *Maintenance of Effort***

- a. Identify the required level of effort and perform tests to verify that the level of effort requirement was met.
- b. Perform test to verify that only allowable categories of expenditures or other effort indicators (e.g., hours, number of people served) were included in the computation and that the categories were consistent from year to year. For example, in some programs, capital expenditures may not be included in the computation.
- c. Perform procedures to verify that the amounts used in the computation were derived from the books and records from which the audited financial statements were prepared.
- d. Perform procedures to verify that non-monetary effort indicators were supported by official records.

### **2.2 Level of Effort – *Supplement Not Supplant***

- a. Ascertain if the non-federal entity used federal funds to provide services which they were required to make available under federal, state, or local law and were also made available by funds subject to a supplement not supplant requirement.
- b. Ascertain if the non-federal entity used federal funds to provide services which were provided with non-federal funds in the prior year.
  - (1) Identify the federally funded services.
  - (2) Perform procedures to determine whether the federal program funded services that were previously provided with non-federal funds.
  - (3) Perform procedures to ascertain if the total level of services applicable to the requirement increased in proportion to the level of federal contribution.

### 3. Earmarking

- a. Identify the applicable percentage or dollar requirements for earmarking.
- b. Perform procedures to verify that the amounts recorded in the financial records met the requirements (e.g., when a minimum amount is required to be spent for a specified type of service, perform procedures to verify that the financial records show that at least the minimum amount for this type of service was charged to the program; or, when the amount spent on a specified type of service may not exceed a maximum amount, perform procedures to verify that the financial records show no more than this maximum amount for the specified type of service was charged to the program).
- c. When earmarking requirements specify a minimum percentage or amount, select a sample of transactions supporting the specified amount or percentage and perform tests to verify proper classification to meet the minimum percentage or amount.
- d. When the earmarking requirements specify a maximum percentage or amount, review the financial records to identify transactions for the specified activity which were improperly classified in another account (e.g., if only 10 percent may be spent for administrative costs, review accounts for other than administrative costs to identify administrative costs which were improperly classified elsewhere and cause the maximum percentage or amount to be exceeded).
- e. When earmarking requirements prescribe the minimum number or percentage of specified types of participants that can be served, select a sample of participants that are counted toward meeting the minimum requirement and perform tests to verify that they were properly classified.
- f. When earmarking requirements prescribe the maximum number or percentage of specified types of participants that can be served, select a sample of other participants and perform tests to verify that they were not of the specified type.

## H. PERIOD OF PERFORMANCE

### Compliance Requirements

A non-federal entity may charge to the federal award only allowable costs incurred during the period of performance and any costs incurred before the federal awarding agency or pass-through entity made the federal award that were authorized by the federal awarding agency or pass-through entity (2 CFR section 200.309).

Unless the federal awarding agency or pass-through entity authorizes an extension, a non-federal entity must liquidate all obligations incurred under the federal award not later than 90 calendar days after the end date of the period of performance as specified in the terms and conditions of the federal award (2 CFR section 200.343(b)). When used in connection with a non-federal entity's utilization of funds under a federal award, "obligations" means orders placed for property and services, contracts and subawards made, and similar transactions during a given period that require payment by the non-federal entity during the same or a future period (2 CFR section 200.71).

### Source of Governing Requirements

The requirements for the period of performance are contained in 2 CFR section 200.71 (definition of "obligations"), 2 CFR section 200.77 (definition of "period of performance"), 2 CFR section 200.309 (period of performance), 2 CFR section 200.343 (closeout), program legislation, federal awarding agency regulations; and the terms and conditions of the award.

### Audit Objectives

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. Determine whether the federal award was only charged for: (a) allowable costs incurred during the period of performance; or (b) costs incurred prior to the date the federal award was made that were authorized by the federal awarding agency or pass-through entity.
3. Determine whether obligations were liquidated within the required time period.

### Suggested Audit Procedures – Internal Control

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for the period of performance and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.

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

### **Suggested Audit Procedures – Compliance**

1. Review the award documents and regulations pertaining to the program and determine any award-specific requirements related to the period of performance.
2. For federal awards with performance period beginning dates during the audit period, test transactions for costs recorded during the beginning of the period of performance and verify that the costs were not incurred prior to the start of the period of performance unless authorized by the federal awarding agency or the pass-through entity.
3. For federal awards with performance period ending dates during the audit period, test transactions for costs recorded during the latter part and after the period of performance and verify that the costs had been incurred within the period of performance.
4. For federal awards with performance period ending dates during the audit period, test transactions for federal award costs for which the obligation had not been liquidated (payment made) as of the end of the period of performance and verify that the liquidation occurred within the allowed time period.
5. Test adjustments (e.g., manual journal entries) for federal award costs and verify that these adjustments were for transactions that occurred during the period of performance.

## I. PROCUREMENT AND SUSPENSION AND DEBARMENT

### Compliance Requirements - Procurement

#### 1. Procurement—Grants and Cooperative Agreements

##### *States*

When procuring property and services, states must use the same policies and procedures they use for procurements from their non-federal funds (2 CFR section 200.317).

##### *Non-Federal Entities Other than States*

Non-federal entities other than states, including those operating federal programs as subrecipients of states, must follow the procurement standards set out at 2 CFR sections 200.318 through 200.326. They must use their own documented procurement procedures, which reflect applicable state and local laws and regulations, provided that the procurements conform to applicable federal statutes and the procurement requirements identified in 2 CFR part 200. A non-federal entity must:

1. Meet the general procurement standards in 2 CFR section 200.318, which include oversight of contractors' performance, maintaining written standards of conduct for employees involved in contracting, awarding contracts only to responsible contractors, and maintaining records to document history of procurements.
2. Conduct all procurement transactions in a manner providing full and open competition, in accordance with 2 CFR section 200.319.
3. Use the micro-purchase and small purchase methods only for procurements that meet the applicable criteria under 2 CFR sections 200.320(a) and (b). Under the micro-purchase method, the aggregate dollar amount does not exceed \$3,500 (\$2,000 in the case of acquisition for construction subject to the Wage Rate Requirements (Davis-Bacon Act)). Small purchase procedures are used for purchases that exceed the micro-purchase amount but do not exceed the simplified acquisition threshold. Micro-purchases may be awarded without soliciting competitive quotations if the non-federal entity considers the price to be reasonable (2 CFR section 200.320(a)). If small purchase procedures are used, price or rate quotations must be obtained from an adequate number of qualified sources (2 CFR section 200.320(b)). See discussion regarding higher thresholds for micro-purchase and small purchase methods in the NDAA 2017 and 2018 sections in this Part.
4. For acquisitions exceeding the simplified acquisition threshold, the non-federal entity must use one of the following procurement methods: the sealed bid method if the acquisition meets the criteria in 2 CFR section 200.320(c); the competitive proposals method under the conditions specified in 2 CFR section 200.320(d); or the noncompetitive proposals method (i.e., solicit a proposal from only one source) but only when one or more of four circumstances are met, in accordance with 2 CFR section 200.320(f).

5. Perform a cost or price analysis in connection with every procurement action in excess of the simplified acquisition threshold, including contract modifications (2 CFR section 200.323(a)). The cost plus a percentage of cost and percentage of construction cost methods of contracting must not be used (2 CFR section 200.323(d)).
6. Ensure that every purchase order or other contract includes applicable provisions required by 2 CFR section 200.326. These provisions are described in Appendix II to 2 CFR part 200, “Contract Provisions for Non-Federal Entity Contracts Under Federal Awards.”

## **2. Procurement—Cost-Reimbursement Contracts under the Federal Acquisition Regulation**

When awarding subcontracts, non-federal entities receiving cost-reimbursement contracts under the FAR must comply with the clauses at 48 CFR section 52.244-2 (consent to subcontract), 52.244-5 (competition), 52.203-13 (code of business ethics), 52.203-16 (conflicts of interest), and 52.215.12 (cost or pricing data); and the terms and conditions of the contract. The FAR defines “subcontracts” as a contract, i.e., a mutually binding legal relationship obligating the seller to furnish the supplies or services (including construction) and the buyer to pay for them, entered into by a subcontractor to furnish supplies or services for performance of a prime contract or a subcontract. It includes, but is not limited to, purchase orders, and changes and modifications to purchase orders.

### **Source of Governing Requirements – Procurement**

The requirements that apply to procurement under grants and cooperative agreements are contained in 2 CFR sections 200.317 through 200.326, program legislation, federal awarding agency regulations, and the terms and conditions of the award. The requirements that apply to procurement under cost-reimbursement contracts under the FAR are contained in 48 CFR parts 03, 15, 44 and the clauses at 48 CFR sections 52.244-2, 52.244-5, 52.203-13, 52.203-16, and 52.215-12; agency FAR Supplements; and the terms and conditions of the contract.

### **Compliance Requirements – Suspension and Debarment**

Non-federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred. “Covered transactions” include contracts for goods and services awarded under a non-procurement transaction (e.g., grant or cooperative agreement) that are expected to equal or exceed \$25,000 or meet certain other criteria as specified in 2 CFR section 180.220. All non-procurement transactions entered into by a pass-through entity (i.e., subawards to subrecipients), irrespective of award amount, are considered covered transactions, unless they are exempt as provided in 2 CFR section 180.215.

When a non-federal entity enters into a covered transaction with an entity at a lower tier, the non-federal entity must verify that the entity, as defined in 2 CFR section 180.995 and agency adopting regulations, is not suspended or debarred or otherwise excluded from participating in the transaction. This verification may be accomplished by (1) checking the System for Award Management (SAM) Exclusions maintained by the General Services Administration (GSA) and available at <https://www.sam.gov/SAM/> (click on Search Record, then click on Advanced

Search-Exclusions) (**Note:** The OMB guidance at 2 CFR part 180 and agency implementing regulations still refer to the SAM Exclusions as the Excluded Parties List System (EPLS)), (2) collecting a certification from the entity, or (3) adding a clause or condition to the covered transaction with that entity (2 CFR section 180.300).

Non-federal entities receiving contracts from the federal government are required to comply with the contract clause at FAR 52.209-6 before entering into a subcontract that will exceed \$30,000, other than a subcontract for a commercially available off-the-shelf item.

### **Source of Governing Requirements – Suspension and Debarment**

The requirements for nonprocurement suspension and debarment are contained in OMB guidance in 2 CFR part 180, which implements Executive Orders 12549 and 12689, “Debarment and Suspension;” federal awarding agency regulations in Title 2 of the CFR adopting/implementing the OMB guidance in 2 CFR part 180; program legislation; and the terms and conditions of the award.

Most federal agencies have adopted or implemented 2 CFR part 180, generally by relocating their associated agency rules in Title 2 of the CFR. Appendix II to the Supplement includes the current CFR citations for all agencies adoption or implementation of the nonprocurement suspension and debarment guidance.

Government-wide requirements related to suspension and debarment and doing business with suspended or debarred subcontractors under cost reimbursement contracts under the FAR are contained in 48 CFR section 9.405-2(b) and the clause at 48 CFR section 52.209-6.

### **National Defense Authorization Act (NDAA) of 2017 and 2018**

The following information is provided regarding timing and impact of the NDAA of 2017 and 2018. Additional guidance to the auditor is provided in Appendix VII-A – “Other Audit Advisories” of the Supplement.

#### *NDAA of 2017*

The NDAA of 2017, Section 217 (Pub. L. No. 114-328, 130 Stat. 6 (2016)) and 41 USC 1902(a)(2) contained the following provisions.

- Raise the micro-purchase threshold to \$10,000 for procurements under grants and cooperative agreements to institutions of higher education or related or affiliated nonprofit entities, independent research institutes and nonprofit research organizations.
- Allow a threshold higher than \$10,000 as determined appropriate by the head of the relevant executive agency.

The provisions of this Act are specific to institutions of higher education or related or affiliated nonprofit entities, independent research institutes and nonprofit research organizations. Official OMB guidance M-18-18 (<https://www.whitehouse.gov/wp-content/uploads/2018/06/M-18-18.pdf>) was issued on June 20, 2018, and indicated that the effective date of this Act was when

the NDAA 2017 was signed into law on December 23, 2016. It also states that the non-federal entity must document this decision in its internal procurement policies.

Note that the exception for higher micro-purchase threshold is *not available to ALL auditees* and that when implemented by eligible auditees, it would apply to procurements purchased under ALL federal grants and cooperative agreements.

Institutions of higher education, or related or affiliated nonprofit entities, independent research institutes and nonprofit research organizations also can request micro-purchase threshold higher than \$10,000, but in accordance with OMB M-18-18, it would need a formal approval from the entity's cognizant federal agency for indirect cost rates. Once approved, the non-federal entity must document this decision to use the higher threshold in its internal procurement policies.

### *NDAA of 2018*

The NDAA of 2018, Sections 805 (41 USC 134) and 806 (41 USC 1902 (a) (1)), increased the simplified acquisition threshold to \$250,000 and the micro-purchase threshold to \$10,000, respectively. These changes effectively redefine the level for the simplified acquisition threshold (section 200.88 of the Uniform Guidance) and the micro-purchase threshold (section 200.67 of the Uniform Guidance). These changes will become effective when they are formally codified in the Federal Acquisition Regulations (FAR) (proposed 10/02/2019, 84 FR 52420).

Once codified, the higher thresholds will be available to all auditees. The non-federal entity must document this decision to use the higher thresholds in its internal procurement policies.

OMB M-18-18 allows the federal agencies to permit the use of the higher thresholds by the grant recipients and states that "agencies should apply this exception to all recipients." This action allows the maximum flexibility to grant recipients for early implementation, effectively June 20, 2018, with the approval of the federal cognizant agency for indirect costs rates. Grant recipients should document any change based on this exception in its internal procurement policies. Also see Appendix VII of this Supplement related to audit findings.

### **Availability of Other Information**

2 CFR section 200.110(a), Effective/Applicability Date was amended on May 17, 2017, to allow non-federal entities to continue to comply with the procurement standards in OMB Circular A-110 or the A-102 common rule, as applicable, through December 25, 2017, extending the grace period from two years to three years. Implementation of the procurement standards in 2 CFR sections 200.317 through 200.326 was required for auditee fiscal years beginning on or after December 26, 2017. For example, for a non-federal entity with a June 30th year end, implementation was required for its fiscal year beginning July 1, 2018.

### **Audit Objectives**

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).

2. Determine whether procurements under federal awards were made in compliance with applicable federal regulations and other procurement requirements specific to an award or subaward.
3. For covered transactions determine whether the non-federal entity verified that entities are not suspended, debarred, or otherwise excluded.

### **Suggested Audit Procedures – Internal Control**

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for procurement and suspension and debarment requirements and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the remaining risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

### **Suggested Audit Procedures – Compliance**

*(Procedure 1 applies only to states under grants and cooperative agreements.)*

1. Test a sample of procurements to ascertain if the state's laws and procedures were followed and that the policies and procedures used were the same as for non-federal funds (2 CFR section 200.317).

*(Procedures 2 – 5 apply to non-federal entities other than states.)*

2. Obtain the entity's procurement policies and verify that the policies comply with the compliance requirements highlighted above.
3. Verify that the entity has written standards of conduct that cover conflicts of interest and govern the performance of its employees engaged in the selection, award, and administration of contracts (2 CFR section 200.318(c) and 48 CFR sections 52.203-13 and 52.303-16).
4. Ascertain if the entity has a policy to use statutorily or administratively imposed in-state or local geographical preferences in the evaluation of bids or proposals. If yes, verify that these limitations were not applied to federally funded procurements except where applicable federal statutes expressly mandate or encourage geographic preference (2 CFR section 200.319(b)).

5. Select a sample of procurements and perform the following procedures:
- a. Examine contract files and verify that they document the history of the procurement, including the rationale for the method of procurement, selection of contract type, basis for contractor selection, and the basis for the contract price (2 CFR section 200.318(i) and 48 CFR part 44 and section 52.244-2).
  - b. For grants and cooperative agreements, verify that the procurement method used was appropriate based on the dollar amount and conditions specified in 2 CFR section 200.320. Current micro-purchase and simplified acquisition thresholds can be found in the FAR (48 CFR subpart 2.1, "Definitions").
  - c. Verify that procurements provide full and open competition (2 CFR section 200.319 and 48 CFR section 52.244-5).
  - d. Examine documentation in support of the rationale to limit competition in those cases where competition was limited and ascertain if the limitation was justified (2 CFR sections 200.319 and 200.320(f) and 48 CFR section 52.244-5).
  - e. Ascertain if cost or price analysis was performed in connection with all procurement actions exceeding the simplified acquisition threshold, including contract modifications, and that this analysis supported the procurement action (2 CFR section 200.323 and 48 CFR section 15.404-3).

**Note:** A cost or price analysis is required for each procurement action, including each contract modification, when the total amount of the contract and related modifications is greater than the simplified acquisition threshold.

- f. Verify consent to subcontract was obtained when required by the terms and conditions of a cost reimbursement contract under the FAR (48 CFR section 52.244-2).

**Note:** If the non-federal entity has an approved purchasing system, consent to subcontract may not be required unless specifically identified by contract terms or conditions. The auditor should verify that the approval of the purchasing system is effective for the audit period being reviewed.

- g. Refer to Appendix VII for guidance on reporting audit test results during the implementation periods for the National Defense Authorization Acts of 2017 and 2018.

*(Procedures 6 and 7 apply to all non-federal entities.)*

6. Review the non-federal entity's procedures for verifying that an entity with which it plans to enter into a covered transaction is not debarred, suspended, or otherwise excluded (2 CFR sections 200.212 and 200.318(h); 2 CFR section 180.300; 48 CFR section 52.209-6).
7. Select a sample of procurements and subawards and test whether the non-federal entity followed its procedures before entering into a covered transaction.

## J. PROGRAM INCOME

### Compliance Requirements

Program income is gross income earned by a non-federal entity that is directly generated by a supported activity or earned as a result of the federal award during the period of performance (unless there is a requirement for disposition of program income after the end of the period of performance as provided in 2 CFR section 200.307(f)).

Program income (2 CFR section 200.80) includes, but is not limited to income from:

- Fees for services performed,
- The use or rental of real or personal property acquired under federal awards,
- The sale of commodities or items fabricated under federal awards,
- License fees and royalties on patents and copyrights, except as provided below, and
- Principal and interest on loans made with federal award funds.

Program income does *not* include:

- Interest earned on advances of federal funds.
- Except as otherwise provided in federal statutes, regulations or the terms and conditions of the federal award, rebates, credits, discounts and interest earned on any of them.
- Taxes, special assessments, levies, fines, and other such revenues raised by a non-federal entity, unless the federal award or federal awarding agency regulations specifically identify the revenues as program income (2 CFR section 200.307(c)).
- The proceeds from the sale of equipment or real property acquired in whole or in part under the federal award (2 CFR section 200.307(d)).
- Royalties or income earned by an institution of higher education or a nonprofit organization on inventions conceived or first actually reduced to practice in the performance of work under a funding agreement with a federal agency that is shared with the inventor (2 CFR section 200.307(g); 37 CFR sections 401.2 and 401.14(k); 35 USC 201(i), and 35 USC 202(c)(7)(B)).

If authorized by federal regulations or the federal award, costs incidental to the generation of program income may be deducted from gross income to determine program income, provided those costs have not been charged to the federal award (2 CFR section 200.307(b)).

Program income may be used in any of the following three methods, consistent with 2 CFR section 200.307(e):

1. *Deduction*

Program income is deducted from total allowable costs in order to determine the net allowable costs, rather than to increase the funds committed to the project. This method must be used if the federal awarding agency has given no prior approval for how program income is to be used and its regulations and the terms and conditions of the federal award are silent on this matter. Where this method is used, program income must be applied to current costs unless the federal awarding agency authorizes otherwise (2 CFR section 200.307(e)(1)).

2. *Addition*

With prior approval of the federal awarding agency, program income may be added to the federal award by the federal agency and the non-federal entity. This method must be used for federal awards to institutions of higher education and nonprofit research institutions if the federal awarding agency does not specify in its regulations or the terms and conditions of the federal award how program income is to be used (2 CFR section 200.307(e)(2)).

3. *Cost Sharing or Matching*

With prior approval of the federal awarding agency, program income may be used to meet the cost sharing or matching requirement of the federal award. The amount of the federal award remains the same (2 CFR section 200.307(e)(3)).

Unless federal awarding agency regulations or the terms and conditions of the federal award specify otherwise, non-federal entities have no obligation to the federal government regarding program income earned after the end of the period of performance (2 CFR section 200.307(f)).

### **Source of Governing Requirements**

The requirements that apply to program income are contained in 2 CFR section 200.80 (definition of “program income”), 2 CFR section 200.307 (program income), program legislation, federal awarding agency regulations, and the terms and conditions of the federal award.

### **Audit Objectives**

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. Determine whether program income is correctly determined, recorded, and used in accordance with applicable governing requirements.

**Suggested Audit Procedures – Internal Control**

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for program income and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the remaining risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

**Suggested Audit Procedures – Compliance**

1. *Identify Program Income*
  - a. Review the statutes, regulations, and terms and conditions of the federal award applicable to the program and ascertain if program income was anticipated. If so, ascertain the requirements for determining or assessing the amount of program income (e.g., a scale for determining user fees, prohibition of assessing fees against certain groups of individuals), and the requirements for recording and using program income.
  - b. Inquire of management and review accounting records to ascertain if program income was received.
2. *Determining or Assessing Program Income* – Perform tests to verify that program income was properly determined or calculated in accordance with stated criteria, and that amounts collected were classified as program income only if collected from allowable sources.
3. *Recording of Program Income* – Perform tests to verify that all program income was properly recorded in the accounting records.
4. *Use of Program Income* – Perform tests to ascertain if program income was used in accordance with 2 CFR section 200.307(e) and the program requirements set by the federal awarding agency in its regulations and the terms and conditions of the award.

**K. [RESERVED]**

## L. REPORTING

### Compliance Requirements

For purposes of programs included in parts 4 and 5 of this Supplement, the designation “Not Applicable” in relation to “Financial Reporting,” “Performance Reporting,” and “Special Reporting” means that the auditor is not expected to audit anything in these categories, whether or not award terms and conditions may require such reporting.

#### *Financial Reporting*

Recipients must use the standard financial reporting forms or such other forms as may be authorized by OMB (approval is indicated by an OMB paperwork control number on the form) when reporting to the federal awarding agency. Each recipient must report program outlays and program income on a cash or accrual basis, as prescribed by the federal awarding agency. If the federal awarding agency requires reporting of accrual information and the recipient’s accounting records are not normally maintained on the accrual basis, the recipient is not required to convert its accounting system to an accrual basis but may develop such accrual information through analysis of available documentation. The federal awarding agency may accept identical information from the recipient in machine-readable format, computer printouts, or electronic outputs in lieu of closed formats or on paper.

Similarly, a pass-through entity must not require a subrecipient to establish an accrual accounting system and must allow the subrecipient to develop accrual data for its reports on the basis of an analysis of available documentation.

The financial reporting requirements for subrecipients are as specified by the pass-through entity. In many cases, these will be the same as or similar to those for recipients.

The standard financial reporting forms for grants and cooperative agreements are as follows:

- *Request for Advance or Reimbursement (SF-270) (OMB No. 0348-0004)*. Recipients are required to use the SF-270 to request reimbursement payments under non-construction programs, and may be required to use it to request advance payments.
- *Outlay Report and Request for Reimbursement for Construction Programs (SF-271) (OMB No. 0348-0002)*. Recipients use the SF-271 to request funds for construction projects unless they are paid in advance or the SF-270 is used.
- *Federal Financial Report (FFR) (SF-425/SF-425A) (OMB No. 0348-0061)*. Recipients use the FFR as a standardized format to report expenditures under federal awards, as well as, when applicable, cash status (Lines 10.a, 10.b, and 10c). References to this report include its applicability as both an expenditure and a cash status report unless otherwise indicated.

Electronic versions of the standard forms are located on agency’s home page.

Financial reporting requirements for cost reimbursement contracts subject to the FAR are contained in the terms and conditions of the contract.

### *Performance and Special Reporting*

Non-federal entities may be required to submit performance reports at least annually but not more frequently than quarterly, except in unusual circumstances, using a form or format authorized by OMB (2 CFR section 200.328(b)(1)). They also may be required to submit special reports as required by the terms and conditions of the federal award.

Compliance testing of performance and special reporting are only required for data that are quantifiable and meet the following criteria:

1. Have a direct and material effect on the program.
2. Are capable of evaluation against objective criteria stated in the statutes, regulations, contract or grant agreements pertaining to the program.

Performance and special reporting data specified in Part 4, “Agency Program Requirements,” and Part 5, “Clusters of Programs,” meet the above criteria.

### **Source of Governing Requirements**

Reporting requirements are contained in the following:

1. Financial reporting, 2 CFR section 200.327.
2. Monitoring and reporting program performance, 2 CFR section 200.328.
3. Program legislation.
4. Federal awarding agency regulations.
5. The terms and conditions of the award.

### **Audit Objectives**

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. Determine whether required reports for federal awards include all activity of the reporting period, are supported by applicable accounting or performance records, and are fairly presented in accordance with governing requirements.

**Suggested Audit Procedures – Internal Control**

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for reporting and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the remaining risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

**Suggested Audit Procedures – Compliance**

**Note:** For recipients using HHS' Payment Management System (PMS) to draw federal funds, the auditor should consider the following steps numbered 1 through 4 as they pertain to the cash reporting portion of the SF-425A, regardless of the source of the data included in the PMS reports. (During FY 2016, HHS is completing the transition from pooled payment to use of subaccounts.) Although certain data is supplied by the federal awarding agency (e.g., award authorization amounts) and certain amounts are provided by HHS' Payment Management Services, the auditor should ensure that such amounts are in agreement with the recipient's records and are otherwise accurate.

1. Review applicable statutes, regulations, and the terms and conditions of the federal award pertaining to reporting requirements. Determine the types and frequency of required reports. Obtain and review federal awarding agency or pass-through entity, in the case of a subrecipient, instructions for completing the reports.
  - a. For financial reports, ascertain the accounting basis used in reporting the data (e.g., cash or accrual).
  - b. For performance and special reports, determine the criteria and methodology used in compiling and reporting the data.
2. Select a sample of reports and perform appropriate analytical procedures and ascertain the reason for any unexpected differences. Examples of analytical procedures include:
  - a. Comparing current period reports to prior period reports.
  - b. Comparing anticipated results to the data included in the reports.

- c. Comparing information obtained during the audit of the financial statements to the reports.
3. Select a sample of each of the following report types, and test for accuracy and completeness:
    - a. *Financial reports*
      - (1) Ascertain if the financial reports were prepared in accordance with the required accounting basis.
      - (2) Review accounting records and ascertain if all applicable accounts were included in the sampled reports (e.g., program income, expenditure credits, loans, interest earned on federal funds, and reserve funds).
      - (3) Trace the amounts reported to accounting records that support the audited financial statements and the Schedule of Expenditures of Federal Awards and verify agreement or perform alternative procedures to verify the accuracy and completeness of the reports and that they agree with the accounting records. If reports require information on an accrual basis and the entity does not prepare its accounting records on an accrual basis, determine whether the reported information is supported by available documentation.
      - (4) For any discrepancies noted in SF-425 reports concerning cash status when the advance payment method is used, review subsequent SF-425 reports to ascertain if the discrepancies were appropriately resolved with the applicable payment system.
    - b. *Performance and special reports*
      - (1) Review the supporting records and ascertain if all applicable data elements were included in the sampled reports. Trace the reported data to records that accumulate and summarize data.
      - (2) Perform tests of the underlying data to verify that the data were accumulated and summarized in accordance with the required or stated criteria and methodology, including the accuracy and completeness of the reports.
    - c. *For each type of report*
      - (1) When intervening computations or calculations are required between the records and the reports, trace reported data elements to supporting worksheets or other documentation that link reports to the data.
      - (2) Test mathematical accuracy of reports and supporting worksheets.

4. Obtain written representation from management that the reports provided to the auditor are true copies of the reports submitted or electronically transmitted to the federal awarding agency, the applicable payment system, or pass-through entity in the case of a subrecipient.

## M. SUBRECIPIENT MONITORING

**Note:** Transfers of federal awards to another component of the same auditee under 2 CFR part 200, subpart F, do not constitute a subrecipient or contractor relationship.

### Compliance Requirements

A pass-through entity (PTE) must:

- *Identify the Award and Applicable Requirements* – Clearly identify to the subrecipient: (1) the award as a subaward at the time of subaward (or subsequent subaward modification) by providing the information described in 2 CFR section 200.331(a)(1); (2) all requirements imposed by the PTE on the subrecipient so that the federal award is used in accordance with federal statutes, regulations, and the terms and conditions of the award (2 CFR section 200.331(a)(2)); and (3) any additional requirements that the PTE imposes on the subrecipient in order for the PTE to meet its own responsibility for the federal award (e.g., financial, performance, and special reports) (2 CFR section 200.331(a)(3)).
- *Evaluate Risk* – Evaluate each subrecipient’s risk of noncompliance for purposes of determining the appropriate subrecipient monitoring related to the subaward (2 CFR section 200.331(b)). This evaluation of risk may include consideration of such factors as the following:
  1. The subrecipient’s prior experience with the same or similar subawards;
  2. The results of previous audits including whether or not the subrecipient receives single audit in accordance with 2 CFR part 200, subpart F, and the extent to which the same or similar subaward has been audited as a major program;
  3. Whether the subrecipient has new personnel or new or substantially changed systems; and
  4. The extent and results of federal awarding agency monitoring (e.g., if the subrecipient also receives federal awards directly from a federal awarding agency).
- *Monitor* – Monitor the activities of the subrecipient as necessary to ensure that the subaward is used for authorized purposes, complies with the terms and conditions of the subaward, and achieves performance goals (2 CFR sections 200.331(d) through (f)). In addition to procedures identified as necessary based upon the evaluation of subrecipient risk or specifically required by the terms and conditions of the award, subaward monitoring must include the following:
  1. Reviewing financial and programmatic (performance and special reports) required by the PTE.

2. Following-up and ensuring that the subrecipient takes timely and appropriate action on all deficiencies pertaining to the federal award provided to the subrecipient from the PTE detected through audits, on-site reviews, and other means.
  3. Issuing a management decision for audit findings pertaining to the federal award provided to the subrecipient from the PTE as required by 2 CFR section 200.521.
- *Ensure Accountability of For-Profit Subrecipients* – Some federal awards may be passed through to for-profit entities. For-profit subrecipients are accountable to the PTE for the use of the federal funds provided. Because 2 CFR part 200 does not make subpart F applicable to for-profit subrecipients, the PTE is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients for the subaward. The agreement with the for-profit subrecipient must describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the agreement, and post-award audits (2 CFR section 200.501(h)).

### **Source of Governing Requirements**

The requirements for subrecipient monitoring for the subaward are contained in 31 USC 7502(f)(2) (Single Audit Act Amendments of 1996 (Pub. L. No. 104-156)), 2 CFR sections 200.330, .331, and .501(h); federal awarding agency regulations; and the terms and conditions of the award.

### **Audit Objectives**

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. Determine whether the PTE identified the subaward and applicable requirements at the time of the subaward (or subsequent subaward modification) in the terms and conditions of the subaward and other award documents sufficient for the PTE to comply with federal statutes, regulations, and the terms and conditions of the federal award.
3. Determine whether the PTE monitored subrecipient activities to provide reasonable assurance that the subrecipient administered the subaward in compliance with the terms and conditions of the subaward.

### **Suggested Audit Procedures – Internal Control**

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.

2. Plan the testing of internal control to support a low assessed level of control risk for subrecipient monitoring and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether additional compliance tests and reporting are required because of ineffective internal control.
3. Consider the results of the testing of internal control in assessing the remaining risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.

### **Suggested Audit Procedures – Compliance**

**Note:** The auditor may consider coordinating the tests related to subrecipients performed as part of C, “Cash Management” (tests of cash reporting submitted by subrecipients); E, “Eligibility” (tests that subawards were made only to eligible subrecipients); and I, “Procurement and Suspension and Debarment” (tests of ensuring that a subrecipient is not suspended or debarred) with the testing of “Subrecipient Monitoring.”

1. Review the PTE’s subrecipient monitoring policies and procedures to gain an understanding of the PTE’s process to identify subawards, evaluate risk of noncompliance, and perform monitoring procedures based upon identified risks.
2. Review subaward documents including the terms and conditions of the subaward to ascertain if, at the time of subaward (or subsequent subaward modification), the PTE made the subrecipient aware of the award information required by 2 CFR section 200.331(a) sufficient for the PTE to comply with federal statutes, regulations, and the terms and conditions of the award.
3. Review the PTE’s documentation of monitoring the subaward and consider if the PTE’s monitoring provided reasonable assurance that the subrecipient used the subaward for authorized purposes in compliance with federal statutes, regulations, and the terms and conditions of the subaward.
4. Ascertain if the PTE verified that subrecipients expected to be audited as required by 2 CFR part 200, subpart F, met this requirement (2 CFR section 200.331(f)). This verification may be performed as part of the required monitoring under 2 CFR section 200.331(d)(2) to ensure that the subrecipient takes timely and appropriate action on deficiencies detected through audits.

## N. SPECIAL TESTS AND PROVISIONS

### Compliance Requirements

The specific requirements for Special Tests and Provisions are unique to each federal program and are found in the statutes, regulations, and the provisions of contract or grant agreements pertaining to the program. For programs listed in this Supplement, the compliance requirements, audit objectives, and suggested audit procedures for Special Tests and Provisions are in Part 4, “Agency Program Requirements,” or Part 5, “Clusters of Programs.” For programs not included in this Supplement, the auditor must review the program’s contract and grant agreements and referenced statutes and regulations to identify the compliance requirements and develop the audit objectives and audit procedures for Special Tests and Provisions which could have a direct and material effect on a major program. The auditor should also inquire of the non-federal entity to help identify and understand any Special Tests and Provisions.

Additionally, both for programs included and not included in this Supplement, the auditor must identify any additional compliance requirements which are not based in statute or regulation (e.g., were agreed to as part of audit resolution of prior audit findings), which could be material to a major program. Reasonable procedures to identify such compliance requirements would be inquiry of non-federal entity management and review of the contract and grant agreements pertaining to the program. Any such requirements which may have a direct and material effect on compliance with the requirements of that major program must be included in the audit.

### Internal Control

The following audit objective and suggested audit procedures should be considered in tests of special tests and provisions in addition to those provided in Part 4, “Agency Program Requirements;” Part 5, “Clusters of Programs;” and, in accordance with Part 7, “Guidance for Auditing Programs Not Included in This Compliance Supplement:”

### Audit Objectives

Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).

### Suggested Audit Procedures

1. Perform procedures to obtain an understanding of internal control sufficient to plan the audit to support a low assessed level of control risk for the program.
2. Plan the testing of internal control to support a low assessed level of control risk for special tests and provisions and perform the testing of internal control as planned. If internal control over some or all of the compliance requirements is likely to be ineffective, see the alternative procedures in 2 CFR section 200.514(c)(4), including reporting a significant deficiency or material weakness in accordance with 2 CFR section 200.516, assessing the control risk at the maximum and considering whether

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

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