

OMB Administrative Requirements

NASCSP

February 22, 2010

Kay Sohl

kay@kaysohlconsulting.net



Kay Sohl has provided training and consulting resources for over 4000 community-based nonprofit organizations and led workshops and discussions for national not-for-profit conferences of the American Institute of CPAs, the National Association for State Community Services Programs, CAPLAW and numerous state and regional associations of nonprofits and state program managers.

Kay designs her workshops to engage adult learners. Participants are encouraged to pose challenges and share strategies they have used to address key issues. Each workshop includes an extensive materials packet to help participants share what they have learned with others in their organizations through self assessment tools, checklists, and sample reports and forms.

Participants praise Kay's ability to make complex financial tools and concepts understandable for both nonfinancial and financial audiences and the depth of her understanding of the realities of life in often underfunded, overstressed nonprofit organizations. Through her experiences as a nonprofit board member, as well as an executive director, consultant, and auditor, Kay provides multiple perspectives on some of the most daunting issues confronting nonprofits today.

Financial Management Topics:

- **Managing Federal Funds**
- **Cost Allocation Challenges and Strategies**
- **Effective Board Financial Oversight**
- **Fraud Prevention and Internal Controls**
- **Nonprofit Financial Fundamentals:**
- **Budget Tools and Strategies**
- **Audit Prep Strategies**

Capacity Building Topics:

- **Leadership Transitions**
- **Building Infrastructure in Community-Based Nonprofits**
- **Getting and Keeping 501 (c) (3) Tax Exempt Status**
- **Nonprofit Spin-Offs from Governmental Entities**
- **Evaluating Mergers, Collaborations, and Shared Services**

Affordable Housing Topics

- **Budgeting & Forecasting in Affordable Housing**
- **Low Income Housing Tax Credit Financial Management Challenges**
- **Financial Info for Asset Management**
- **Board Financial Oversight in Affordable Housing**

Find out more about Kay's work at www.kaysohlconsulting.net

OMB Administrative Requirements

NASCSP
February 22, 2010

Kay Sohl
kay@kaysohlconsulting.net



How are Federal \$\$ like STDs?

www.kaysohlconsulting.net

Must Know Where Your \$ Has Been

- **Federal requirements**
stay attached to **federal \$\$\$** no matter how many intermediary recipients stand between the end recipient and the feds

www.kaysohlconsulting.net

Federal Requirements cover

- Direct federal agreements
- Federal dollars received through state or local government
- Sub-awards made by recipients of federal \$\$\$

www.kaysohlconsulting.net

**What Rules?
Rock, Paper, Scissors**

- Specific contract/grant agreement provisions
- OMB Circulars
- Code of Federal Regulations

www.kaysohlconsulting.net

OMB Circulars

- Use and management of Federal funds
- A-110 and A-122 for nonprofits
- A-87 and A-102 for state and local government

www.kaysohlconsulting.net

OMB A-133

- Audit requirements for nonprofits, government, and education expending more than **\$500,000** in federal funds in fiscal year
- A-133 Compliance Supplement provides guidance for specific federal programs
- A-133 Compliance Supplement Addendum – June, 2009 -ARRA

www.kaysohlconsulting.net

OMB Circulars are now in CFRS: Code of Federal Regulations

- For Nonprofits:
 - A-110 = **2 CFR 215**
 - A-122 = **2 CFR 230**
- For State, Local, & Tribes
 - A -87 = **2 CFR 225**
 - A -103 = **24 CFR 85**

www.kaysohlconsulting.net

Code of Federal Regulations

- Codification of rules published in Federal Register
- If any statute specifically prescribes policies or requirements that differ from OMB Circulars, the **provisions of the statute govern**

www.kaysohlconsulting.net

Organization of CFRs

- **50 Titles**
- **Title: Volume: Chapter: Part**
- **CSBG:**
 - 45 CFR Part 16
 - 45 CFR Part 74
 - 45 CFR Part 96

www.kaysohlconsulting.net

Key Online Tools

- **Code of Federal Regulations**
www.gpoaccess.gov/CFR
- **OMB Circulars**
www.whitehouse.gov/omb/circulars_a122_2004/

www.kaysohlconsulting.net

ARRA Requirements

- **Office of Community Services:
CSBG Information Memoranda**
- **OMB A-133 June, 2009
Compliance Supplement
Addendum**

www.kaysohlconsulting.net

Matrix for Federal Funds Recipients

- Identify all Federal sources and CFDA #s
- Identify applicable CFR provisions
- Identify CFR conflicts/additions to A-110 & A-122
- Identify any modifications required to systems and/or procedures

www.kaysohlconsulting.net

A-110: 2 CFR 215

Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Ed, Hospitals, and Nonprofit Organizations

www.kaysohlconsulting.net

A-110 Sub-parts

- A: Definition of terms
- B: Pre-award
- C: Management of award
- D: After the award

www.kaysohlconsulting.net

**A-110 Appendix A
Contract Provisions**

- Equal Opportunity Act
- Anti Kick-back
- Davis Bacon
- Work hours & safety
- Invention rights
- Clean Air Act
- Anti-Lobbying Act
- Debarment & Suspension

www.kaysohlconsulting.net

**A-110 Subpart C
Post Award Requirements**

- Financial & program management
- Property standards
- Procurement standards
- Reports & records

www.kaysohlconsulting.net

**A110 Financial & Program
Management Requirements**

- Records document source and application of funds for federally –sponsored activities
- Control over funds, property, other assets

www.kaysohlconsulting.net

Management- continued

- Comparison of budget to actual for each award
- Records supported by documentation
- Written procedures for
 - Cash management
 - Determination that expenditures are reasonable, allowable, allocable

www.kaysohlconsulting.net

Cash Management

- Separate bank account **not required**
- Must be able to track deposit & disbursement of funds
- Interest bearing accounts required (some exceptions)

www.kaysohlconsulting.net

Cost Sharing - Matching

- Verifiable
- Necessary for program goals
- Allowable
- Not counted as match for other federal program
- Not paid with federal \$

www.kaysohlconsulting.net

Program Income

- Generated through prog activity
- Retained by nonprofit
- Considered non-federal match
- Used for allowable program purposes

www.kaysohlconsulting.net

A-110 Procurement Requirements

- Avoid purchasing unnecessary items
- Analyze alternatives to identify the most economical and practical procurement
- Conduct solicitations properly

www.kaysohlconsulting.net

Purchasing Thresholds

- **< \$3,000:** No requirement to solicit competitive proposals
- **>3,000 but < 30,000:** obtain 3 or more oral or written proposals
- **> 30,000 but < 100,000:** written request for at least 3 proposals, obtain written proposals
- **>100,000:** Sealed bids per FARS

www.kaysohlconsulting.net

Procurement System Elements

- Written policies and procedures
- System for testing compliance
- Consequences for non-compliance
- Continuous review and revision as needed

www.kaysohlconsulting.net

Procurement Compliance Issues

- Documentation of analysis and rationale
- Suspension and Debarment checking
- Conflict of Interest

www.kaysohlconsulting.net

A-122: Cost Principles for Nonprofit Organizations

- For use by all federal agencies
- Determine costs for all work performed under grants, cooperative agreements, and contracts with nonprofits

www.kaysohlconsulting.net

A-122 Attachments

- A: General principles**
- B: Selected items of cost**
- C: Nonprofits that are not subject to A 122**

www.kaysohlconsulting.net

A-122 General Principles

- **Allowability**
- **Reasonableness**
- **Allocability of costs**

www.kaysohlconsulting.net

Allowable Costs

- **Reasonable**
- **Conform to limits – in A 122 and specific award**
- **Consistent with P&P of your organization**
- **In accord with GAAP**
- **Not included as match for any other award**
- **Documented adequately**

www.kaysohlconsulting.net

A-122 Allowable Costs: Attachment B

Defines specific costs as:

- Allowable
- Disallowable
- Allowable w. prior written approval
- Allowable when criteria are met

www.kaysohlconsulting.net

Reasonableness

- Prudent person test
- Restraints/ requirements of State or federal law, terms of award

www.kaysohlconsulting.net

Allocability Terms

- Cost Objective
- Direct Costs
- Indirect Costs

www.kaysohlconsulting.net

Cost Objective

- **Work unit for which costs are accumulated**
- **Could be a function, subdivision, contract, or grant**

www.kaysohlconsulting.net

A-122 & GAAP

- **GAAP requires nonprofits to distinguish Program, Management, and FR expenses**
- **These “functions” parallel A-122 “cost objectives”**

www.kaysohlconsulting.net

Core Concept

- **Establish a cost center for each program**
- **Use a sub-cost center for specific grants/contracts which support that program**

www.kaysohlconsulting.net

Exhibit 11
 Organization A - Program A by funding source with multiple caps and limitations

	Program A			Total
	Gov't grant	Private grant	General ops.	
Expenses:				
Salaries and wages	\$ 5,000	—	13,613	18,613
Employee benefits	—	—	2,792	2,792
Materials and supplies	2,600	—	2,600	5,200
Postage and shipping	—	605	—	605
Printing and publications	—	1,000	—	1,000
Telephone	115	—	641	756
Occupancy	400	—	1,819	2,219
Depreciation	—	—	684	684
Total direct expenses	8,115	1,605	22,149	31,869
Allocation of indirect costs	243	106	1,763	2,112
	\$ 8,358	1,711	23,912	33,981

1. Government grant caps salaries at \$5,000, benefits and depreciation at 0, and indirect costs at 3%.
 2. Private grant pays only postage and shipping, and printing and publications, but accepts the 6.6% indirect cost rate.

www.kaysohlconsulting.net

Alternative Approach

- Establish separate cost center for each grant or contract
- If some grants support multiple programs, use sub-cost centers to track the program costs

www.kaysohlconsulting.net

Direct Costs

- Costs easily identified with a specific cost center
- *Example:*
 Head Start teacher easily identified with Head Start cost center

www.kaysohlconsulting.net

Indirect Costs

- Costs incurred for common or joint objectives
- Costs which must be shared among some or all cost centers

www.kaysohlconsulting.net

Indirect & Administrative Costs

- Administration is a function or purpose
- The term “Indirect” describes a behavior

www.kaysohlconsulting.net

A-122 Requires

- Identifying cost objectives for program, administrative, fund raising, and lobbying costs
- Fair allocation of costs which benefit multiple cost objectives

www.kaysohlconsulting.net

A-122 addresses both function and behavior of costs

• Function:

Cost is incurred for a program, admin, or fundraising purpose

• Behavior:

Cost can be directly or indirectly attributable to a function/cost center/final cost objective

www.kaysohlconsulting.net

Cost Allocation Plan

- **Written explanation of nonprofit's method for attributing costs to cost objectives (cost center)**

- **May include multiple methods for allocating costs**

www.kaysohlconsulting.net

Nonprofits with Direct Federal Awards

- **Negotiate Indirect Cost Rates with cognizant federal agency**
- **Federal award agreements include direct & indirect cost at negotiated rate**

www.kaysohlconsulting.net

Nonprofits without Direct Federal Awards

- **Cannot negotiate** Federal Indirect Cost Rate
- **Must have** written Cost Allocation Plan
- State/local funders determine adequacy of Plan

www.kaysohlconsulting.net

Cost Allocation Plan Basics

- Identify Cost Objective structure for the entire organization
- Identify “shared costs” that benefit more than one cost objective
- Describe how shared costs will be allocated

www.kaysohlconsulting.net

Sample Cost Allocation Plan

http://nccic.acf.hhs.gov/pact/xyz_allocation_plan.pdf

www.kaysohlconsulting.net

Costs to Allocate

- Personnel working on multiple cost objectives
- Shared facilities
- Telephone, copier, internet, common supplies

www.kaysohlconsulting.net

Administrative Costs

GAAP Definition:

- Financial management
- HR administration
- Public relations
- Board support
- Organization-wide management

www.kaysohlconsulting.net

Administrative Costs:

A-122 Attachment A
Section C.3

“Administration” is defined general administration and general expenses such as the director’s office, accounting, personnel, library expenses and all other types of expenditures not listed specifically under one of the subcategories of “Facilities” (including cross allocations from other pools, where applicable)

www.kaysohlconsulting.net

**Admin Costs for CSBG:
OCS IM 37**

Costs “such as strategic direction, Board development, Executive Director functions, accounting, budgeting, personnel, procurement, and legal services.”

www.kaysohlconsulting.net

**Federal Awards &
Administrative Costs**

- Federal awards are made for Program objectives
- Allow for use of some funds for administrative purposes
- Often impose limits on % of program \$ used for admin

www.kaysohlconsulting.net

**Admin Costs in the Cost
Allocation Plan**

- Costs directly identifiable with administrative functions are charged to admin cost center
- Shared costs which benefit admin functions are allocated to admin cost center

www.kaysohlconsulting.net

Allocating Admin Costs

- Federally Negotiated Indirect Cost Rate proposal details how Admin Costs (and other shared costs) will be allocated to Cost Objectives/Cost Center

www.kaysohlconsulting.net

Allocating Admin – Part 2

- Nonprofits without approved federal indirect cost rate must describe method for allocating admin costs to program cost centers

www.kaysohlconsulting.net

Allocating Shared Costs

- Nonprofits with approved federal indirect cost rates have reached agreement with cognizant agency regarding allocation of both admin and other shared costs

www.kaysohlconsulting.net

Allocate Methods for Common Costs

- Indirect \$ as % of direct \$
- Indirect \$ as % of personnel costs
- % of staff time (FTE) devoted to each program/cost center
- % of square feet devoted to each program/cost center

www.kaysohlconsulting.net

Impermissible Allocation Method

- **Availability** of funds
- **Cannot** base allocation of costs on limits on indirect or admin costs imposed by specific funders
- Must **apply** allocation methods **consistently** to all programs/final cost objective

www.kaysohlconsulting.net

Cost Allocation Approaches

- **Transaction by transaction** allocation
- **Pool shared costs** – allocate pool total using allowable method
- Use of “**indirect rate**” must be **substantiated** by tracking actual indirect costs

www.kaysohlconsulting.net

Exhibit 1

Organization A - Indirect cost rate of 6.6%

	Total expenses					
	Programs			Admin.	Indirect	Total
	A	B	C			
Expenses:						
Salaries and wages	\$ 18,613	19,500	23,347	18,557	5,150	85,167
Employee benefits	2,792	2,925	3,502	2,784	772	12,775
Materials and supplies	5,200	8,900	3,581	1,124	-	18,805
Postage and shipping	605	987	4,251	895	2,088	8,826
Printing and publications	1,000	1,355	756	201	50	3,362
Telephone	756	1,222	1,336	2,285	2,263	7,862
Occupancy	2,219	4,590	9,675	11,116	-	27,600
Depreciation	684	758	95	151	-	1,688
Total direct expenses	31,869	40,237	46,543	37,113	10,323	166,085
Allocation of indirect costs	2,112	2,667	3,084	2,460	(10,323)	-
	\$ 33,981	42,904	49,627	39,573	-	166,085

1. The effective indirect cost rate = 6.6% (\$10,323/(\$166,085 - \$10,323)).
2. The administrative rate = 23.8% (\$39,573/\$166,085).
3. Indirect costs are allocated by applying the indirect cost rate (6.6%) to each cost center's total direct expenses [e.g., Program A: 6.6% x \$31,869 = \$2,112].

www.kaysohlconsulting.net

Exhibit 2

Organization B - Indirect cost rate of 65.8%

	Total expenses					
	Programs			Admin.	Indirect	Total
	A	B	C			
Expenses:						
Salaries and wages	\$ 12,500	14,950	19,635	15,400	22,682	85,167
Employee benefits	1,875	2,243	2,945	2,310	3,402	12,775
Materials and supplies	3,300	6,000	895	1,400	7,210	18,805
Postage and shipping	500	1,035	3,675	1,682	1,934	8,826
Printing and publications	950	1,184	642	120	466	3,362
Telephone	1,672	1,724	1,126	2,418	922	7,862
Occupancy	-	-	-	-	27,600	27,600
Depreciation	-	-	-	-	1,688	1,688
Total direct expenses	20,797	27,136	28,918	23,330	65,904	166,085
Allocation of indirect costs	13,184	15,768	20,709	16,243	(65,904)	-
	\$ 33,981	42,904	49,627	39,573	-	166,085

1. The effective indirect cost rate = 65.8% (\$65,904/(\$166,085 - \$65,904)).
2. The administrative rate = 23.8% (\$39,573/(\$166,085)).
3. Indirect costs are allocated based on each cost center's direct salaries & wages as a percentage of total direct salaries & wages [e.g., Program A: \$65,904 x (\$12,500/(\$85,167 - \$22,682)) = \$13,184].

www.kaysohlconsulting.net

Exhibit 3

Organization C - Indirect cost rate of 0%

	Total expenses					
	Programs			Admin.	Indirect	Total
	A	B	C			
Expenses:						
Salaries and wages	\$ 19,255	21,621	25,388	18,903	-	85,167
Employee benefits	2,881	3,050	3,727	3,117	-	12,775
Materials and supplies	5,200	8,900	3,581	1,124	-	18,805
Postage and shipping	923	1,612	4,541	1,750	-	8,826
Printing and publications	1,025	1,300	800	157	-	3,362
Telephone	1,290	1,417	2,244	2,911	-	7,862
Occupancy	3,219	4,590	8,675	11,116	-	27,600
Depreciation	188	334	671	495	-	1,688
Total direct expenses	33,981	42,904	49,627	39,573	-	166,085
Allocation of indirect costs	-	-	-	-	-	-
	\$ 33,981	42,904	49,627	39,573	-	166,085

1. The indirect cost rate = 0%. No indirect allocation mechanism is used; all expenses are charged directly.
2. The administrative rate = 23.8% (\$39,573/(\$166,085)).

www.kaysohlconsulting.net

Exhibit 7
Organization A - 5% cap on indirect costs that can be charged to Program A

	Total expenses					Total
	Programs			Admin.	Indirect	
	A	B	C			
Expenses:						
Salaries and wages	\$ 18,613	19,500	23,347	18,557	5,150	85,167
Employee benefits	2,792	2,925	3,502	2,784	772	12,775
Materials and supplies	5,200	8,900	3,581	1,124	-	18,805
Postage and shipping	605	987	4,251	895	2,088	8,826
Printing and publications	1,000	1,355	756	201	50	3,362
Telephone	756	1,222	1,336	2,285	2,263	7,862
Occupancy	2,219	4,590	9,675	11,116	-	27,600
Depreciation	684	758	95	151	-	1,688
Total direct expenses	31,869	40,237	46,543	37,113	10,323	166,085
Allocation of 5% approved indirect cost cap	1,593	-	-	-	(1,593)	-
Total expenses of Program A reportable to contractor	33,462					
Allocation of Program A's 1.6% excess	519	-	-	-	(519)	-
Allocation of remaining indirect costs	-	2,667	3,084	2,460	(8,211)	-
	\$ 33,981	42,904	49,627	39,573	-	166,085

1. $31,869 \times 5\% = 15,934.5 \rightarrow$ maximum indirect costs chargeable to Program A.
 2. Total indirect cost rate remains 6.6% $(\$16,323 / \$166,085 = 9.8\%)$.

www.kaysohlconsulting.net

Exhibit 8
Organization B - Multiple cost pools

	Total expenses						Total	
	Programs			Admin.	Indirect cost pools			
	A	B	C		1	2		3
Expenses:								
Salaries and wages	\$ 12,500	14,950	19,635	15,400	22,682	-	85,167	
Employee benefits	1,875	2,243	2,945	2,310	3,402	-	12,775	
Materials and supplies	3,300	6,000	895	1,400	7,210	-	18,805	
Postage and shipping	500	1,035	3,675	1,682	-	1,934	8,826	
Printing and publications	950	1,184	642	120	466	-	3,362	
Telephone	1,672	1,724	1,126	2,418	-	922	7,862	
Occupancy	-	-	-	-	12,589	15,011	27,600	
Depreciation	-	-	-	-	-	1,688	1,688	
Total direct expenses	20,797	27,136	28,918	23,330	46,349	17,867	166,085	
Allocation of indirect costs 1	9,272	11,089	14,565	11,423	(46,349)	-	-	
Allocation of indirect costs 2	6,497	3,249	4,872	3,249	-	(17,867)	-	
Allocation of indirect costs 3	359	467	718	144	-	-	(1,688)	
	\$ 36,925	41,941	49,073	38,146	-	-	166,085	
FTEs	2.0	1.0	1.5	1.0	-	-	5.5	
Square footage utilized	500	650	1000	200	-	-	2350	

1. Indirect cost pool 1: costs allocated to programs based on direct salaries and wages.
 2. Indirect cost pool 2: costs allocated to programs based on FTE.
 3. Indirect cost pool 3: costs allocated to programs based on square footage.

www.kaysohlconsulting.net

Exhibit 11
Organization A - Program A by funding source with multiple caps and limitations

	Program A			Total
	Gov't grant	Private grant	General ops.	
Expenses:				
Salaries and wages	\$ 5,000	-	13,613	18,613
Employee benefits	-	-	2,792	2,792
Materials and supplies	2,600	-	2,600	5,200
Postage and shipping	-	605	-	605
Printing and publications	-	1,000	-	1,000
Telephone	115	-	641	756
Occupancy	400	-	1,819	2,219
Depreciation	-	-	684	684
Total direct expenses	8,115	1,605	22,149	31,869
Allocation of indirect costs	243	106	1,763	2,112
	\$ 8,358	1,711	23,912	33,981

1. Government grant caps salaries at \$5,000, benefits and depreciation at 0, and indirect costs at 3%.
 2. Private grant pays only postage and shipping, and printing and publications, but accepts the 6.6% indirect cost rate.

www.kaysohlconsulting.net

Fed Negotiated Indirect Cost Rate requires:

- Calculation of **Indirect costs as a % of Base**
- Resulting % is applied to direct costs of each program to determine allowable indirect costs

www.kaysohlconsulting.net

Base for Federal Indirect Rate

- Total direct costs exclusive of capital expenditures and other distortions (major sub-grants, subcontracts > \$25,000) **OR**
- Direct salaries and wages or other base with equitable result

www.kaysohlconsulting.net

Key Choice in Federal Indirect Rate Approach

- Simplified Method: common costs and admin costs included in indirect rate
- Direct Method: common costs are allocated case-by-case to cost objectives and only administrative costs are included in the indirect rate

www.kaysohlconsulting.net

Why Use Direct Method?

- Results in lower Indirect Rate
- May be more understandable and acceptable to private funders

www.kaysohlconsulting.net

Exhibit 10

Organization A - Federal indirect cost proposal format - direct allocation method

	TOTAL EXPENSES					Total
	A	B	C	Fundraising	Admin	
Expenses:						
Salaries & wages	\$ 18,613	19,500	23,347	4,390	19,317	85,167
Employee benefits	2,792	2,925	3,502	790	2,766	12,775
Materials & supplies	5,200	8,900	3,581	0	1,124	18,805
Postage & shipping	605	987	4,251	0	2,983	8,826
Printing & publications	1,000	1,355	756	0	251	3,362
Telephone	756	1,222	1,336	861	3,687	7,862
Occupancy	2,219	4,590	9,615	1,866	9,150	27,600
Depreciation	684	758	95	0	151	1,688
Total expenses	31,869	40,237	46,543	8,007	39,429	166,085
Less Direct Cost Adjustments:						
Materials & supplies	(1,645)	(2,499)	(866)	0	0	(5,010)
Alterations & Improvements	(980)	(1,210)	0	0	0	(2,190)
Depreciation	(684)	(758)	(95)	0	0	(1,537)
	(2,625)	(3,709)	(866)	0	0	(7,200)
Less Indirect Cost Adjustments:						
Occupancy (Interest)	0	0	0	0	(762)	(762)
Depreciation	0	0	0	0	(151)	(151)
	0	0	0	0	(913)	(913)
\$	29,244	36,528	45,677	8,007	38,516	157,972

1. Indirect cost rate = \$38,516/(\$157,972) = 24.38%

www.kaysohlconsulting.net

Why Use Simplified Method

- May be efficient than allocating common costs on case-by-case basis
- Appropriate when almost all funds are through direct federal agreements

www.kaysohlconsulting.net

Provisional & Final Rates

- **Provisional Rate:** Temporary rate based on budget estimates
- **Final Rate:** based on actual cost & used to adjust the indirect costs claimed under prov. rate

www.kaysohlconsulting.net

Predetermined Rate

- **Permanent rate** not subject to adjustment
- **Established for specific current or future periods**

www.kaysohlconsulting.net

Fixed Rate

- **Permanent rate, established for future period of time**
- **Adjustments for actual under/over recovery are carried forward to future periods**

www.kaysohlconsulting.net

Common Challenges

- Timesheets and level of effort documentation
- Planned use of time versus actual
- Administrative cost limitations in specific awards

www.kaysohlconsulting.net

Documenting Personnel Costs

- Allocate personnel costs based upon use of staff time
- Timesheets distinguish direct and indirect uses of staff time
- Contemporaneously maintained time records are essential

www.kaysohlconsulting.net

Fringe Benefit Costs

- May allocate employee by employee
- May establish rates for groups of employees
- May allocate based on overall fringe benefit rate

www.kaysohlconsulting.net

Emerging Challenges

- ARRA Davis Bacon requirement for DOE & DOL
- OMB dissatisfaction with A-133 auditors' work
- Rapid growth and/or contraction

www.kaysohlconsulting.net

Impact of Growth/Contraction

- **Indirect costs** generally **rise/fall more slowly** than direct costs
- **Methods** in Cost Allocation Plan still **valid**
- Use of **out-of-date allocation formulae** to apply methods can result in **unsubstantiated** costs

www.kaysohlconsulting.net

??? During Rapid Increase

- How will Admin or other Indirect costs change as % of Direct costs?
- Do new funding sources have **Admin cost limits** lower than fair share?
- Does org have other sources of funds to cover Admin gap?

www.kaysohlconsulting.net

???? During Constrictions

- How will Admin or other Indirect Costs change as % of Direct costs?
- Does **revised calculation** of share of Admin costs **exceed Admin limits** of any source?
- Does org have other sources of funds to cover Admin gap?

www.kaysohlconsulting.net

Your Next Steps?

- Review your monitoring checklist?
- Identify areas of greatest compliance challenges for CAAs in your state?

www.kaysohlconsulting.net

Control Review Checklist

Control	Control documentation reviewed	Reviewed by	Review date
Control Environment			
Conflict of Interest P&P			
Whistleblower Policy			
Code of Ethics/Integrity policy			
Board evaluation of CEO			
Board review of compensation & management capacity			
Board review of monthly financial statements			
Board audit committee/auditor discussions			
Board review of resolution of audit & monitoring findings			
Board review of programmatic accomplishments			
Other			
General Risk Assessment			
External risk review including funding environment, community perception, changing demand/need for services			
Review and update of internal risk identification			
Exposure analysis- ranking of risks by significance of potential losses and likelihood of occurrence			
Contract Compliance Risk Assessment:			
OMB A-110 requirements			
• Allowable activities			
• Allowable cost			
• Cash management			
• Davis Bacon act			
• Eligibility			
• Equip/Real Property management			
• Matching/level of effort			
• Period of availability of fed funds			
• Procurement, suspension & debarment			
• Program income			
• Real property acquisition			
• Reporting			
• Sub recipient monitoring			
• Special tests & provisions			
OMB A-122 requirements			
• Current approved federal indirect cost rate			
• Written cost allocation plan			
• Monitoring of actual indirect costs in comparison to budget			

Control Review Checklist

Control	Control documentation reviewed	Reviewed by	Review date
CFR Requirements			
<ul style="list-style-type: none"> • Review of CFRs for each funding source • Policies & procedures to assure compliance with CFR requirements varying from OMB Circulars 			
Control Activities			
Written fiscal and operational policies & procedures			
Top management review of financial & program activities			
Management reviews at program or functional level			
Controls over info processing/IT			
Physical controls over vulnerable assets			
Review of performance indicators			
Segregation of duties			
Proper execution of transactions & events			
Accurate & timely recording of events			
Access restrictions & accountability for resources & records			
Appropriate documentation of transactions & internal control			
Information & Communication			
Monthly financial reporting at program and organization level			
Monthly program accomplishment reporting at program & organizational level			
Manager access to operational and financial data as needed for planning and oversight			
Structures, policies, and procedures to encourage open information flow among all levels of the organization			
Monitoring			
Monthly comparison of planned program and financial activity to actual reviewed by program managers, top management, & Board			
System for tracking all audit & monitoring findings and their correction or resolution			
Responsibility for achieving correction or resolution of all findings clearly assigned			
Authority to resolve/correct findings clearly assigned			

Control Review Checklist

Control	Control documentation reviewed	Reviewed by	Review date
Monitoring – continued			
Progress resolving/correcting findings monitored regularly by CEO & Board			
Reconciliations to verify financial & program data reports routinely completed and reviewed by managers			

Cost Table from HHS Grants Policy Statement – January 1, 2007

Exhibit 4. Selected Items of Cost

Item	Description
Advertising	Allowable only for recruitment of staff or trainees, procurement of goods and services, disposal of scrap or surplus materials, and other specific purpose necessary to meet the requirements of the grant-supported activity.
Alcoholic Beverages	Unallowable as an entertainment expense. Allowable if within the scope of an approved project.
Alteration and Renovation	<p>A&R costs are allowable unless the program legislation, implementing regulations, or other terms and conditions of the award specifically exclude such activity. See “Prior Approval Requirements—OPDIV Prior-Approval” for A&R costs requiring GMO prior approval. A&R costs that do not exceed the prior approval thresholds specified in that section (or in Part IV, as applicable) generally are considered “minor A&R” and those exceeding that amount generally are considered “major A&R.” Major A&R is allowable only if the authorizing statute specifically permits that type of activity, whether characterized as modernization, remodeling, or A&R (see “Construction” in this exhibit).</p> <p>A&R must be consistent with the following criteria and documentation requirements:</p> <ul style="list-style-type: none"> ◆ The building has a useful life consistent with program purposes and is architecturally and structurally suitable for conversion to the type of space required. ◆ The A&R is essential to the purpose of the grant-supported project or program. ◆ The space involved will be occupied by the project or program. ◆ The space is suitable for human occupancy before A&R work is started except where the purpose of the A&R is to make the space suitable for some purpose other than human occupancy, such as storage. ◆ For minor A&R, if the space is rented, evidence is provided that the terms of the lease are compatible with the A&R proposed and cover the duration of the project period. ◆ If the A&R will affect a site listed in (or eligible for inclusion in) the National Register of Historic Places, the requirements specified in “Preservation of Cultural and Historic Resources” have been followed. <p>Routine maintenance and repair of the organization’s physical plant or its equipment, which is allowable and is ordinarily treated as an indirect cost, is not considered A&R.</p> <p>Work necessary to obtain an initial occupancy permit for the intended use is not an allowable A&R cost. Certain allowable costs of installing equipment, such as the temporary removal and replacement of wall sections and door frames to place equipment in its permanent location, or the costs of connecting utility lines, replacing finishes and furnishings, and installing any accessory devices required for the equipment’s proper and safe utilization, may be considered either equipment costs or A&R costs, depending on the recipient’s accounting system.</p> <p>A&R costs are not allowable under grants in support of scientific meetings (conference grants).</p>
Animals	Allowable for the acquisition, care, and use of animals for use in research and research-related activities, contingent upon compliance with the applicable requirements of the <i>PHS Policy on Humane Care and Use of Laboratory Animals</i> . If the recipient operates an animal resource facility, charges for use of the facility should be determined in accordance with the <i>Cost Analysis and Rate Setting Manual for Animal Resource Facilities</i> (May 2000), available from NIH’s National Center for Research Resources (NCRR) (http://www.ncrr.nih.gov/newspub/CARS.pdf) or from NCRR’s Office of Science Policy and Public Liaison (e-mail: info@ncrr.nih.gov).

Exhibit 4. Selected Items of Cost

Item	Description
Audiovisual Activities	<p>Allowable for the production of an audiovisual. "Audiovisual" means any product containing visual imagery, sound, or both, such as motion pictures, films, videotapes, live or recorded radio or television programs or public service announcements, slide shows, filmstrips, audio recordings, multimedia presentations, or exhibits where visual imagery, sound, or both are an integral part. "Production" refers to the steps and techniques used to create a finished audiovisual product, including, but not limited to, design, layout, scriptwriting, filming or taping, fabrication, sound recording, and editing.</p> <p>A recipient with in-house production capability must determine whether it would be more efficient and economical to use that capability or to contract for the production of an audiovisual.</p> <p>If an audiovisual intended for members of the general public (i.e., people who are not researchers, health professions, or service delivery personnel or who are not directly involved in project activities as employees, trainees, or participants, such as clients, volunteers or patients) is produced under an HHS grant-supported project or program, the recipient must submit two prints or tapes of the finished product along with its annual or final progress report. The costs of such prints or tapes are allowable costs.</p> <p>Audiovisuals produced under a grant-supported project or program must bear an acknowledgment and disclaimer, such as the following:</p> <p>The production of this [type of audiovisual (motion picture, television program, etc.)] was supported by Grant [number of grant] from [name of OPDIV]. Its contents are solely the responsibility of [name of recipient] and do not necessarily represent the official views of [name of OPDIV].</p>
Audit Costs	<p>Allowable (as specified in Section 230 of OMB Circular A-133). The charges may be treated as a direct cost when the audit's scope is limited to a single HHS grant-supported project or program, as specified in 45 CFR 74.26(d), or when it includes more than one project but the costs can be specifically identified with, and allocated to, each project on a proportional basis, and this practice is followed consistently by the recipient. Otherwise, charges for audits should be treated as indirect costs. In addition, a pass-through entity may charge an HHS award for the cost of a limited scope audit to monitor a subrecipient provided the subrecipient is not required to have a single audit and the other conditions of Section 230(b) (2) of OMB Circular A-133 are met.</p>
Bad Debts	Unallowable.
Bid and Proposal Costs	Allowable as an indirect cost. See 45 CFR 74.27(b)(1) for policy for non-profit organizations covered by OMB Circular A-122.
Bonding	Allowable. See 45 CFR 74.21, 74.48(c) and 92.36 for policies and requirements concerning bonding.
Books and Journals	Allowable. If an organization has a library, books and journals generally should be provided as part of normal library services and treated as indirect costs.
Capital expenditures for land or buildings	See "Land or Building Acquisition" in this exhibit.
Child-Care Costs	Allowable if within the scope of an approved project or program or as incidental costs of a project or program if incurred to enable individuals to participate as subjects in research projects or to receive health services. Such costs also may be allowable as a fringe benefit for individuals working on a grant-supported project (see "Fringe Benefits" in this exhibit).
Communications	Allowable. Such costs include local and long-distance telephone calls, telegrams, express mail, postage, messenger, and electronic or computer transmittal services and usually are treated as indirect costs.
Compliance with Historic Preservation Requirements	Allowable. May include hiring special consultants to research and document the historic value of proposed performance sites and costs associated with preparation and presentation of required materials to inform the public and others.

Exhibit 4. Selected Items of Cost

Item	Description
Construction/ Modernization	<p>Allowable only when program legislation specifically authorizes new construction, modernization, or other activities considered major A&R, and the OPDIV specifically authorizes such costs in the NoA. When authorized, construction activities may include construction of a new facility or projects in an existing building that are considered to be construction, such as relocation of exterior walls, roofs, and floors; attachment of fire escapes; or completion of unfinished shell space to make it suitable for human occupancy.</p>
Consultant Services	<p>Allowable. A consultant is an individual retained to provide professional advice or services for a fee but usually not as an employee of the requiring organization. The term "consultant" also includes a firm that provides paid professional advice or services. Recipients must have written policies governing their use of consultants that are consistently applied regardless of the source of support. Such policies should include the conditions for paying consulting fees. The general circumstances of allowability of these costs, which may include fees and travel and subsistence costs, are addressed in the applicable cost principles under "professional services costs."</p> <p>In unusual situations, a person may be both a consultant and an employee of the same party, receiving compensation for some services as a consultant and for other work as a salaried employee as long as those separate services are not related to the same project and are not charged to the same project. For example, consulting fees that are paid by an educational institution to a salaried faculty member as extra compensation above that individual's base salary are allowable, provided the consultation is across departmental lines or involves a separate or remote operation and the work performed by the consultant is in addition to his or her regular departmental workload.</p> <p>For employee consulting costs to be allowable under grant-supported projects (including subawards or contracts under the grant), recipients, subrecipients, and contractors must establish written guidelines permitting such payments regardless of the source of funding and indicating the conditions under which the payment of consulting fees to employees is proper. Unless subject to OMB Circular A-21, the recipient, subrecipient, or contractor also must document that it would be inappropriate or infeasible to compensate the individual for those services through payment of additional salary. Under no circumstances can an individual be paid as a consultant and an employee under the same HHS grant.</p> <p>Authorization for consulting fees paid to individuals serving as both employees and consultants of the same party must be provided in writing, on a case-by-case basis, by the head of the recipient, subrecipient, or contractor organization incurring the costs, or his/her designee. If the designee is personally involved in the project, the authorization may be given only by the head of the organization. This authorization must include a determination that the required conditions are present and that there is no apparent or actual conflict of interest.</p> <p>Recipients, subrecipients, and contractors under grants are encouraged to obtain written reports from consultants unless such a report is not feasible given the nature of the consultation or would not be useful. Documentation maintained by the receiving organization should include the name of the consulting firm or individual consultant; the nature of the services rendered and their relevance to the grant-supported activities, if not otherwise apparent from the nature of the services; the period of service; the basis for calculating the fee paid (e.g., rate per day or hour worked or rate per unit of service rendered); and the amount paid. This information may be included in the consultant's invoice, in the report, or in another document.</p>

Exhibit 4. Selected Items of Cost

Item	Description
Consumer/ Provider Board Participation	<p>Allowable in accordance with applicable program regulations. When not specifically authorized by program regulations, only the following costs are allowable with OPDIV prior approval:</p> <ul style="list-style-type: none"> ◆ Reasonable and actual out-of-pocket costs incurred solely as a result of attending a scheduled meeting, including transportation, meals, babysitting fees, and lost wages. ◆ The reasonable costs of necessary meals furnished by the recipient to consumer or provider participants during scheduled meetings if not reimbursed to participants as per diem or otherwise. <p>Where programmatic regulations permit such payments but establish a maximum annual income for eligibility for reimbursement of consumer/provider board members for wages lost by reason of their participation in board activities, the determination of eligibility will be made on the basis of gross rather than net income.</p> <p>Members of consumer/provider boards are not considered employees or consultants of the recipient. Therefore, they may not be compensated for their services other than as above, nor are they eligible for associated fringe benefits. Although not eligible for individual insurance coverage, board members may be covered by an organizational insurance policy while acting in their official capacities as board members.</p>
Contingency Funds	<p>Contributions set aside for events whose occurrence cannot be foretold with certainty as to time, intensity, or assurance of their happening are unallowable under nonconstruction grants. Contingency funds do not include pension funds, self-insurance funds, and normal accruals for severance and post-retirement health costs (also see "Reserve Funds" in this exhibit). Construction grants may include a contingency fund in initial construction contract cost estimates to provide for unanticipated charges. These funds will be limited to 5 percent of construction and equipment costs before bids or proposals are received and must be reduced to 2 percent after a construction contract has been awarded.</p>
Customs and Import Duties	<p>Allowable under grants to domestic organizations when performance will take place entirely within the United States, its possessions, or its territories, or when foreign involvement in the project is incidental to the overall grant-supported project. Charges may include consular fees, customs surtaxes, value-added taxes, and other related charges. (Also see "Requirements for Specific Types of Recipients" of this part for the allowability of these costs.)</p>
Depreciation or Use Allowances	<p>Allowable. Such costs usually are treated as indirect costs. Depreciation or use charges on equipment or buildings acquired under a federally supported project are not allowable.</p>
Donor Costs	<p>Allowable for payment to volunteers or research subjects who contribute blood, urine samples, and other body fluids or tissues that are specifically project related.</p>
Drugs	<p>Allowable if within the scope of an approved project. Project funds may not be used to purchase drugs classified by FDA as "ineffective" or "possibly effective" except in approved clinical research projects or in cases where there is no alternative other than therapy with "possibly effective" drugs. Recipient acquisition practices for drugs used in outpatient treatment must meet Federal requirements regarding cost-effectiveness and reasonableness as found in 42 CFR part 40, Subpart E, and OMB Circulars A-122 and A-87.</p>
Dues or Membership Fees	<p>Allowable as an indirect cost for organizational membership in business, professional, or technical organizations or societies. Payment of dues or membership fees for an individual's membership in a professional or technical organization is allowable as a fringe benefit or an employee development cost, if paid according to an established organizational policy consistently applied regardless of the source of funds.</p>
Entertainment Costs	<p>Unallowable. This includes the cost of amusements, social activities, and related incidental costs.</p>

Exhibit 4. Selected Items of Cost

Item	Description
Equipment	<p>Allowable for purchase of new, used, or replacement equipment as a direct cost or as part of indirect costs, depending on the intended use of the equipment. OPDIV prior approval may be required as specified in "Prior-Approval Requirements." Funds provided under a conference grant may not be used to purchase equipment.</p> <p>For policies governing the classification, use, management, and disposition of equipment, see "Property Management." For policies governing the allowability of costs for rental of equipment, see "Rental or Lease of Facilities and Equipment" in this exhibit.</p>
Federal (U.S. Government) Employees	<p>Only four types of costs—consultant fees, outpatient or subject costs, salary or fringe benefits, and travel costs—can be charged to HHS grants on behalf of Federal employees, and only under the conditions specified. Recipients should advise any Federal employees with whom these types of arrangements may be made to consult with their employing agency concerning their ability to meet the required conditions.</p> <p>Regardless of whether costs will be charged to the grant, special requirements apply when a Federal employee will be involved in an HHS grant-supported activity in any capacity other than as an employee working on a grant to a Federal institution, an outpatient, or a study subject. The requirements of that section do not apply to individuals that are classified as special government employees because of service on advisory groups or as a result of a formal consulting arrangement with a Federal agency. (See the HHS Standards of Conduct at 45 CFR part 73, Subpart J for additional guidance.) See "Requirements for Specific Types of Recipients—Grants to Federal Institutions and Allowable Costs and Payments to (or on Behalf of) Federal Employees under Grants" for the allowability of payments made to, or on behalf of, Federal employees under HHS grants.</p>
Fines and Penalties	<p>Unallowable except when resulting from violations of, or failure of the organization to comply with, Federal, State, or local laws and regulations and incurred as a result of compliance with specific provisions of an award, or when such payments are authorized in advance in writing by the GMO.</p>
Fringe Benefits	<p>Allowable as part of overall employee compensation in proportion to the amount of time or effort an employee devotes to the grant-supported project or program, provided such costs are incurred under formally established and consistently applied policies of the organization (see "Salaries and Wages" in this exhibit).</p> <p>Tuition or tuition remission for regular employees is allowable as a fringe benefit. For organizations subject to OMB Circular A-21, tuition benefits for family members other than the employee are unallowable. For policies applicable to tuition remission for students working on grant-supported research projects, see "Salaries and Wages" in this exhibit.</p>
Fundraising Costs	<p>Unallowable.</p>
Hazardous Waste Disposal	<p>Allowable. Usually treated as an indirect cost.</p>
Honoraria	<p>Unallowable when the primary intent is to confer distinction on, or to symbolize respect, esteem, or admiration for, the recipient of the honorarium. A payment for services rendered, such as a speaker's fee under a conference grant, is allowable.</p>
Hospitalization	<p>See "Research Patient Care" in this exhibit.</p>
Incentive Costs	<p>Incentive payments to volunteers or patients participating in a grant-supported project or program are allowable. Incentive payments to individuals to motivate them to take advantage of grant-supported health care or other services are allowable if within the scope of an approved project. See "Salaries and Wages" in this exhibit for incentive payments to employees.</p>
Indemnification	<p>Allowable to the extent expressly provided in the award for indemnification against liabilities to third parties and any other loss or damage not compensated by insurance or otherwise. The Federal government is obligated to indemnify the institution only to the extent expressly provided for in the NoA.</p>

Exhibit 4. Selected Items of Cost

Item	Description
Independent Research and Development Costs	Unallowable, including their proportionate share of indirect costs.
Insurance	<p>Allowable. Insurance usually is treated as an indirect cost. In certain situations, however, where special insurance is required as a condition of the grant because of risks peculiar to the project, e.g., provision of health services, the premium may be charged as a direct cost if doing so is consistent with organizational policy. If so, the insurance should be treated as a direct cost and assigned to individual grants based on the manner in which the insurer allocates the risk to the population covered by the insurance. Medical liability (malpractice) insurance is an allowable cost of research programs at educational institutions only if the research involves human subjects.</p> <p>The cost of insuring equipment, whether purchased with grant funds or furnished as federally owned property, normally should be included in indirect costs but may be allowable as a direct cost if this manner of charging is the normal organizational policy.</p>
Interest	<p>Allowable as an indirect cost for certain assets as specified in the applicable cost principles.</p> <p>Unallowable for hospitals.</p>
Invention, Patent, or Licensing Costs	Unallowable as a direct cost unless specifically authorized in the NoA. May be allowable as indirect costs provided they are authorized under applicable cost principles and are included in the negotiation of indirect cost rates. Such costs include licensing or option fees, attorney's fees for preparing or submitting patent applications, and fees paid to the U.S. Patent and Trademark Office for patent application, patent maintenance, or recordation of patent-related information.
Land or Building Acquisition	<p>Not allowable unless acquisition or construction is specifically authorized by program legislation and provided for in the NoA. Under those programs that have authority to permit recipients to acquire facilities, considerations such as the type of program being supported and the Federal interest in purchased property will be taken into account by the awarding office in determining whether property should be leased or purchased. For real property acquired with grant support, the cost of title insurance may be charged to the grant in proportion to the Federal share of the acquisition cost. Filing fees incurred with the recordation in appropriate official records of the applicable jurisdiction of the Federal interest in the real property also may be charged to the grant. Use allowance or depreciation on buildings that were not acquired under a Federal project are allowable, usually as an indirect cost.</p>
Leave	Allowable for employees as a fringe benefit (see "Fringe Benefits" in this exhibit). See program guidance or Part IV for policy on leave for fellows and trainees.
Legal Services	Allowable. Generally treated as an indirect cost but, subject to the limitations described in the applicable cost principles, may be treated as a direct cost for legal services provided by individuals who are not employees of the recipient. Before a recipient incurs legal costs that are extraordinary or unusual, the recipient should make an advance agreement regarding the appropriateness and reasonableness of such costs with the GMO. Legal costs incurred in defending or prosecuting claims, whether equitable or monetary, including administrative grant appeals, are unallowable charges, except as provided in the applicable cost principles.
Library Services	General library support is not allowable as a direct cost but may be included in a recipient's indirect cost pool. These services are allowable as a direct cost when specifically required for the conduct of the project and when identifiable as an integral part of the grant-supported activity (e.g., in those programs designed to develop and support such services).
Lobbying	Generally unallowable, including costs of lobbying activities to influence the introduction, enactment, or modification of legislation by the U.S. Congress or a State legislature. Under certain circumstances, as provided in the applicable cost principles, costs associated with activities that might otherwise be considered "lobbying" that are directly related to the performance of a grant may be allowable. The recipient should obtain an advance understanding with the GMO if it intends to engage in these activities.

Exhibit 4. Selected Items of Cost

Item	Description
Meals	<p>Generally unallowable except for the following:</p> <ul style="list-style-type: none"> ◆ Subjects and patients under study ◆ Where specifically approved as part of the project or program activity, e.g., in programs providing children's services ◆ When an organization customarily provides meals to employees working beyond the normal workday, as a part of a formal compensation arrangement ◆ As part of a per diem or subsistence allowance provided in conjunction with allowable travel ◆ Under a conference grant, when meals are a necessary and integral part of a conference, provided that meal costs are not duplicated in participants' per diem or subsistence allowances. <p>Guest meals are not allowable. (See "Consumer/Provider Board Participation" in this exhibit regarding the allowability of the cost of meals for consumer and provider board participants in grant-supported activities.)</p>
Moving	See "Recruitment Costs," "Relocation Costs," and "Transportation of Property" in this exhibit.
NEPA Analysis	Costs associated with evaluation of the environmental effects of a proposed activity and producing the Environmental Impact Statement (EIS) are allowable.
Overtime	See "Salaries and Wages" in this exhibit.
Pension Plan Costs	<p>Allowable. For institutions of higher education and non-profit organizations, the following applies:</p> <ul style="list-style-type: none"> ◆ Such costs must be incurred according to the established policies of the organization consistently applied regardless of the source of funds. ◆ The organization's policies must meet the test of reasonableness. ◆ The methods of cost allocation must be equitable for all activities. ◆ The amount assigned to each fiscal year must be determined in accordance with generally accepted accounting principles. ◆ The cost assigned to a given fiscal year must be paid or funded for all plan participants within 6 months after the end of that fiscal year. <p>State, local, or Indian tribal governments or hospitals may use the "pay-as-you-go" cost method (i.e., when pension benefits are paid by the recipient directly to, or on behalf of, retired employees or their beneficiaries) in lieu of the method described above. Under this method, the benefits may be charged in the recipient's fiscal year in which the payments are made to, or on behalf of, retired employees or their beneficiaries, provided that the recipient follows a consistent policy of treating such payments as expenses in the year of payment.</p> <p>See the applicable cost principles for additional information on the allowability of costs associated with pension plans.</p>

Exhibit 4. Selected Items of Cost

Item	Description
Pre-Award (Pre-Agreement) Costs	<p>Allowable. Where authorized by the OPDIV as an expanded authority (see Part IV of the HHS GPS), a recipient may, at its own risk and without OPDIV prior approval, incur obligations and expenditures to cover costs up to (and including) 90 days before the beginning date of the initial budget period of a new or competing continuation award if such costs</p> <ul style="list-style-type: none"> ◆ are necessary to conduct the project or program, and ◆ would be allowable under the grant, if awarded. <p>However, even if authorized as an expanded authority, if a specific expenditure would otherwise require prior approval, the cost or activity must meet the same tests of allowability as if incurred after award.</p> <p>If not authorized as part of expanded authorities, the applicant/recipient must seek OPDIV prior approval before incurring pre-award costs. OPDIV prior approval is required for any costs to be incurred more than 90 days before the beginning date of the initial budget period of a new or competing continuation award.</p> <p>Recipients may incur pre-award costs before the beginning date of a non-competing continuation award without regard to the time parameters stated above and without prior approval. The incurrence of pre-award costs in anticipation of a competing or non-competing award imposes no obligation on the OPDIV either to make the award or to increase the amount of the approved budget if an award is made for less than the amount anticipated and is inadequate to cover the pre-award costs incurred. Recipients are expected to be fully aware that pre-award costs result in borrowing against future support and that such borrowing must not impair the recipient's ability to accomplish the project or program objectives in the approved time frame or in any way adversely affect the conduct of the project or program.</p>
Public Relations Costs	<p>Allowable only for costs specifically required by the award or for costs of communicating with the public and the press about specific activities or accomplishments under the grant-supported activity or other appropriate matters of public concern. Such costs may be treated as direct costs but should be treated as indirect costs if they benefit more than one sponsored agreement or if they benefit the grant and other work of the organization.</p>
Publications	<p>Allowable. Page charges for publication in professional journals are allowable if the published paper reports work supported by the grant and the charges are levied impartially on all papers published by the journal, whether or not by government-sponsored authors. The costs of reprints and publishing in other media, such as books, monographs, and pamphlets, also are allowable.</p> <p>Publications and journal articles produced under an HHS grant-supported activity must bear an acknowledgment and disclaimer, as appropriate, as provided in "Intellectual Property—Publications."</p>
Recruitment Costs	<p>Allowable subject to the conditions and restrictions contained in the applicable cost principles. These costs may include help-wanted advertising costs, costs of travel by applicants for interviews for prospective employment, and travel costs of employees while engaged in recruiting personnel. Grant funds may not be used for a prospective trainee's travel costs to or from the recipient organization for the purpose of recruitment. However, other costs incurred in connection with recruitment under training programs, such as advertising, may be allocated to a grant-supported project according to the provisions of the applicable cost principles (also see "Travel" and "Relocation Costs" in this exhibit).</p>
Registration Fees	<p>Allowable for attendance at conferences, symposiums, or seminars if necessary to accomplish project or program objectives.</p>

Exhibit 4. Selected Items of Cost

Item	Description
Relocation Costs	<p>Allowable—in other than change of grantee organization situations—when such costs are incurred incidental to a permanent change of duty assignment (for an indefinite period or for a stated period of no less than 12 months) for an existing employee working on a grant-supported project, or when a new employee is recruited for work on the project, provided that the move is for the recipient's benefit rather than the individual's and that payment is made according to established organizational policies consistently applied regardless of the source of funds. Relocation costs may include the cost of transporting the employee and his or her family, dependents, and household goods to the new location and certain expenses associated with the sale of the former home. If relocation costs have been incurred in connection with the recruitment of a new employee, whether as a direct cost or an indirect cost, and the employee resigns for reasons within his or her control within 12 months after hire, the recipient must credit the grant account for the full cost of the relocation charged to the grant. When there is a change in the grantee organization, the personal relocation expenses of the PI/PD and others moving to the new recipient are not allowable charges.</p>
Rental or Lease of Facilities and Equipment	<p>Allowable subject to the limitations below. Rental costs are allowable to the extent that the rates are reasonable at the time of the decision to lease in light of such factors as rental costs of comparable property, if any; market conditions in the area; the type, life expectancy, condition, and value of the property leased; and available alternatives. Because of the complexity involved in determining the allowable amount under certain types of leases, recipients are encouraged to consult the GMO before entering into leases that will result in direct charges to an award. In general, the rental costs for facilities and equipment applicable to each budget period should be charged to that period. However, see "Property Management" for an exception to this general rule.</p> <p>Rental costs under leases that create a material equity in the leased property, as defined in the applicable cost principles, are allowable only up to the amount that would be allowed had the recipient purchased the property on the date the lease agreement was executed. This would include depreciation or use allowances, maintenance, taxes, and insurance, but would exclude unallowable costs.</p> <p>When a recipient transfers property to a third party through sale, lease, or otherwise and then leases the property back from that third party, the lease costs that may be charged to an HHS grant generally may not exceed the amount that would be allowed if the recipient continued to own the property.</p> <p>Rental costs under "less-than-arms-length" leases are allowable only up to the amount that would be allowed under the applicable cost principles had title to the property been vested in the recipient. A less-than-arms-length lease is one in which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to, those between divisions of an organization; between organizations under common control through common officers, directors, or members; and between an organization and its directors, trustees, officers, or key employees (or the families of these individuals), directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.</p>
Research Patient Care	<p>The costs of routine and ancillary services provided by hospitals to individuals, including patients and volunteers, participating in research programs are allowable if included in the NoA or approved as a post-award change as specified in "Prior-Approval Requirements—OPDIV Prior Approval."</p> <p>"Routine services" include the regular room services, minor medical and surgical supplies, and the use of equipment and facilities for which a separate charge is not customarily made. "Ancillary services" are those special services for which charges customarily are made in addition to routine services, e.g., x-ray, operating room, laboratory, pharmacy, blood bank, and pathology. See "Research Patient Care Costs" for policy concerning reimbursement of these costs.</p> <p>The following otherwise allowable costs are not classified as research patient care costs: items of personal expense reimbursement, such as patient travel; consulting physician fees; and any other direct payments to individuals, including inpatients, outpatients, subjects, volunteers, and donors.</p>
Reserve Funds	<p>Contributions to a reserve fund for self-insurance are allowable as specified in the governing cost principles (also see "Contingency Funds" in this exhibit).</p>

Exhibit 4. Selected Items of Cost

Item	Description
Sabbatical Leave Costs	Sabbatical leave costs may be included in a fringe benefit rate or in the organization's indirect cost rate. Costs of leave of absence by employees for performance of graduate work or sabbatical study, travel, or research are allowable as a direct charge provided the organization has a uniform policy on sabbatical leave for people engaged in research and the salary is proportional to the service rendered. Where sabbatical leave is included in fringe benefits for which a cost is determined for assessment as a direct charge, the aggregate amount of such assessments applicable to all work of the organization during the base period must be reasonable in relation to the organization's actual practice under its sabbatical leave policy. Sabbatical leave paid by an individual's employer, in combination with other compensation (e.g., partial salary from an HHS grant), may not exceed 100 percent of that individual's regular salary from his or her organization.
Salaries and Wages	Allowable. Compensation for personal services covers all amounts, including fringe benefits, paid currently or accrued by the organization for employee services rendered to the grant-supported project or program. Compensation costs are allowable to the extent that they are reasonable, conform to the established policy of the organization consistently applied regardless of the source of funds, and reflect no more than the percentage of time actually devoted to the OPDIV-funded project or program. Where restricted by language in the HHS appropriations act, OPDIVs will not reimburse recipients for the direct salaries of individuals at a rate in excess of the level specified. Direct salary is exclusive of fringe benefits and indirect costs. If there is a salary limitation, it does not apply to consultant payments or to contracts for routine goods and services, but it does apply to subrecipients (including consortium participants). Specific considerations are addressed below.
<i>Payroll Distribution</i>	<p>Salary and wage amounts charged to grant-supported projects or programs for personal services must be based on an adequate payroll distribution system that documents such distribution in accordance with generally accepted practices of like organizations. Standards for payroll distribution systems are contained in the applicable cost principles (other than those for for-profit organizations). Briefly summarized, acceptable systems are as follows:</p> <p><i>Hospitals</i></p> <ul style="list-style-type: none"> ◆ Monthly after-the-fact reports of the distribution of time or effort for professional staff members. ◆ Time and attendance and payroll distribution records for non-professional employees. <p><i>Non-profit organizations</i></p> <ul style="list-style-type: none"> ◆ Monthly after-the-fact reports, including a signed certification, by the employee, or by a responsible supervisory official having first-hand knowledge of the work performed, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the period covered by the report. Each report must account for the total activity required to fulfill the employee's obligations to the organization as well as the total activity for which he or she is compensated. ◆ For non-professional employees, additional supporting reports, indicating the total number of hours worked each day, must be maintained in conformance with DoL regulations implementing the Fair Labor Standards Act (29 CFR part 516). ◆ The distribution of salaries and wages must be supported by personnel activity reports as described above, except when a substitute system has been approved, in writing, by the Federal cognizant agency designated under OMB Circular A-122. <p><i>State, local, and Indian tribal governments</i></p> <ul style="list-style-type: none"> ◆ Time and attendance or equivalent records for all employees. ◆ Time distribution records for employees whose compensation is chargeable to more than one grant or other cost objective.

Exhibit 4. Selected Items of Cost

Item	Description
	<p><i>Educational institutions</i></p> <ul style="list-style-type: none"> ◆ A plan confirmation system for professorial and other professional staff members that is based on budgeted, planned, or assigned work activity and that is updated to reflect any significant changes in work distribution. This system must be incorporated into the organization's official records and must identify activity applicable to each sponsored agreement and to each category needed to identify indirect costs and the functions to which they are allocable. At least annually, the employee, PI/PD, or responsible officials will verify, by suitable means, that the work was performed and that the salaries and wages charged to sponsored agreements, whether as direct charges or in other categories of cost, are reasonable in relation to the work performed. ◆ A system, supported by after-the-fact activity reports, that reflects the distribution of covered employees' activity allocable to each grant and includes identification and recording of significant changes in work activity when initial charges were based on estimates. The system also must specify each category of activity needed to identify indirect costs and the functions to which they are allocable. For professorial and other professional staff members, the activity reports will be prepared each academic term, but at least every 6 months. For other employees, unless the OPDIV agrees to alternate arrangements, the reports will be prepared at least monthly and will coincide with one or more pay periods. ◆ A multiple confirmation records system, for professorial and other professional staff members, that is supported by records certifying costs separately for direct costs and indirect costs, with reports prepared each academic term, but at least every 6 months, that confirm the activities as allocable to direct or indirect costs. ◆ By mutual agreement, any other method meeting the criteria specified in Section J.10 of OMB Circular A-21. <p><i>For-profit organizations</i></p> <p>HHS requires for-profit organizations to conform with industry standards to support salary and wage charges to HHS grants. Therefore, unless an alternate system is approved by the GMO, the recipient must maintain a time-and-effort reporting system for both professional and other-than-professional staff reflecting daily after-the-fact reporting of hours expended on individual projects or indirect activities. The system must record both hours worked and hours absent. This information must be certified by an authorized organizational representative no less frequently than every pay period.</p>
<i>Overtime Premiums</i>	<p>Premiums for overtime generally are allowable; however, such payments are not allowable for faculty members at institutions of higher education. If overtime premiums are allowable, the categories or classifications of employees eligible to receive overtime premiums should be determined according to the formal policies of the organization consistently applied regardless of the source of funds.</p>
<i>Bonuses/ Incentive Payments</i>	<p>Allowable for employees as part of a total compensation package, provided such payments are reasonable and are made according to a formal policy of the recipient that is consistently applied regardless of the source of funds.</p>
<i>Payments for Dual Appointments</i>	<p>For investigators with university and clinical practice plan appointments, compensation from both sources may be considered the base salary if the following criteria are met:</p> <ul style="list-style-type: none"> ◆ Clinical practice compensation must be guaranteed by the university. ◆ Clinical practice effort must be shown on the university appointment form and must be paid through the university. ◆ Clinical practice effort must be included and accounted for on the university's effort report.

Exhibit 4. Selected Items of Cost

Item	Description
<i>Compensation of Students</i>	<p>Tuition remission and other forms of compensation paid as, or in lieu of, wages to students (including fellows and trainees) under research grants are allowable, provided the following conditions are met:</p> <ul style="list-style-type: none"> ◆ The individual is performing activities necessary to the grant. ◆ Tuition remission and other forms of compensation are consistently provided, in accordance with established institutional policy, to students performing similar activities conducted in non-sponsored as well as in sponsored activities. ◆ During the academic period, the student is enrolled in an advanced degree program at a recipient or affiliated institution and the activities of the student in relation to the federally sponsored research project are related to the degree program. ◆ The tuition or other payments are reasonable compensation for the work performed and are conditioned explicitly upon the performance of necessary work. ◆ It is the institution's practice to similarly compensate students in non-sponsored as well as sponsored activities. <p>Charges for tuition remission and other forms of compensation paid to students as, or in lieu of, salaries and wages are subject to the reporting requirements in Section J.10 of OMB Circular A-21, or an equivalent method for documenting the individual's effort on the research project. Tuition remission may be charged on an average rate basis.</p> <p>Payments made for educational assistance (e.g., scholarships, fellowships, and student aid costs) are allowable only when the purpose of the grant is to provide training to selected participants and the charge is approved by the OPDIV. These costs are unallowable charges to research grant funds even when they would appear to benefit the research project.</p>
Service Charges	<p>Allowable. The costs to a user of organizational services and central facilities owned by the recipient, such as central laboratory and computer services, are allowable and must be based on organizational fee schedules consistently applied regardless of the source of funds.</p>
Severance Pay	<p>Allowable only to the extent that such payments are required by law, are included in an employer-employee agreement, are part of an established policy effectively constituting an implied agreement on the part of the organization, or meet the circumstances of the particular employment. The amount of severance pay to be provided should be determined according to established organizational policy consistently applied regardless of the source of funds and should be reasonable, taking into consideration the practice of similar types of organizations and the extent of the organization's dependence on Federal funds. The applicable cost principles should be consulted regarding the different treatment of severance pay in regular and mass termination situations.</p>
Stipends	<p>Allowable as cost-of-living allowances for trainees and fellows if permitted by a program's statute authorizing or implementing regulations. The specific amounts may be established by policy. Generally, these payments are made according to a pre-established schedule based on the individual's experience and level of training. (See "Traineeships, Fellowships, and Similar Awards Made to Organizations on Behalf of Individuals—Allowable Costs.") A stipend is not a fee-for-service payment and is not subject to the cost accounting requirements of the cost principles. Stipends are not allowable under research grants even when they appear to benefit the research project.</p>
Subawards/ Contracts under Grants	<p>Allowable to carry out a portion of the programmatic effort or for the acquisition of routine goods or services under the grant. Such arrangements may be in the form of consortium agreements or commercial contracts and may require OPDIV approval (see "Prior-Approval Requirements").</p>
Supplies	<p>Allowable.</p>
Taxes	<p>Allowable. Such costs include taxes that an organization is required to pay as they relate to employment, services, travel, rental, or purchasing for a project. Recipients must avail themselves of any tax exemptions for which activities supported by Federal funds may qualify. State sales and use taxes for materials and equipment are allowable only when the State does not grant a refund or exemption on such taxes.</p>

Exhibit 4. Selected Items of Cost

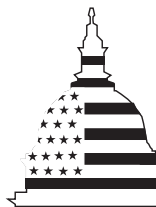
Item	Description
Termination or Suspension Costs	Unallowable except as follows. If a grant is terminated or suspended, the recipient may not incur new obligations after the effective date of the termination or suspension and must cancel as many outstanding obligations as possible. The awarding office will allow full credit to the recipient for the Federal share of otherwise allowable costs if the obligations were properly incurred before suspension or termination—and not in anticipation of it—and, in the case of termination, are not cancelable. The GMO may authorize other costs in, or subsequent to, the notice of termination or suspension. See 45 CFR 74.62(c) and 92.43.
Toys and Nursery Items	Allowable for the purchase of items such as toys and games to allow patients to participate in research protocols or, if age appropriate, in programs or projects serving children.
Trailers and Modular Units	<p>Allowable only if considered equipment as provided below. A “trailer” is defined as a portable vehicle built on a chassis that is designed to be hauled from one site to another by a separate means of propulsion and that serves, wherever parked, as a dwelling or place of business. A “modular unit” is a prefabricated portable unit designed to be moved to a site and assembled on a foundation to serve as a dwelling or a place of business. The determination of whether costs to acquire trailers or modular units are allowable charges to HHS grant-supported projects depends on whether such units are classified as real property or equipment. The classification will depend on whether the recipient’s intended use of the property is permanent or temporary.</p> <p>A trailer or modular unit is considered real property when the unit and its installation are designed or planned to be installed permanently at a given location so as to seem fixed to the land as a permanent structure or appurtenance thereto. Units classified as real property may not be charged to an HHS grant-supported project unless authorizing legislation permits construction or acquisition of real property and the specific purchase is approved by the OPDIV.</p> <p>A trailer or modular unit is considered equipment when the unit and its installation are designed or planned to be used at any given location for a limited time only. Units classified as equipment may be charged to HHS grant-supported projects only if the terms and conditions of the award do not prohibit the purchase of equipment and OPDIV prior approval is obtained, as appropriate.</p> <p>A trailer or modular unit properly classified as real property or as equipment at the time of acquisition retains that classification for the life of the item, thereby determining the appropriate accountability requirements under 45 CFR 74.32 or 74.34 or 92.31 or 92.32, as applicable.</p>
Trainee Costs	Allowable if permitted by statute, regulation, or program policy, as defined in the authorizing document, and included in the NoA.
Transportation of Property	Allowable for freight, express, cartage, postage, and other transportation services relating to goods either purchased, in process, or delivered, including instances when equipment or other property is moved from one recipient to another. In a change-of-grantee situation, the cost of transportation may be charged to the grant at either the original or the new organization, depending on the circumstances and the availability of funds in the appropriate active grant account.
Travel	Allowable as a direct cost where such travel will provide direct benefit to the project or program.
<i>Employees</i>	<p>Consistent with the organization’s established travel policy, costs for employees working on the grant-supported project or program may include associated per diem or subsistence allowances and other travel-related expenses, such as mileage allowances if travel is by personal automobile.</p> <p>Domestic travel is travel performed within the recipient’s own country. For U.S. and Canadian recipients, it includes travel within and between any of the 50 States of the United States and its possessions and territories and also travel between the United States and Canada and within Canada.</p>

Exhibit 4. Selected Items of Cost

Item	Description
	<p>Foreign travel is defined as any travel outside of Canada and the United States and its territories and possessions. However, for an organization located outside Canada and the United States and its territories and possessions, foreign travel means travel outside that country.</p> <p>In all cases, travel costs are limited to those allowed by formal organizational policy; in the case of air travel, the lowest reasonable commercial airfares must be used. For-profit recipients' allowable travel costs may not exceed those established by the FTR, issued by GSA, including the maximum per diem and subsistence rates prescribed in those regulations. This information is available at http://www.gsa.gov. If a recipient organization has no formal travel policy, those regulations will be used to determine the amount that may be charged for travel costs.</p> <p>Recipients are strongly encouraged to take advantage of discount fares for airline travel through advance purchase of tickets if travel schedules can be planned in advance (such as for national meetings and other scheduled events).</p> <p>Recipients must comply with the requirement that U.S. flag air carriers be used by domestic recipients to the maximum extent possible when commercial air transportation is the means of travel between the United States and a foreign country or between foreign countries. This requirement must not be influenced by factors of cost, convenience, or personal travel preference. The cost of travel under a ticket issued by a U.S. flag air carrier that leases space on a foreign air carrier under a code-sharing agreement is allowable if the purchase is in accordance with GSA regulations on U.S. flag air carriers and code shares (see http://www.gsa.gov/gsa/cm_attachments/GSA_DOCUMENT/110304_FTR_R2QA53_0Z5RDZ-i34K-pR.pdf). (A code-sharing agreement is an arrangement between a U.S. flag carrier and a foreign air carrier in which the U.S. flag carrier provides passenger service on the foreign air carrier's regularly scheduled commercial flights.)</p>
<i>Patients or Service Beneficiaries</i>	<p>If patient care, including research patient care, or other direct health or social services are approved activities of the grant-supported project or program, the costs of transporting individuals participating in the program or project to the site where services are being provided, including costs of public transportation, are allowable. The purchase of motor vehicles for this purpose also may be allowable.</p>

November 1999

Standards for Internal Control in the Federal Government



G A O

Accountability * Integrity * Reliability

Foreword

Federal policymakers and program managers are continually seeking ways to better achieve agencies' missions and program results, in other words, they are seeking ways to improve accountability. A key factor in helping achieve such outcomes and minimize operational problems is to implement appropriate internal control. Effective internal control also helps in managing change to cope with shifting environments and evolving demands and priorities. As programs change and as agencies strive to improve operational processes and implement new technological developments, management must continually assess and evaluate its internal control to assure that the control activities being used are effective and updated when necessary.

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires the General Accounting Office (GAO) to issue standards for internal control in government. The standards provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement. Office of Management and Budget (OMB) Circular A-123, Management Accountability and Control, revised June 21, 1995, provides the specific requirements for assessing and reporting on controls. The term internal control in this document is synonymous with the term management control (as used in OMB Circular A-123) that covers all aspects of an agency's operations (programmatic, financial, and compliance).

Recently, other laws have prompted renewed focus on internal control. The Government Performance and Results Act of 1993 requires agencies to clarify their missions, set strategic and annual performance goals, and measure and report on performance

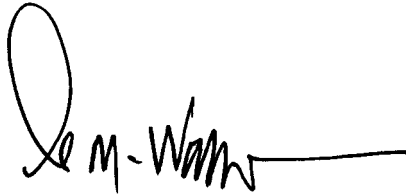
toward those goals. Internal control plays a significant role in helping managers achieve those goals. Also, the Chief Financial Officers Act of 1990 calls for financial management systems to comply with internal control standards, and the Federal Financial Management Improvement Act of 1996 identifies internal control as an integral part of improving financial management systems.

Rapid advances in information technology have highlighted the need for updated internal control guidance related to modern computer systems. The management of human capital has gained recognition as a significant part of internal control. Furthermore, the private sector has updated its internal control guidance with the issuance of Internal Control — Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Consequently, we have developed this standards update which supersedes our previously issued “Standards for Internal Controls in the Federal Government.”

This update gives greater recognition to the increasing use of information technology to carry out critical government operations, recognizes the importance of human capital, and incorporates, as appropriate, the relevant updated internal control guidance developed in the private sector. The standards are effective beginning with fiscal year 2000 and the Federal Managers Financial Integrity Act reports covering that year.

Foreword

We appreciate the efforts of government officials, public accounting professionals, and other members of the financial community and academia who provided valuable assistance in developing these standards.

A handwritten signature in black ink, appearing to read "D. M. Walker", with a long horizontal line extending to the right.

David M. Walker
Comptroller General
of the United States

Introduction

The following definition, objectives, and fundamental concepts provide the foundation for the internal control standards.

Definition and Objectives

Internal Control

An integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

Internal control is a major part of managing an organization. It comprises the plans, methods, and procedures used to meet missions, goals, and objectives and, in doing so, supports performance-based management. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. In short, internal control, which is synonymous with management control, helps government program managers achieve desired results through effective stewardship of public resources.

Internal control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories:

Introduction

- Effectiveness and efficiency of operations including the use of the entity's resources.
- Reliability of financial reporting, including reports on budget execution, financial statements, and other reports for internal and external use.
- Compliance with applicable laws and regulations.

A subset of these objectives is the safeguarding of assets. Internal control should be designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use, or disposition of an agency's assets.

Fundamental Concepts

Internal Control

- A continuous built-in component of operations.
- Effected by people.
- Provides reasonable assurance, not absolute assurance.

The fundamental concepts provide the underlying framework for designing and applying the standards.

Internal Control Is a Continuous Built-in Component of Operations

Internal control is not one event, but a series of actions and activities that occur throughout an entity's operations and on an ongoing basis. Internal control should be recognized as an integral part of each system that management uses to regulate and guide its operations rather than as a separate system within an agency. In this sense, internal control is management control that is built into the entity as a

Introduction

part of its infrastructure to help managers run the entity and achieve their aims on an ongoing basis.

Internal Control Is Effected by People

People are what make internal control work. The responsibility for good internal control rests with all managers. Management sets the objectives, puts the control mechanisms and activities in place, and monitors and evaluates the control. However, all personnel in the organization play important roles in making it happen.

Internal Control Provides Reasonable Assurance, Not Absolute Assurance

Management should design and implement internal control based on the related cost and benefits. No matter how well designed and operated, internal control cannot provide absolute assurance that all agency objectives will be met. Factors outside the control or influence of management can affect the entity's ability to achieve all of its goals. For example, human mistakes, judgment errors, and acts of collusion to circumvent control can affect meeting agency objectives. Therefore, once in place, internal control provides reasonable, not absolute, assurance of meeting agency objectives.

Internal Control Standards

Presentation of the Standards

The Five Standards for Internal Control

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communications
- Monitoring

These standards define the minimum level of quality acceptable for internal control in government and provide the basis against which internal control is to be evaluated. These standards apply to all aspects of an agency's operations: programmatic, financial, and compliance. However, they are not intended to limit or interfere with duly granted authority related to developing legislation, rule-making, or other discretionary policy-making in an agency. These standards provide a general framework. In implementing these standards, management is responsible for developing the detailed policies, procedures, and practices to fit their agency's operations and to ensure that they are built into and an integral part of operations.

In the following material, each of these standards is presented in a short, concise statement. Additional information is provided to help managers incorporate the standards into their daily operations.

Control Environment

Management and employees should establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control and conscientious management.

A positive control environment is the foundation for all other standards. It provides discipline and structure as well as the climate which influences the quality of internal control. Several key factors affect the control environment.

One factor is the integrity and ethical values maintained and demonstrated by management and staff. Agency management plays a key role in providing leadership in this area, especially in setting and maintaining the organization's ethical tone, providing guidance for proper behavior, removing temptations for unethical behavior, and providing discipline when appropriate.

Another factor is management's commitment to competence. All personnel need to possess and maintain a level of competence that allows them to accomplish their assigned duties, as well as understand the importance of developing and implementing good internal control. Management needs to identify appropriate knowledge and skills needed for various jobs and provide needed training, as well as candid and constructive counseling, and performance appraisals.

Management's philosophy and operating style also affect the environment. This factor determines the degree of risk the agency is willing to take and management's philosophy towards performance-based management. Further, the attitude and philosophy of management toward information systems, accounting, personnel functions, monitoring, and audits and evaluations can have a profound effect on internal control.

Another factor affecting the environment is the agency's organizational structure. It provides management's framework for planning, directing, and controlling operations to achieve agency objectives. A good internal control environment requires that the agency's organizational structure clearly define key areas of authority and responsibility and establish appropriate lines of reporting.

The environment is also affected by the manner in which the agency delegates authority and responsibility throughout the organization. This delegation covers authority and responsibility for operating activities, reporting relationships, and authorization protocols.

Good human capital policies and practices are another critical environmental factor. This includes establishing appropriate practices for hiring, orienting, training, evaluating, counseling, promoting, compensating, and disciplining personnel. It also includes providing a proper amount of supervision.

A final factor affecting the environment is the agency's relationship with the Congress and central oversight agencies such as OMB. Congress mandates the programs that agencies undertake and monitors their progress and central agencies provide policy and guidance on many different matters. In addition,

Inspectors General and internal senior management councils can contribute to a good overall control environment.

Risk Assessment

Internal control should provide for an assessment of the risks the agency faces from both external and internal sources.

A precondition to risk assessment is the establishment of clear, consistent agency objectives. Risk assessment is the identification and analysis of relevant risks associated with achieving the objectives, such as those defined in strategic and annual performance plans developed under the Government Performance and Results Act, and forming a basis for determining how risks should be managed.

Management needs to comprehensively identify risks and should consider all significant interactions between the entity and other parties as well as internal factors at both the entitywide and activity level. Risk identification methods may include qualitative and quantitative ranking activities, management conferences, forecasting and strategic planning, and consideration of findings from audits and other assessments.

Once risks have been identified, they should be analyzed for their possible effect. Risk analysis generally includes estimating the risk's significance, assessing the likelihood of its occurrence, and

deciding how to manage the risk and what actions should be taken. The specific risk analysis methodology used can vary by agency because of differences in agencies' missions and the difficulty in qualitatively and quantitatively assigning risk levels.

Because governmental, economic, industry, regulatory, and operating conditions continually change, mechanisms should be provided to identify and deal with any special risks prompted by such changes.

Control Activities

Internal control activities help ensure that management's directives are carried out. The control activities should be effective and efficient in accomplishing the agency's control objectives.

Control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives, such as the process of adhering to requirements for budget development and execution. They help ensure that actions are taken to address risks. Control activities are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results.

Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews,

maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation. Control activities may be applied in a computerized information system environment or through manual processes.

Activities may be classified by specific control objectives, such as ensuring completeness and accuracy of information processing.

Examples of Control Activities

- Top level reviews of actual performance,
- Reviews by management at the functional or activity level,
- Management of human capital,
- Controls over information processing,
- Physical control over vulnerable assets,
- Establishment and review of performance measures and indicators,
- Segregation of duties,
- Proper execution of transactions and events,
- Accurate and timely recording of transactions and events,
- Access restrictions to and accountability for resources and records, and
- Appropriate documentation of transactions and internal control.

There are certain categories of control activities that are common to all agencies. Examples include the following:

Internal Control Standards

Top Level Reviews of Actual Performance	Management should track major agency achievements and compare these to the plans, goals, and objectives established under the Government Performance and Results Act.
Reviews by Management at the Functional or Activity Level	Managers also need to compare actual performance to planned or expected results throughout the organization and analyze significant differences.
Management of Human Capital	Effective management of an organization's workforce—its human capital—is essential to achieving results and an important part of internal control. Management should view human capital as an asset rather than a cost. Only when the right personnel for the job are on board and are provided the right training, tools, structure, incentives, and responsibilities is operational success possible. Management should ensure that skill needs are continually assessed and that the organization is able to obtain a workforce that has the required skills that match those necessary to achieve organizational goals. Training should be aimed at developing and retaining employee skill levels to meet changing organizational needs. Qualified and continuous supervision should be provided to ensure that internal control objectives are achieved. Performance evaluation and feedback, supplemented by an effective reward system, should be designed to help employees understand the connection between their performance and the organization's success. As a part of its human capital planning, management should also consider how best to retain valuable employees, plan for their eventual succession, and ensure continuity of needed skills and abilities.
Controls Over Information Processing	A variety of control activities are used in information processing. Examples include edit checks of data entered, accounting for transactions in numerical sequences, comparing file totals with control

Internal Control Standards

accounts, and controlling access to data, files, and programs. Further guidance on control activities for information processing is provided below under “Control Activities Specific for Information Systems.”

Physical Control Over Vulnerable Assets

An agency must establish physical control to secure and safeguard vulnerable assets. Examples include security for and limited access to assets such as cash, securities, inventories, and equipment which might be vulnerable to risk of loss or unauthorized use. Such assets should be periodically counted and compared to control records.

Establishment and Review of Performance Measures and Indicators

Activities need to be established to monitor performance measures and indicators. These controls could call for comparisons and assessments relating different sets of data to one another so that analyses of the relationships can be made and appropriate actions taken. Controls should also be aimed at validating the propriety and integrity of both organizational and individual performance measures and indicators.

Segregation of Duties

Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event.

Proper Execution of Transactions and Events

Transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. This is the principal means of assuring that only valid transactions to exchange, transfer, use, or commit resources and other events are initiated or entered

Internal Control Standards

into. Authorizations should be clearly communicated to managers and employees.

Accurate and Timely
Recording of
Transactions and Events

Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded.

Access Restrictions to
and Accountability for
Resources and Records

Access to resources and records should be limited to authorized individuals, and accountability for their custody and use should be assigned and maintained. Periodic comparison of resources with the recorded accountability should be made to help reduce the risk of errors, fraud, misuse, or unauthorized alteration.

Appropriate
Documentation of
Transactions and
Internal Control

Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained.

These examples are meant only to illustrate the range and variety of control activities that may be useful to agency managers. They are not all-inclusive and may not include particular control activities that an agency may need.

Furthermore, an agency's internal control should be flexible to allow agencies to tailor control activities to fit their special needs. The specific control activities used by a given agency may be different from those

used by others due to a number of factors. These could include specific threats they face and risks they incur; differences in objectives; managerial judgment; size and complexity of the organization; operational environment; sensitivity and value of data; and requirements for system reliability, availability, and performance.

**Control Activities
Specific for
Information Systems**

- General Control
- Application Control

There are two broad groupings of information systems control - general control and application control. General control applies to all information systems—mainframe, minicomputer, network, and end-user environments. Application control is designed to cover the processing of data within the application software.

General Control

This category includes entitywide security program planning, management, control over data center operations, system software acquisition and maintenance, access security, and application system development and maintenance. More specifically:

- Data center and client-server operations controls include backup and recovery procedures, and contingency and disaster planning. In addition, data center operations controls also include job set-up and scheduling procedures and controls over operator activities.

- System software control includes control over the acquisition, implementation, and maintenance of all system software including the operating system, data-based management systems, telecommunications, security software, and utility programs.
- Access security control protects the systems and network from inappropriate access and unauthorized use by hackers and other trespassers or inappropriate use by agency personnel. Specific control activities include frequent changes of dial-up numbers; use of dial-back access; restrictions on users to allow access only to system functions that they need; software and hardware “firewalls” to restrict access to assets, computers, and networks by external persons; and frequent changes of passwords and deactivation of former employees’ passwords.
- Application system development and maintenance control provides the structure for safely developing new systems and modifying existing systems. Included are documentation requirements; authorizations for undertaking projects; and reviews, testing, and approvals of development and modification activities before placing systems into operation. An alternative to in-house development is the procurement of commercial software, but control is necessary to ensure that selected software meets the user’s needs, and that it is properly placed into operation.

Application Control

This category of control is designed to help ensure completeness, accuracy, authorization, and validity of all transactions during application processing. Control should be installed at an application’s interfaces with other systems to ensure that all inputs are received and are valid and outputs are correct and properly distributed. An example is computerized edit checks built into the system to review the format, existence, and reasonableness of data.

General and application control over computer systems are interrelated. General control supports the functioning of application control, and both are needed to ensure complete and accurate information processing. If the general control is inadequate, the application control is unlikely to function properly and could be overridden.

Because information technology changes rapidly, controls must evolve to remain effective. Changes in technology and its application to electronic commerce and expanding Internet applications will change the specific control activities that may be employed and how they are implemented, but the basic requirements of control will not have changed. As more powerful computers place more responsibility for data processing in the hands of the end users, the needed controls should be identified and implemented.

Information and Communications

Information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities.

For an entity to run and control its operations, it must have relevant, reliable, and timely communications relating to internal as well as external events. Information is needed throughout the agency to achieve all of its objectives.

Program managers need both operational and financial data to determine whether they are meeting their agencies' strategic and annual performance plans and meeting their goals for accountability for effective and efficient use of resources. For example, operating information is required for development of financial reports. This covers a broad range of data from purchases, subsidies, and other transactions to data on fixed assets, inventories, and receivables. Operating information is also needed to determine whether the agency is achieving its compliance requirements under various laws and regulations. Financial information is needed for both external and internal uses. It is required to develop financial statements for periodic external reporting, and, on a day-to-day basis, to make operating decisions, monitor performance, and allocate resources. Pertinent information should be identified, captured, and distributed in a form and time frame that permits people to perform their duties efficiently.

Effective communications should occur in a broad sense with information flowing down, across, and up the organization. In addition to internal communications, management should ensure there are adequate means of communicating with, and obtaining information from, external stakeholders that may have a significant impact on the agency achieving its goals. Moreover, effective information technology management is critical to achieving useful, reliable, and continuous recording and communication of information.

Monitoring

Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties.

Separate evaluations of control can also be useful by focusing directly on the controls' effectiveness at a specific time. The scope and frequency of separate evaluations should depend primarily on the assessment of risks and the effectiveness of ongoing monitoring procedures. Separate evaluations may take the form of self-assessments as well as review of control design and direct testing of internal control. Separate evaluations also may be performed by the agency Inspector General or an external auditor. Deficiencies found during ongoing monitoring or through separate evaluations should be communicated to the individual responsible for the function and also to at least one level of management above that individual. Serious matters should be reported to top management.

Monitoring of internal control should include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved. Managers are to (1) promptly evaluate findings from

audits and other reviews, including those showing deficiencies and recommendations reported by auditors and others who evaluate agencies' operations, (2) determine proper actions in response to findings and recommendations from audits and reviews, and (3) complete, within established time frames, all actions that correct or otherwise resolve the matters brought to management's attention. The resolution process begins when audit or other review results are reported to management, and is completed only after action has been taken that (1) corrects identified deficiencies, (2) produces improvements, or (3) demonstrates the findings and recommendations do not warrant management action.